



ASSOCIATION OF FINANCIAL ADVISERS LTD

## AFA submission to the Treasury Product Rationalisation Project –

Confidential.

Prepared by the Association of Financial Advisers Ltd.

September 2007

Product Rationalisation Project  
Corporations and Financial Services Division  
The Treasury  
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Submission by the Australian Financial Advisers Association.

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The Association of Financial Advisers Australia, provides this submission to the project as a first phase of the journey toward fulfillment of the policy objective.

Collectively our diverse membership base provides advice to over 3 million Australians each year, employs over 300,000 people and provides over \$40 billion worth of services to consumers and other sectors of the community.

The membership base ranges from self-employed, small business people to corporate giants such as Zurich, ING, Commlnsure and MLC and advisers working for these firms. As a national organisation AFA is committed to providing services to advisers in both city, regional and rural areas.

The Association supports the product rationalisation policy objectives, as it will, in our view, provide a substantial benefit to the clients owning the plans and policies. This is the sole criteria in our view, for the process of moving forward with this program.

We look forward to further discussion with you on various aspects of a technical nature in relation to the project.

Yours sincerely

Richard Klipin  
Chief Executive Officer.

# **Submission to the Department of the Treasury - Product Rationalisation project by the Association of Financial Advisers Australia.**

## **Discussion point**

1 Should product rationalisation be limited to a one off opportunity or should it be available on an ongoing basis? What are the reasons for your views?

1: As an Association dealing with nearly three million clients, we see the opportunity for product rationalisation, as an action that should be driven by the client in the case of life insurance, and therefore this segment should be an ongoing programme.

Whereas the rationalisation of retirement savings requires only a one-off opportunity to complete an upgrade to present day conditions, for the superannuation plans.

The reasons for our views are twofold.

Firstly life insurances are more complex contracts, that are designed to be in place for the life span of the client. For example whole of life policies mean exactly that, whole of life.

Therefore a client with a whole of life policy or an endowment insurance policy, would need to take advice from a well qualified adviser, as to the advantage or disadvantage for them, in upgrading the particular product to a new product. A large number of life insurance companies in Australia no longer offer capital guaranteed products, and would then be unable to offer upgraded equivalent products to their existing clients. This may be a consideration for some companies to restart this type of product offer.

Our second argument is that superannuation is a basic retirement savings product and can be upgraded readily to new platforms and systems. Although superannuation may have attendant life risk insurance policies contained within them, they are in the main, term policies, and thus are far less complex.

It would be to the substantial advantage of most clients, to have smaller superannuation savings plans that are subject to hefty withdrawal fees compulsorily transferred to new or existing superannuation plans that they presently have. The only requirement would be for the client to designate "a primary plan".

Therefore on balance it is in the interests of most policy or plan owners for such a product rationalisation to take place both as a once only offer and on an ongoing basis.

## Discussion points

2 Should there be threshold requirements limiting which products may be rationalised? If yes, what should these requirements be, and why do you think they are justified? Is it necessary to specify which product providers and product types are to be included? If yes, which ones should be included or excluded, and for what reasons?

3 Which parties should have the right to bring forward product rationalisation proposals?

4 Should beneficiaries have the right to object to product rationalisation proposals? If so, what special measures should apply if objections exceed a certain critical level, and what should the critical level be?

2: The Australian Financial Advisers Association takes the view, that some limitations may be necessary.

These would be for the following categories of product, being whole of life insurance policies, endowment insurance policies, and other policies that have bonus rights from the number 1 fund of life insurers.

These bonuses accrued over time, and represent the surplus funds within the particular number 1 fund, and are generally distributed to all existing policyholders annually.

In some cases the bonuses can be many times the face value of the insured amount.

We also take the view that if the policies are going to be transferred to new systems or platforms, then the new systems must have the capacity to record basic fundamental details of the policies and to continue to apply the bonuses as they arise annually.

The rationalisation process should not be seen as a Government endorsement of the closure of capital guaranteed insurance products.

The only limitation we believe would be essential would be for all policies to translate with the contract provisions of their original policy wording intact. In other words, the policies may be upgraded to new systems to achieve the information technology savings, but the clients will not be disadvantaged by the policy words being upgraded as well, removing benefits from clients and thus reducing insurer liabilities for particular contract.

We assess that there is no reason to exclude superannuation or managed investments from mandated upgrading as these are simple, and have no real barriers to translation to the primary account of the client.

There are very few remaining endowment insurance superannuation plans in existence, when compared to the numbers of term policies presently being written.

3: We believe the product manufacturers should be able to nominate their product for rationalisation.

We further believe the product manufacturers should be able to meet the fundamental matrix of client protection required by this program using a “no disadvantage” test .

4: It is a fundamental right of the client who is being asked to agree to a product rationalisation, that the full impact of such a rationalisation on their in benefits be spelled out.

It is a simple but basic consumer right for objective advice to be provided to each client. This fact is also a mandated requirement of the Corporations Act in relation to Financial Services Product.

Most product manufacturers have large registers of clients attached to financial advisers who can readily determine and provide advice to clients as to the agreement or objection to the process of rationalisation.

Special measures may be required for certain types of product, to have a mini statement of advice, prepared by the adviser for the client in order to satisfy the basic and fundamental needs of the Corporations Act in regard to the consumer protection component of the clients final outcome.

Critical levels can be readily determined by the no disadvantage test, and the default position should be that there had been no disadvantage to any client in all.

5 Should compulsory transfer of beneficiaries be a part of a product rationalisation mechanism?

6 If not, how would you address the issue of a small remnant of beneficiaries, for instance in a life insurance product, refusing to consent to a rationalisation proposal and thereby preventing the realisation of the benefits of the proposal?

5: The AFA believes that the compulsory transfer of beneficiaries as a product rationalisation mechanism, is warranted for superannuation and managed investments.

However we disagree with the compulsory rationalisation mechanism for life insurance products, unless there is a clear and determined positive outcome for all clients in the class of insurances held in the number 1 fund of the life company concerned.

6: There may be situations where a small remnant the beneficiaries in a life insurance product will need to be compensated by the life insurance company, over and above, the compensation that may be achieved by maintaining this same or similar product on a new platform.

The life insurer may have to make commercial judgment that the payment of compensation would act as an incentive to those beneficiaries to transfer on a once only basis, thus releasing a life insurance company, to close down the older system and gain the savings necessary.

Indeed the cost of maintaining obsolete equipment may far outstrip any compensation costs life insurance companies may have to pay a small remnant of beneficiaries as an inducement to transfer.

7 Should the legislation itself contain a detailed test? If so, what should the contents of the test be?

8 If the legislation does not prescribe the test in detail, what high level principles should it contain? Should guidance be provided for each principle? Who should provide this guidance?

9 How should the test be applied to beneficiaries? Do you think it is feasible to require analysis of each beneficiary and their circumstances? How should product providers demonstrate that the no detriment test has been satisfied?

7: The AFA takes the view that the legislation should contain a detailed test.

It further takes the view that the contents of the test should be predicated upon two basic principles.

The first principle is that a no disadvantage test to the outcomes of the written policy should be applied.

The second principle is that the policy wording should be translated to the new platform. This is a simplistic process, in that the policy may have a new identification number running on a new platform, but the policy wording and outcomes for the client would remain the same.

The actuarial under-pinning for these types of policies is readily discernible by the distinctive numbers used to describe in the new system for such policies, especially those policies continue to have a capital guaranteed base.

Some life insurers may take the view that they want to remove entirely capital guaranteed product, as the provisioning on the balance sheet of such product under the APRA rules which is not seen as a competent allocation of shareholder capital.

However most of these life companies were originally founded as mutual funds, and the policy basis being capital guaranteed, stems from this corporate structure, not a publicly listed company structure.

Thus the fundamental driver by major insurers will be to relinquish as much product as possible that requires a capital guarantee under the guise of product rationalisation.

This is a direct disadvantage to clients holding in continuing to fund premiums for this product, and receiving bonuses from the number 1 fund bonus pool.

8: The AFA submits that the detailed test can be determined by the Commonwealth actuary together with a panel of experienced actuaries drawn from each of the major life insurance companies.

It is our view that the Treasury should seek from the Commonwealth actuary, a view as to the structure of the detailed test, its principles, and the guidance to be provided.

Our further view is only by the use of the Commonwealth actuary, would there be sufficient independent advice that would be focused on the outcomes for each owner of the policy, in relation to the no disadvantage test.

9: The application of the test to individual beneficiaries is not difficult.

It is a simple matter to draft a series of matrix's that allow the benchmarking of outcomes were individual policyholders for the policy to run full term, or to the death of the policyholder.

It is also a simple matter to average the application of bonuses to the policy over the next 5 to 15 years, to demonstrate to the policyholder that the compensation or supplementation to the policy value would not change and would be fulfilled.

We take the view that if these tests are applied via a matrix for each policyholder, via simple reporting programs generated by life insurers using the detailed tests generated by the Commonwealth actuary, then we would be in the support of this approach.

10 Which entity should be responsible for applying the equivalent rights and benefits test? Should there be more than one entity involved? If so, what would the difference in responsibilities be among the entities involved?

10: The AFA takes the view that the appropriate agency is the Australian Prudential Regulation Authority.

We take this view as the Authorities capacity and understanding of the insurance, superannuation, and managed investment funds industry, is wide and thorough.

We also take the view that APRA is uniquely situated by its current operational mandate to be that the responsible entity. We believe legislation should be enacted to add to the Corporations Act specific sections empowering APRA and the Commonwealth actuary to give effect to the policy change.

11 What rules should apply to the procedures of the approving entity and what should the scope of its powers be?

11: the rules that apply to the procedures of the approving entity, should be defined in accordance with the present processes of the Australian Prudential Regulation Authority.

Its powers in this respect should be absolute, if the agreement of the Commonwealth actuary on any dispute other than be defined detailed tests is obtained.

12 Should the regulators have a special role in the approval process? If yes, what should this role be? Is there a case for making a distinction between the regulators, given their different responsibilities?

12: The AFA believes there is probably no role for the other regulators, other than as advisers to the Australian Prudential Regulation Authority. It may be appropriate to legislate for there to be agreement between the Australian Securities and Investments Commission, the Australian Prudential Regulation Authority, and the Commonwealth actuary on matters of policy. The primary guiding issue would be the no disadvantage test to the holders of policies, superannuation plans, or managed investment funds.

13 Can there be a single process covering all types of products? If yes, how should the differences be addressed? If no, what separate processes should there be and in what respects should they be differentiated?

13: Our Association believes that there must be a single process covering all types of products and that the differences are not that great that they cannot be readily addressed.

For example, if the actuarial basis determined by the Commonwealth actuary in association with the actuaries of the life offices concerned, provides a solution that does not disadvantage policyholders, and that requires compensation to policyholders, then such a solution should be agreed.

The limitation would be that the compensation cannot exceed determined savings of benefit to all policyholders over time.

This principal can be applied to all product, and certainly the fundamentals would be attractive to product manufacturers, as there would be a series of phases for product translation given the administrative workloads.

It may be that such a transfer arrangement would be measured in years and a program determined by the Australian Prudential Regulation Authority in conjunction with product manufacturers, in order to have a set series of mandatory implementation timelines.

14 Do you agree with the issues as outlined above and with the general approaches proposed to address them? If not, why not? Are there other ways to achieve the intended outcomes?

15 Are there other tax issues that should be considered? What are they, why are they important in this context and how do you think they could be addressed?

14: The AFA believes that there will need to be a less prescriptive and dogmatic application by the Australian Taxation Office of the tax implications for the transfer of legacy products.

It should not be that difficult to provide supplemental tax legislation based on dates and product types to transferred capital gain inherent in the legacy product to be transferred to the new product.

Such a gain would only be crystallised or a CGT event created, when the client by some circumstances such as death, total and permanent disability, or redemption occurred. There would need to be transitional provisions for cases that occur when translation is underway.

If the intended outcomes of the transfer of the legacy product was to increase the efficiency and financial strength of this sector of the economy, then the ATO should devise the methodology to do so without the impact of any tax imposition on the program.

The consideration of other tax matters is specific to products and our concerns are in the following areas:

- . That the rationalisation process, does not concede date driven CGT events.
- . That the rationalisation process, does not interfere with estate planning already in place, using whole of life insurance policies, that still may have many years to run. These are common methods used to ensure intergenerational change with say farms.

15: The AFA takes a further view that the role of the Tax Commissioner in this rationalisation program has been understated, and he should be invited by the Department of the Treasury, to supply a specialist to the program, and that the Department of Treasury Revenue branch should supervise this arrangement with the Australian Prudential Regulation Authority.

The changes to the tax law should be a default to a no detriment to the policy or plan holder.

16 With respect to pre rationalisation disclosure, what information would need to be given to beneficiaries? Should the disclosure documentation need approval, for example by the regulator? Should the regulator or other approving entity be able to impose special requirements in individual cases?

16: The AFA believes that pre-rationalisation disclosure is essential.

We further take the position, that the documentation would need the approval of the regulator to prescribe special requirements for individual cases.

Such cases would be where owners of insurance policies were unable to determine for themselves with advice, outcomes.

These cases would be aware policy owners were classified under the Mental Health Acts in various States, due to diseases such as Alzheimer's or the like. In such cases guardians, would have special responsibilities, and under the law in each state, may need to seek the approval of guardianship board's or other appropriate authorities.

17 If a right to object is included, how much time should beneficiaries be given to respond? Is there a need for special rules to apply if beneficiaries do not respond?

17: The position of the Association, is that the right to object is fundamental.

Beneficiaries should be given the right to respond, with a repetition of the request for a response within 14 days of the end of the initial 30 day period.

If at the end of a further 30 day period no response is received, then the product manufacturer, should attempt via the Financial Adviser servicing the client, to further contact the client. If after 90 days the client has not responded, where such adequate opportunity has been provided, the product manufacturer should advertise in the newspapers for formal responses by the person so named in the advertising. If no response is received within 14 days our view would be that the beneficiaries rights and entitlements transferred by default.

18 What procedures should apply in the case of lost beneficiaries? Should they be automatically transferred to the new product? If yes, what conditions should apply? If not, what should be done with their investments?

18: The Association understands the concerns in relation to loss to beneficiaries.

If lost beneficiaries cannot be identified, then they should be automatically transferred to the new product.

The reason for this is that in some cases policies, have been made fully paid up, or lost, or misplaced.

It is sometimes not realised until a person becomes deceased, that there is some accrued benefit that may be due. This is usually due to families and lawyers acting for estates discovering policy documents hidden away.

We take the further view, in relation to this issue, that the conditions that should apply, would be the same as the default “non response beneficiary”, and that their investments, should be placed into the market, on an aged based investment profile, as determined by the regulator.

Such investment options that such clients may be placed in by the product manufacturer, utilising such an aged based investment profile agreed by the regulator, would be into investment options accessible by the product manufacturer, within their own platforms.

19 As regards post rationalisation disclosure, should there be any special requirements other than notification of new allocations?

19: The AFA takes the view, that within 90 days of product rationalisation occurring, a formal disclosure document should be sent to the client or owner of policies all investments, providing a product description, together with a statement of placement, or be provision of a new policy document.

Such a provision should include the policy words and contract structures. This would complete the cycle for the product manufacturer, and obviate future liabilities that may arise for the non-provision of complete full and frank disclosure.

20 Can one entity cover complaints and compensation regarding all products, or is more than one required? If one entity only, which entity would you suggest? If more than one, which ones would you suggest and how should their functions be separated?

20: The AFA takes the view that one regulator is more than capable of setting up with the industry a composite complaints and compensation panel regarding all products.

It would be untenable for there to be a public sector driven complaints and compensation panel, where compensation funds are being sourced from companies with responsibilities to shareholders.

Therefore the compensation and complaints panel may be able to be a subset of the Financial Industry Complaints Scheme,(FICS) and funded accordingly.

21 What process and timeframes should apply to applications to this body? Should there be a time limit within which claims can be brought forward?

21: The Association takes the view that the process of an application to this body, should be formal and be based on one simple form, together with supporting documentation providing a clear concise and readable application.

The timeframe we assert, should be legislated as a maximum of 12 months from the date of formal notification to the client account or policyholder of the completion of the transfer, together with the provision of product descriptions, policy wording and structures, and any necessary explanatory memoranda.

This period appears to be adequate given the proposed high level of advertising to consumers clients and policyholders, of the government and product manufacturer intentions in regard to this program.

22 What is the appropriate scope of the claims and complaints the scheme may hear? Should it be limited to assessing claims for monetary compensation? If the scheme may determine compensation amounts, should it be subject to some sort of cap? If the scope of the mechanism were wider than monetary compensation, what types of remedies should the scheme be able to impose? How long should the right to claim compensation endure after the product rationalisation has occurred?

22: The AFA takes the view that the appropriate scope for the claims and complaints should be strictly limited to the product owned by the client or policyholder at the time of transfer.

There should be no capacity to review product selection decisions of past years in this process.

To do so would open up product manufacturers to substantial legal argument as to the appropriateness of decisions, the advice to clients, over 30 to 40 years of product generation within different legal structures of consumer protection.

We further take the view that monetary compensation should be limited to specific outcomes taken as commercial decisions by product manufacturers to terminate certain products.

For example if the product manufacturer takes the decision to no longer support a particular product structure, and its cancellation results in a loss of benefit to the client, then the product manufacturer can offer an alternative or monetary compensation.

If the client rejects the alternative and seeks the monetary compensation in excess of that offered by the product manufacturer using the regulators matrix, then there should be no further claim compensation outside of these boundaries.

In relation to the scope for further or wider monetary compensation, there should be a mechanism for such complaints to go from the complaints panel to the regulator for independent review and assessment.

Such independent review should take only into account whether or not the offer to the client is consistent with a future value in the case of life insurance, or a present value in the case of managed investments.

The result of the regulator review should be returned to the panel for final determination and decision.

We believe that the regulations governing this component of decision cycle should state unequivocally that there is no appeal mechanism once a final decision has been made following the review by the regulator, of any disputed compensation proposal not accepted by clients.

To do otherwise would allow extended litigation, not in the interests of policyholders, investors, or the financial services industry. The right for a complaint in relation to compensation to all alternatives offered by product manufacturers, should expire one year from the date of the notification and disclosure documents have been provided to the client.

23 Who should bear the costs associated with the operation of the entity and the compensation awards? Should it be the product providers, the schemes or funds, or should there be some measure of sharing, and if so what should it be? Alternative arrangements are also conceivable, for example a compensation pool funded by the industry. Is this or some other arrangement a preferable solution? If so, what should it be and how should it operate?

23: The AFA takes the view that the product manufacturers in saving nearly \$1 billion by the translation of older obsolete or legacy products should meet on pool basis the costs of the operation of the entity.

The meeting of the cost of compensation awards should be on a product manufacturer to clients or investor basis.

Some product manufacturers stand to gain much more by the vesting of legacy products than do others.

Compensation pools are not driven by market forces.

The preferable solution and the one that we would support, would be a process by where the product manufacturer gaining the benefit meets the costs. This mechanism in our view, is the present industry EDR scheme, that can be expanded temporarily to provide the necessary administrative arrangements for the effective implementation of this policy. This will limit the costs of the policy initiative to all involved.

24 Which parties should bear or enjoy the costs and benefits arising out of product rationalisation transfers? Should they be attributable solely to product providers and their shareholders, or should there be some sharing between shareholders and beneficiaries? If so, how could these costs and benefits be calculated?

24: We understand that the beneficiaries of policies presently enjoy those benefits, and if those benefits are to be degraded by a commercial decision of policy or product manufacturer, then such a process presently has legislative remedies for compensation.

Your proposal which we support, is to rationalise legacy product where the costs of such rationalisation borne by those who stand to gain most, which is the product manufacturers.

Therefore the costs in our view, should be borne by the product manufacturers, providers and their shareholders, who stand to gain from this process.

We take the view that unless the beneficiaries or investors are protected in their rights and entitlements enshrined by the process, and no disadvantage test applied, then the investors and beneficiaries have nothing to gain by agreeing to the process and should not do so.

25 Should there be a special mechanism for resolving the problem of high exit fees? If so, what should it be?

26 Alternatively should exit fees be addressed as part of the equivalence test?

25 and 26: The AFA takes the view that high exit fees are of special interest to over one million Australians.

The mechanism to resolving the problem of high exit fees are simple, in that the exit fee is a deliberate impost or cost recovery mechanism of many years ago, and impacted on the early superannuation accounts and was used to maintain the non-portability provisions of many funds.

Similar imposts of an administrative nature have been used by both public offer funds and industry super funds as a member retention tool.

The mechanism to resolve this is relatively simple, with the application of a simple charge of a maximum of 2% of the account balance, together with an administrative fee of \$60 replacing all existing exit fees.

This universal application of an exit fee would meet the administrative overheads of the transfer, and be universally acceptable to policy holders or account holders.

Using an equivalence test only transfers the exit fee to a new platform.

The Association takes the view charging the new platform with an exit fee merely transfers from one computer system to another computer system, the inability for the client to have choice and aggregation which is ultimately to their benefit.

27 Do you think that regulatory action is required to achieve a reduction in the rate of creation of legacy products, and if so what specific measures would have to be adopted?

28 What action do you think that businesses could take to reduce the rate of creation of legacy products, thereby lessening the need for government intervention? What measures could be taken to encourage businesses to adopt such practices?

27: The AFA has considered the issue of the creation of legacy product, and understands with market forces there will be the creation of financial services insurance and investment products that from time to time, will become of the legacy type.

We believe that a simple amendment to the Superannuation Act to prohibit fund exit fees, and to implement the recommendations of a Senate Superannuation Report of 2006, requiring a rollover to be affected within 30 days, needs to be considered and enacted.

28: Legacy product only exists because of time, and an incentive by product manufacturers to maintain obsolete nontransparent and non-transferable financial services products in the marketplace.

A further consideration would be that there be legislated minimum time for the product structure to be offered publicly, with a further minimum notification time to all policyholders or investors, two years, prior to the product being terminated from public offer.

We believe that this notification should be done each six months to each policyholder for two years as a base default position.

This would make changes to products, no matter how fiscally attractive to product manufacturers in defining and influencing the market, much less attractive. Full disclosure of the reasons for such change must be given.

29 Do you think that beneficiaries of existing managed funds into which beneficiaries of legacy products are transferred require special protection measures?

29: The AFA takes a special view of this issue and primarily it deals with our concerns as to the administrative charges made to the funds by product manufacturers in dealing with such transfers.

We believe that administrative costs or margins for legacy products transferred to existing managed funds should be discounted by a minimum of 50% in order to discourage price gouging of administrative fees.

We further believe that the Australian Prudential Regulation Authority should seek by regulation a six monthly administrative report on all administrative costs charged to legacy products going to these funds for the first five years.

We further believe that the regulator should approve any changes to costs that are not common to all members of the fund present and prospective fund during this transferred period the legacy products.

30 What are the specific problems posed by participating policies, and how should they be addressed?

30: Participating policies are not difficult issues and pose no more specific problems than do investors in managed investment fund.

Our view is that the Treasury should obtain the detailed actuarial view of the Commonwealth actuary as to be rights and entitlements of participating policies prior to addressing any such issues.

31 Are there any other issues that need to be considered? How should they be addressed?

The AFA sees some other issues that should be considered and addressed and these are:

1. Maturation dates of term superannuation and life insurance and the attendant options for additional insurance units.

These policies presently have the capacity for clients or policy owners to add additional insurance into the policies, in some cases without further underwriting, or to make the policies fully paid with an end benefit date.

The transfer of these policies the new platforms must carefully consider and protect the rights and entitlements of the owners of these policies.

2. Specific products such as investment linked deferred annuities, which an early form of superannuation savings, investment linked single premium products and single premium bonds can be properly treated for conversion, but the advice of the Commonwealth actuary and his appointed panel, prior to the regulator defining the methodology for translation needs to be obtained in regard to the no disadvantage test.
3. Further regular premium and single premium products in the number 1 funds of life insurers should be encompassed with this actuary review, to ensure adequate safeguards in relation to those products that still enjoy a capital guarantee.