Association of Financial Advisers Ltd
ACN: 008 619 921
ABN: 29 008 619 921
PO Box Q279, Sydney 1230
1800 656 009
afa.asn.au

14 November 2022

Secretariat, Quality of Advice Review
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attention: Michelle Levy

By email: AdviceReview@treasury.gov.au

Dear Ms Levy,

AFA Response to Quality of Advice Review - Conflicted Remuneration Consultation Paper

We thank you for the opportunity to provide a response on the QAR Conflicted Remuneration Consultation Paper.

Please find attached our response in the stipulated template. In our submission, we have supported all the proposals, however we have gone further and raised the following two important additional actions that we believe are critical that relate to life insurance advice:

- The Life Insurance Framework needs to be modified to better enable financial advisers to provide life insurance advice to everyday Australians and younger Australians who will not, on the basis of the current capped commission model, generate sufficient commissions to make it viable for the adviser to service them.
- The clawback model incorporated into the Life Insurance Framework was designed in a different era, one where substantial premium increases did not exist and in benign economic circumstances, when it was rare that a client may suddenly lose the capacity to pay their premiums. The economic consequences of the COVID Pandemic caused a lot of insurance cover to be cancelled for reasons completely unrelated to the adviser, as will the likely economic implications of a future recession. Clawback was designed to address inappropriate product replacement. In reality, it has penalised advisers substantially, when the cause of the lapse or reduction in cover was premium increases or economic circumstances.

We would like to make a few additional comments with respect to life insurance advice, which we have set out below.

Feedback on the Data Provided

We have some particular concerns about the life insurance data collection statistics reported on page 2 of the paper, which we feel are either unreliable or are lacking sufficient specificity. Our concerns are as follows:

- We know that the number of new life insurance policies has declined substantially between 2017 and 2021, however we would welcome analysis of how much that decline has been and what the contributing factors were.
- Why did the proportion of new life insurance policies sold by financial advisers go up from 70% to 83% between 2017 and 2021? Presumably this is related to the regulatory problems experienced in the Direct market and the substantial differential between the service and product quality experienced by financial advice clients.
- We are very surprised by the suggestion that the average new business premiums went up by only 15 percent between 2017 and 2021. We would have expected it to be much greater than that. We seek further analysis on this, including context around the contribution that the phenomenon of upfront premium discounting, that emerged in this timeframe, may have had.
- We note the assertion that for Death cover the average sum insured increased significantly, however the premium rate per $1,000 of sum insured decreased. This is selective, as a focus on Income Protection would reveal a very different result. This outcome, if it is correct, might be explained by upfront premium discounting, the decline in the more expensive direct insurance products and the scales of economy that come with larger sums insured.
- The decline in commissions paid to financial advisers is self evident, however we welcome this being placed on the record.
- Whilst we note the decline in lapse rates, the exact amount has not been expressed, and the explanation has not been articulated. External factors, such as COVID would have had a material impact in pushing up lapse rates. Clawback would have had a big impact in financial advisers working hard to assist clients to find a way to retain their cover.

In terms of the ASIC file review information presented on page 3, we offer the following feedback:

- It is pleasing to see a 21% increase in the pass rate between the 2017 file review and the 2021 file reviews, however we are very surprised and disappointed with the 2017 results.
- We have not received any feedback from ASIC on the results with the 2021 file reviews, however it is our understanding that we were previously told that the 2017 file reviews had gone reasonably well. The reported results are inconsistent with this.
- A 37% pass rate result, is a lot worse than the ASIC Report 413 result of a 63% pass rate. What is the explanation for such a significant deterioration? Does it come down to a change in the methodology, or are other factors at play?
- We are particularly concerned to see reference to 12% of clients experiencing detriment or harm in the 2017 file reviews. The 7% result for the 2021 file reviews is better, but still concerning. In this context, we would have expected to see significant regulatory intervention, however we are not aware of this having taken place.
- We note the reference to a decline in indicators of churn between 2017 and 2021, however we ask what are these indicators of churn and what are the numbers behind this assessment.

With such an important piece of work, we would like to see a lot more data than just these very high level statements and numbers. We would like to see examples of the client detriment referred to in this paper. We would also like to see what type of issues led to these files being assessed as a failure.

Much more data has been presented in previous reviews, such as ASIC Reports 413, 562, 575 and 639. We note that each of 562 (super switching), 575 (SMSF) and 639 (super fund advice) had major reports and detailed analysis. Each of these also had higher fail rates than the 2021 LIF review, however we would like more context around these results. We are also very conscious of the broadly positive conclusion that ASIC reached with respect to ASIC report 639 in December 2019, despite a pass rate of less than 50%, and assume that a similar conclusion would be reached on the 2021 results in this review.

Addressing Life Insurance Issues

We would also like to take this opportunity to repeat some of the points that we have made in previous submissions to the Quality of Advice Review on life insurance advice:

- The average level of cover in a Group super fund is around $150k (it varies depending upon different sources), however the average mortgage in Australia is $560k (according to the recent census). Without the intervention of advice, Australians are unlikely to get the level of cover that they need.
- Life insurance is complex, in terms of working out the client's needs, understanding the different product options, finding the best cover and at the right price. Direct is never a viable alternative to getting advice, in terms of meeting the clients needs or access to the best products.
- The life insurance products (i.e. retail advised, group super and direct) that are available, are very different and have been designed to serve different purposes. The assumption that they are comparable or interchangeable is misplaced.
- Automatic acceptance of cover in group super, reduces the costs, however it has other important implications, in that it will always be for lower levels of cover, with underwriting required for any increase, and it materially increases the risk within the pool. The fact that the cost of placement is a lot lower, does not necessarily mean that it is a better outcome for the members of the fund.
- Current adviser level data shows that group cover is a lot more expensive than retail advised cover. Unfortunately, there is no aggregate level published data to support this important conclusion. Maybe this is a piece of work the consumer groups could do.
- The default group super life insurance product plays an important role in ensuring that a large number of Australians have a base level of cover, however it is unlikely to ever offer adequate levels of cover. Whilst this cover can be increased within the super fund offering, the client would be required to go through an individual underwriting process. On a pricing basis alone, it is often cheaper for the client to move to an individually advised product under a retail offering through an adviser, than to increase their cover with the super fund directly, which offers cover with a single insurer only. Importantly, in the context of insurance inside super, there is the competing objective of minimising the extent of erosion of the superannuation benefit, which very much impacts the ability to access the required level of cover.
- The value of default cover via super is to assist with a baseline level of default cover only and has never been intended to provide a complete solution. It is beneficial to individuals who have complex health issues or are uninsurable due to having a high risk occupation. For the vast majority of those who chose to access individually tailored cover through an adviser, they not only benefit by accessing more competitive premiums but gain access to a wider range of insurance offerings that provide a higher level of protection for the consumer, ranging from policy features such as Guaranteed terms, the ability to manage long term affordability through greater choice of premium structures, portability of cover, being insured for their own occupation, and more. There are also additional benefits and protections for the client when using the services of an adviser, namely the benefits of strategic advice, their services delivering time savings and convenience for the client, assistance at claims time and the knowledge that their adviser will have professional obligations such as professional indemnity insurance and the requirement to act in the client's best interest.

- Advisers can charge a fee to the client, and given that this type of advice is covered under the Sole Purpose Test, it could come out of the client's super account (as opposed to their bank account). Increasingly super funds, including industry funds, are permitting advisers to charge fees (either once off or ongoing fees), making it feasible to be paid a fee for advice to upgrade the cover in the client's existing super fund, if that is the best outcome for the client.
- Research undertaken over recent years by a range of sources has demonstrated that clients are very reluctant to pay a fee for life insurance advice, however are happy to pay a commission. When offered the choice of an upfront fee or a commission, the vast majority of clients select the option of a commission. This is based upon a number of factors, including that with a commission, the cost can be spread over a number of years. They also appreciate that if the adviser is unable to obtain cover due to health factors, then they will at most pay a small fee for the advice.
- At present, financial advisers are not having any difficulty finding new clients, and will therefore focus on clients where they can comfortably generate adequate remuneration. Recommending a client upgrade their existing life insurance will almost inevitably require a Statement of Advice, and they will engage in this assignment with this in mind. If they do not believe that they can be remunerated for the work that is required, then they will inevitably focus upon other clients.
- Just as in any other advice scenario, the adviser needs to assess what is in the Best Interests of the client, and unless they can meet those needs, then they are forced to decline to provide the advice. There is a risk that an adviser could recommend a client switch out of group super cover to an individually advised life insurance product, when this is not in the best interests of the client, however this is an unlikely outcome and there are already a range of controls in place to better ensure that this does not eventuate.

All of the points above help to reinforce the important role that advice on life insurance plays and that access to this advice is dependent upon the continuation of the commission model. The LIF reforms have had a range of impacts, however one of the most important and concerning is the impact that it has had on access to life insurance advice for everyday Australians. This is a subject that warrants enhanced understanding. Life insurance is a long-term product, and the market moves gradually over time, however the Government should be very focussed on key developments such as:

- Changes in the number of new lives entering the life insurance pools.
- Changes in the average age of new lives entering these pools.
- Changes in the average age of all lives in these life insurance pools.

Each of these are important indicators of the health of the overall life insurance market, and the recent trends have not been positive. More needs to be done to get younger lives into the life insurance pools, however understanding the problem is the first step.

With life insurance, which is a product that people do not normally choose to acquire without education and encouragement, placement is important. Group super funds are one form of placement, that is suitable for default basic products with simpler features and lower levels of cover. The utilisation of products that are aligned to the needs of the client, will only come through access to financial advice. The retention of this channel for placement is critically important for the entire life insurance environment.

Concluding Comments

We thank you for the opportunity to provide feedback on the Conflicted Remuneration consultation paper. We support the proposals in the consultation paper, however ask that the Quality of Advice Review have a close look at the issues of clawback and how the Life Insurance Framework can be sensibly modified to better enable financial advisers to provide life insurance advice to younger and everyday Australians.

We would be happy to discuss this submission further, or to provide additional information if required. Please contact us on (02) 9267 4003.

Yours sincerely,

Phil Anderson
Chief Executive Officer
Association of Financial Advisers Ltd