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AFA Submission – Response to Draft Legislation on Life Insurance Reforms

The Association of Financial Advisers Limited ("AFA") has served the financial advice industry for 69 years. Our aim is to achieve Great Advice for More Australians and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a code of conduct
- investing in consumer-focused research
- Providing professional development pathways for financial advisers
- Providing the professional certification of the Fellow Chartered Financial Practitioner (FChFP) designation
- connecting key stakeholders within the financial advice community
- educating consumers on the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians' reach their potential through building, managing and protecting wealth.

We welcome the opportunity to provide comments on the exposure draft *Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2015*. The AFA is committed to achieving a strong, trusted retail life insurance sector in Australia and our willingness to be engaged in developing the framework for the future of Life Insurance has been demonstrated through both the Life Insurance and Advice Working Group we convened together with the Financial Services Council (FSC), and the subsequent roundtable negotiations with the Assistant Treasurer, FSC and Financial Planning Association (FPA).

Achieving a consensus outcome on the Life Insurance Framework (LIF) has been extremely challenging with our members questioning how the LIF improves consumer outcomes. **Indeed we hold concerns that any gains to consumers may be minimal at best unless the Code of Conduct to apply to Life Insurers enforces an alignment of their activity with the best interest obligation owed by financial advisers to their clients.**

This draft bill implements only part of the LIF (those related to adviser remuneration) and our comments and support for the Bill is conditional upon the remaining elements being put into effect in the same time frame.

In this submission we address the following:

A. Background
B. Submission focus
C. Summary of recommendations
D. Examples of correspondence from members
E. Conclusion

A. Background

The Association of Financial Advisers has 69 years of experience in dealing with life insurance advice having commenced as the Life Underwriters Association in 1946. We now represent the views of over 9,000 advisers through relationships we have with around 40 of Australia's leading licensees, and around 3,400 individual members.

Typically, clients who obtain life insurance via a financial adviser have on average 3 times the level of cover that non-advised consumers hold (source KPMG and FSC Lump Sum Experience Study 2008). The often said line "that insurance is sold and not bought" is therefore particularly evident in Australia. It usually takes a consultation with a financial adviser for the average Australian to understand the financial risks that they are exposed to and the valuable role that insurance can play in providing them and their family with financial certainty at times of medical crisis or death.

The advice discussion educates the client to understand their own risks, the amount of money that is required should these risks eventuate, and the types of insurance that can fund the solution. Without receiving financial advice, most Australian's fail to either identify what is the appropriate life insurance to hold, or to persuade themselves to pay for an appropriate amount of insurance cover. **Life Insurance Personal Advice is therefore particularly important in ensuring that clients end up with the insurance that they need.**

Advised life insurance makes up approximately 50% of the total sales of life insurance in Australia. It is therefore essential then that the policy settings to be adopted must ensure that individuals are attracted into the profession to take up the role of financial adviser, and that advisers provide quality financial advice so as to achieve the public benefits of more people holding adequate life insurance cover. **In 2014, $7.2billion was paid out in life insurance claims to around 100,000 families thus providing personal financial relief and dignity in their time of need. It means 100,000 families going through crisis did not need government financial support.**

The alternatives to retail life insurance are Direct Insurance and Group Insurance. These products are usually more expensive than retail products, have inferior product definitions, lower rates of successful claims and higher rates of non-disclosure when compared to advised, retail life insurance. For most Australians, group and direct insurance represent a poor outcome when compared to retail life insurance. **Therefore**

it is essential that this legislation be considered in the context of whether or not Australians will still have sufficient access to advised life insurance solutions rather than being left with inadequate direct and group insurance solutions.

Australia already has a defined and widely recognised underinsurance gap through a number of studies including those from Rice Warner and also KPMG. Because of the prevalence of group insurance within superannuation funds the problem for an individual is often one of adequacy of cover rather than the complete absence of cover. There is a considerable financial literacy challenge alongside this where most Australians misunderstand what they are covered for and the adequacy of the cover. Financial advice overcomes these problems through educating the client and advising on appropriate levels of cover. Importantly, a financial adviser helps the client to recall the reasons for the insurance on a regular basis such that the client retains the cover longer than when they seek direct insurance as evidenced through the very high lapse rates on direct insurance (Plan For Life have reported on these differences in lapse rates).

Development of the Life Insurance Framework

The LIF was developed in response to ***ASIC Report 413: Review of Retail Life Insurance, and the Financial System Inquiry (FSI)***.

ASIC Report 413 released 9 October 2014 found 37% of life insurance in the highly targeted sample failed compliance standards. It should be noted that this is not the same thing as saying that 37% of cases involved consumer detriment. The AFA has examined a number of the failed files and mostly agree with the assessment that they fail compliance, but it was a small minority that disadvantaged the client. In most of the cases where the compliance failed, the client did in fact receive appropriate advice. Pleasingly, the pass rate improved significantly in the post-FoFA advice sample (after the introduction of the Best Interests Duty). **The Explanatory Memorandum (EM) at 1.7 and 2.7 refers to the ASIC report identifying "poor consumer outcomes" and this should be amended to "poor advice compliance" as the ASIC report did not separate out cases of consumer detriment from those of failed compliance.**

ASIC Report 413 was a concentrated, targeted market sample based on insurer data to identify licensees and advisers with high lapse rates and higher than average revenues from life insurance. In this way it was not a representative sample for all life insurance advice. There is however room to improve compliance and advice quality for retail life

insurance advice and the challenge is how to achieve this for the benefit of consumers without unjustly impacting the majority of advisers that have consistently met their legal and compliance responsibilities.

ASIC Report 413 also showed a correlation between high upfront commission (being over 100% in the first year) and advice that failed compliance – 45% non-compliance for advice where high upfront commissions were used representing some 93% of all files that were non-compliant. We observe that this has meant an undue focus has been placed on remuneration structures ahead of adviser training in compliance in identifying solutions to improve advice quality.ASIC Report 413 discussed lapse rates of policies in some depth. Lapse rates are the result of a number of issues. Of greatest concern are lapses where an insurance policy is replaced with another insurance policy where the client receives no significant benefit, yet the adviser receives a considerable commission. This is inappropriate replacement advice commonly referred to as "churn" and would fail the legislated Best Interest Duty that applies to advisers.

Churn activity needs to be clearly separated from replacement advice that offers an increased benefit to the client by way of savings or better cover. In those cases it is in the client's best interests provided all adviser and insureds' disclosure obligations are met and, although it adds to the lapse rate, the client is better off. Insurer conduct is also a significant driver of lapses and must be controlled through an effective Code of Conduct being applied to the insurers. **It must be recognised that no study or results have ever been conducted to determine the amount of replacement business that is not to the client's benefit thus there is no identified quantum of churn.**

Recommendation 24 in the FSI called for level commissions only to be available to life insurance. Although the FSI consulted thoroughly on many areas, it is our understanding that the FSI did not consult with advisers or professional associations with regard to commissions on life insurance, inappropriate replacement advice or any other issues raised in ASIC Report 413. We have publicly stated our concerns with the lack of consultation by the FSI in forming this recommendation.

The Explanatory Memorandum also refers to the **Trowbridge Report** even though it did not represent a united response from the AFA and the FSC as required in the terms of reference.

It is our view that the Trowbridge recommendations did not take account of the consequences for small businesses if they are not able to recover their advice costs without adding substantially to the costs paid by the client. **The Trowbridge recommendations if implemented would have resulted in advisers having to charge fees in addition to commissions to many clients to recover the costs of providing advice. The reduction in commissions paid to advisers would have resulted in significant benefits to insurers yet there was no mechanism suggested to ensure consumers benefitted through significantly reduced premiums. .** The net result would have been that clients pay substantially more for advised life insurance.

Commissions have drawn the most attention during the LIF consultations. Whilst many consider that commissions represent a conflict of interest, they do provide a fair mechanism by which the insured can elect to pay for the adviser's services over a period of time and thus reduce cash flow impacts on their own circumstances. The Financial System Inquiry and successive governments have acknowledged that commissions continue to have a role in life insurance reflecting the grudge-purchase characterisation often given to life insurance.

The LIF decision to reduce the amount of upfront commission significantly will reduce the potential for conflicts of interest but the consequence may well be that initial advice fees will need to be charged in addition to the reduced commission so that an adviser can recover the costs of providing their advice. The effect of this will be that **consumers will ultimately pay more under the new regime than they do currently** unless insurers reduce insurance premiums reflecting the expected lower lapse rates. In proceeding with this legislative solution **we urge Government to be confident that it believes the client's increased cost of paying for advice will be more than offset by the benefits of reducing the conflict of interest perceived of current commission rates.**

The view that removing higher upfront commissions will improve advice outcomes and produce consumer benefits has not been validated by research and it would add significant comfort to advisers if this work was completed as part of an appropriately prepared Regulatory Impact Statement (RIS). **An appropriate RIS would also consider the impact on small business financial advice practices in terms of their sustainability, and also on non-vertically integrated licensees. It would quantify the likely impact on the number of existing financial advisers that will stop practising and the likely impact on the underinsurance gap in Australia.**

B. Submission Focus

There has been significant industry discussion and a negotiated consensus reached with the Life Insurance Framework.

With regard to the draft Bill we raise the following concerns:

1. Section 963B(1)(b)(iii) and Section 963BA(1)(a) should be amended to refer to "monetary benefit" and specifically exclude advice fees.

2. Section 963B(3A) with regard to the basis for calculation of commission caps.

3. Section 963BA(2) with regard to ASIC's powers to determine an acceptable rate of commission.

4. Section 963BA(3) and (4) with regard to Clawback requirements.

5. The need for additional considerations within the Regulatory Impact Statement (RIS)

6. Grandfathering arrangements

This submission will address these concerns, however, will also focus on a further area of significance being implementing other aspects of the Life Insurance Framework and the future ASIC Review:

7. Code of Conduct for Life Insurers

8. Future ASIC Review 2018

Concerns

1. **Section 963B(1)(b)(iii) and Section 963BA(1)(a) should be amended to refer to “monetary benefit” and specifically exclude advice fees.**

Reference to the term benefit in the current drafting could inadvertently capture fee arrangements agreed between the client and the adviser (not commissions) and also non-monetary benefits paid (for example, training provided by an insurer). For clarity the section should be amended to specify “monetary benefits” and a note be added to specifically exclude any fees paid by and agreed with the client, including where collected in conjunction with premium payments by the insurer on behalf of the advice provider.

Clients need the flexibility that a fee they agree to pay to the adviser can be collected through the same means as the premium for the product as this may have tax implications that disadvantage the client in the case, for example, where it is for a retail insurance policy owned by a superannuation fund.

The amendment also avoids the complexity that non-monetary benefits are difficult to determine in advance. Non-monetary benefits in the sense of training or under $300 are separately exempted elsewhere in the legislation. The EM at 1.17 should be amended to reflect this also.

We separately seek clarification that “none of the products” in Section 963B(1)(b)(ii), in the context of holistic advice where a product could be included that includes an aspect of Group Life cover, that the retail products remain unaffected with respect to the operation of the Section and commissions can be paid on those retail policies.

> **Recommendation 1.**
>
> Amend Section 963B(1)(b)(iii) and Section 963BA(1)(a) to specifically refer to “monetary benefit” and also include a note to specifically exclude any fees paid by and agreed with the client, including where collected in conjunction with premium payments by the insurer on behalf of the advice provider.

2. **Section 963B(3A) with regard to the basis for calculation of commission caps**

The current drafting attempts to define the Relevant Amount by itemising various amounts that are to be included in calculating the maximum amount of commission that

an insurer can pay. The weakness of this approach is that it leaves the clause open to gaming by insurers developing new additional charges or terms to describe them so that they are not included in the calculations. The intent when developing the Life Insurance Framework was to exclude only government taxes or charges from being assessed for the purpose of establishing the Relevant Amount.

Recommendation 2.

The AFA recommends deleting the existing wording for s. 963B(3A)(d) and replace with:

> (d) any other amount charged, levied or applied by the insurer with respect to the product, or products for that period;

We believe that this provides greater clarity as to the intent of the agreement. The Explanatory Memorandum would also require updating to be consistent with the Bill.

3. Section 963BA(2) with regard to ASIC's powers to determine an acceptable rate of commission

Our concern is that although this appears to give ASIC the power to enforce particular commission arrangements, it also gives ASIC power to determine the quantum of those commissions both now and in the future. This exceeds the intent of the LIF agreement by giving ASIC the power to unilaterally determine commission caps in the future. We believe the following should be considered and the section then redrafted:

a) ASIC must undertake stakeholder consultation before making any changes to remuneration arrangements (commission caps or Clawback Requirements).

b) ASIC must attain Ministerial approval before implementing any material changes to remuneration arrangements contained in this Bill.

c) The legislation must expressly exclude any fee for service arrangements (including where those fees are collected together with the premiums for the insurance by the insurer and remitted to the adviser via their AFSL).

d) It must expressly exclude ASIC from having any powers to cap the rate of level commissions (meaning that the market can compete in the area of level commissions).

Recommendation 3.

Redraft Section 963BA(2) to restrict ASIC's powers to unilaterally make changes to commission caps requiring stakeholder consultation and Ministerial approval, and to explicitly exclude fee for service and level commission arrangements.

4. Section 963BA(3) and (4) with regard to Clawback requirements.

The clawback requirements will create circumstances where the adviser is placed in a conflict of interest between the needs of a client to reduce or replace cover and the requirement on an adviser to repay a commission if this occurs within the first two years after the issue of a policy. The clause as drafted does not fairly balance client circumstances that lead to a lapse between the insurer and the adviser for the following key reasons:

a) Section 963BA(3)(a)(i) is too limiting and should include all claims and Policy Expiry.

b) Section 963BA(3)(a)(ii) is too inclusive and could mean that a reduction in premiums by the insurer, but no change in cover, leading to a clawback requirement.

c) Section 963BA(4) gives ASIC power to change clawback arrangements in the future without consultation or ministerial approval. We cannot accept this.

Recommendation 4.

The AFA recommends amending the draft legislation to better align the Bill with the LIF as agreed and to more fairly apply the impact of a client's change in circumstances between the insurer and the adviser. ASIC should be excluded from making future determinations on changes to clawback without ministerial approval and stakeholder consultation. Our suggestions are as follows:

a) Section 963BA(3)(a)(i) the product, or one of the products, is cancelled or not renewed (other than because of a claim or the product, or one of the products, expiring due to the insured reaching the Expiry Age in the contract).

b) Section 963BA(3)(a)(ii) the relevant amount for the product, or one of the products, for a period is reduced because of a reduction in the sum insured.

c) Section 963BA(4) ASIC may, by legislative instrument, and after approval by the Minister, implement an industry determined amount or way of working out the amount that is an acceptable repayment for the purposes of paragraph (3)(b).

Add: (Note: The industry agreed clawback requirement is 100% of the benefit given to a financial services licensee in the first 12 months of the policy, and 60% between the first anniversary date and the second anniversary date of the policy.)

5. <u>The need for additional considerations within the Regulatory Impact Statement</u>

We acknowledge having participated in several roundtable discussions over the last year or so, however the regulatory impact statement has been drawn from previous enquiries (ASIC Report 413, Trowbridge and FSI) where assessments were not made with regard to the consumer costs and benefits of the recommendations. Additionally, the AFA is not aware of any Treasury work completed to assess the impact of the LIF recommendations on the sustainability of advice businesses that need to adjust to significantly less upfront commission as well as carrying a contingent liability for two years under the clawback requirements. Further, we are also not aware of any research by Treasury that has been undertaken in regard to the likely impact on underinsurance and the consequential cost impost on the Federal Budget with regard to social security. More particularly we raise the following concerns:

a) Consumer costs and benefits

  i. It is not clear how the cost of advised insurance will impact consumers

    a. It is likely that advisers will need to charge a fee (particularly on cases below the industry average in terms of premium estimated at around $2,000) so that they can recoup the initial costs of providing advice. This fee will be in addition to the cost of the insurance. This will be least afforded by those on modest incomes whom often have the greatest need for insurance protection as they do not have substantial assets or alternative sources of income.

  ii. It is not clear how insurers will be monitored to pass on the cost savings from lower lapse rates and reduced spending on conflicted remuneration payments to licensees in the form of premium reductions.

  iii. If it is likely that the number of advisers will reduce thus compromising the access by consumers to affordable, personal life insurance advice, what will be the impact of an increased reliance on Direct and Group insurance which have a history of paying less claims, lower sums insured, higher premium cost, significantly higher rates of non-disclosure and dramatically higher lapse rates?

b) Effects on advisers, small business advice practices and employment in the sector

i. We do not believe there has been any sensitivity analysis undertaken as part of the RIS or other research referred to that examines the impact on the financial viability for advisers and advice practices by implementing these changes. Our members have shared repeated concerns that the reduction in revenues will result in a combination of either:

   a. Increasing the cost to clients by charging fees in addition to premiums;

   b. Only providing advice where the case size is significant;

   c. Reducing support staff and/or the number of employed advisers because of affordability;

   d. Reduction in revenue leading to sale and closure of their business.

   These indicate a significant disruption to the availability and affordability of life insurance advice and needs greater consideration in the context of the underinsurance gap in Australia before accepting that the RIS is of an appropriate standard.

ii. A significant reason cited as pressure to change life insurance remuneration has been the allegation that Churn (or the replacement of insurance policies such that the Best Interest Duty is failed by the adviser) is a big problem. There is no evidence that has been provided to support this claim and therefore the likely benefit from instituting a two year clawback period on the quality of advice has not been quantified.

   a. The two year clawback significantly shifts commercial risk from the insurer to the adviser in a way that causes a conflict of interest between the adviser and their client. It is reasonable to expect that in imposing this on small business financial advisers it should only be done so if the benefits to consumers significantly outweigh the benefits to the insurers. There is no evidence produced that supports this.

c) A more complete consideration of the financial impacts.

i. There does not appear to be any financial impact considered at the adviser or practice level thus ignoring personal and company income tax effects and reduced employment resulting from reduced revenues from commissions.

ii. The impact on consumers in respect of paying advice fees in addition to insurance premiums or changes that could be expected in insurance premiums.

iii. Government cost impacts that would result from an increase in the levels of underinsurance driven by less access to affordable financial advice for life insurance.

The regulation of remuneration is a significant change to policy in Australia and the full impacts need to be considered before risking an industry that has provided $7.2B in claims to 100,000 families in 2014 alone.

Recommendation 5.

The AFA recommends that a number of additional areas be addressed in the Regulatory Impact Statement to avoid unintended consequences from the legislations and LIF. These include Consumer Costs and Benefits; Effects on Advisers, Small Business Advice Practices and Employment in the Sector; and a More Complete Consideration of the Financial Impacts.

6. <u>Grandfathering Arrangements</u>

As with the implementation of FoFA, appropriate grandfathering provisions are required. We acknowledge the draft Bill attempts to provide this however we believe the drafting can be further improved to ensure that there is greater certainty and clarity in regard to applications for insurance cover that are lodged but not approved prior to key dates in the transition time frames.

Recommendation 6.

The AFA recommends the following amendment:

1702 Applications of amendments relating to life risk insurance products

(1) The amendments made by Schedule 1 to the amending Act apply to a benefit given to a financial services licensee, or a representative of a financial services licensee:

(a) under an arrangement entered into on or after the commencement day; and

(b) under an arrangement entered into before the commencement day, but only in relation to life risk insurance products issued after the commencement day and excluding life risk insurance products where:

(i) a completed application form for the life risk insurance product is submitted to the issuer prior to the commencement date; and

(ii) the life risk insurance product is issued within six months after the commencement date.

7. <u>Code of Conduct for Life Insurers</u>

The Draft Explanatory Memorandum makes the following reference:

2.33 The FSC will have responsibility for creating the Life Insurance Code of Practice. Similar to existing codes for Banking and General Insurance, the Code

would set out best practice standards for insurers, including in relation to underwriting and claims management. This work is already underway.

We are concerned that this does not go so far as to address the sales culture of life insurers that can result in behaviours that ultimately incentivise advisers to operate outside of their legal obligations. As far back as November 2014 as party to the Life Insurance and Advice Working Group (LIAWG), the AFA recommended a comprehensive code of conduct be developed with the Life Insurers as part of the remit of the LIAWG that would see marketing and sales activities of insurers that are likely to interfere with the quality of advice banned. To this point we have not received the insurers or FSC support for a code that will also create this outcome for the common good and benefit of consumers.

We fully support the consumer aspects of such a code with regard to underwriting and claims management, but this code needs to go further than that to support improved outcomes in retail life insurance advice.

Recommendation 7.

We recommend the FSC be required to undertake a comprehensive consultation with consumer groups, professional associations that represent advisers, ASIC, FOS, APRA and Treasury in developing the Life Insurance Code of Practice and we seek government support for this via it being stipulated to the FSC and being included in the EM.

8. Future ASIC Review 2018

The AFA has previously made our views known on ASIC Report 413 and it not reflecting a fair sample of life insurance advice across the financial advice market place. In addition, we have also suggested previously that in collecting and analysing the data, a small amount of additional detail would make the findings significantly more useful.

We note that the draft Bill provides the mechanism for ASIC to collect an increased level of data on lapse rates and replacement business. We support this however caution that lapse data does not of itself determine that there is an advice fault or concern. We do also ask that the following be added:

(a) More detail on the following areas relevant to each adviser included in the sample when ASIC next conducts a thorough quality of retail advice review:

   a. Does any replacement product advice pass or fail the Best Interest Duty (i.e. is it "Churn" or appropriate replacement product advice that is to the client's benefit?)

   b. Is there evidence of client detriment from the advice

   c. Whether or not they have since retired from advising

   d. Education level of the adviser

   e. Years of experience in life risk advice

   f. Professional Association membership status

(b) We also draw attention to the timing of the review and wish to highlight that the data to be used is unlikely to represent advice delivered after the commencement of the end state of the transition to the 60/20 commission model. It certainly will not include lapse data based on policies written under the 60/20 regime as those policies will not as yet have had either their first nor second anniversary dates, and only minimal data would be available on insurance written under the 70/20 regime.

(c) We caution a broad focus on lapsed policies and suggest that the issue of concern ought to be replacement product advice that fails the Best Interest Duty and therefore would represent churn where the adviser has placed their own interests ahead of benefit to the client.

(d) The future review should include in its scope the effect of the Life Insurance Code of Practice on the culture of life insurers relative to their interaction with financial advisers.

Recommendation 8.

The AFA recommends that the Explanatory Memorandum at 2.35 be expanded to state that ASIC needs to consult appropriately with stakeholders in preparing **and** completing the future review and that the review should seek to provide data that can be used more effectively in identifying any systemic issues to be improved through further training and regulatory oversight. Further, the focus should be on replacement product advice that fails the best interest duty, not broadly considered around lapses. Finally it should include a review of the effectiveness of the Life Insurance Code of Practice in improving consumer and advice outcomes.

C. Summary of Recommendations

The below represents the summary of recommendations made in this submission:

Recommendation 1.

Amend Section 963B(1)(b)(iii) and Section 963BA(1)(a) to specifically refer to "monetary benefit" and also include a note to specifically exclude any fees paid by and agreed with the client, including where collected in conjunction with premium payments by the insurer on behalf of the advice provider.

Recommendation 2.

The AFA recommends deleting the existing wording for s. 963B(3A)(d) and replace with:

> (d) any other amount charged, levied or applied by the insurer with respect to the product, or products for that period;

Recommendation 3.

Redraft Section 963BA(2) to restrict ASIC's powers to unilaterally make changes to commission caps requiring stakeholder consultation and Ministerial approval, and to explicitly exclude fee for service and level commission arrangements.

Recommendation 4.

The AFA recommends amending the draft legislation to better align the Bill with the LIF as agreed and to more fairly apply the impact of a client's change in circumstances between the insurer and the adviser. ASIC should be excluded from making future determinations on changes to clawback without ministerial direction and stakeholder consultation. Our suggestions are as follows:

> Section 963BA(3)(a)(i) the product, or one of the products, is cancelled or not renewed (other than because of a claim or the product, or one of the products, expiring due to the insured reaching the Expiry Age in the contract)

Section 963BA(3)(a)(ii) the relevant amount for the product, or one of the products, for a period is reduced because of a reduction in the sum insured.

Section 963BA(4) ASIC may, by legislative instrument, and after approval by the Minister, implement an industry determined amount or way of working out the amount that is an acceptable repayment for the purposes of paragraph (3)(b).

Add: (Note: The industry agreed clawback requirement is 100% of the benefit given to a financial services licensee in the first 12 months of the policy, and 60% between the first anniversary date and the second anniversary date of the policy.)

Recommendation 5.

The AFA recommends that a number of additional areas be addressed in the Regulatory Impact Statement to avoid unintended consequences from the legislations and LIF. These include Consumer Costs and Benefits; Effects on Advisers, Small Business Advice Practices and Employment in the Sector; and a More Complete Consideration of the Financial Impacts.

Recommendation 6.

The AFA recommends the following amendment:

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(a) under an arrangement entered into on or after the commencement day; and

(b) under an arrangement entered into before the commencement day, but only in relation to life risk insurance products issued after the commencement day and excluding life risk insurance products where:

(i) a completed application form for the life risk insurance product is submitted to the issuer prior to the commencement date; and

(ii) the life risk insurance product is issued within six months after the commencement date.

Recommendation 7.

We recommend the FSC be required to undertake a comprehensive consultation with consumer groups, professional associations that represent advisers, ASIC, FOS, APRA and Treasury in developing the Life Insurance Code of Practice and we seek government support for this via it being stipulated to the FSC and being included in the EM.

Recommendation 8.

The AFA recommends that the Explanatory Memorandum at 2.35 be expanded to state that ASIC needs to consult appropriately with stakeholders in preparing **and** completing the future review and that the review should seek to provide data that can be used more effectively in identifying any systemic issues to be improved through further training and regulatory oversight. Further, the focus should be on replacement product advice that fails the best interest duty, not broadly considered around lapses. Finally it should include a review of the effectiveness of the Life Insurance Code of Practice in improving consumer and advice outcomes.

D. Examples of correspondence from members

"The advisor has to bare the brunt of any risk when giving advice. The advice documents are there for all to see in the event of an allegation of poor advice etc. Yet its the advisor who is bearing the pain of reduced income in the event of a lapse, not the insurer or the client. Just the advisor. And the reason for this is? We have no clear definition of what is constituted as a "lapse" and certainly "reduction in premium" is clear in word but not in deed. What if a client comes into money, pays down debt and no longer needs the cover to be so high? They reduce cover and thus premium and the advisor has to pay back the brokerage."

"New Financial Advisers requiring a degree & professional year is warranted for our industry to be recognised as a profession, however, a small practice will struggle to take on a new adviser without appropriate compensation."

"Life Insurance Reform Legislation shows that those given the power to potentially improve the way we provide life insurance products have not listened to the advisers at all. I still can't believe that they continue on with these changes and that the customer is the loser. How can you continue to state they are better aligning the interests of retail life insurers with customers, when the customer gets no real benefit. Premiums remain the same, even though the adviser get hit with reduced commissions and longer responsibility periods, and I just want to know what, the Insurance companies give up. Nothing, zero.

"I am still very concerned with the upfront commissions going to 60% or even level premiums. The people that are making me provide advice at a loss for my business do not understand that when people come to you saying "the cost is too much what can you do about it?" that I need to act quickly and efficiently to try and preserve my client and give them the best product and pricing available at the time. This is so much more common now with people being more and more price sensitive and Insurance companies not afraid to ramp up their premiums. The government is now saying either find them a cheaper option at often a loss to the business or keep them in an inferior product? I don't think any industry has to have this put upon them?"

"60% upfront commission and 2 Year clawback is an absolute disaster for risk advice. This is the burning issue in the industry. I know great young advisers all looking for an exit out of the industry if this legislation passes. The consumer is not better off with these changes."

"I Strongly disagree with changing the current payment structure offered by insurers, commission or a rebate and flat fee. Let the consumer chose, if the issue is churning then address that issue with better compliance and regulation. The Insurance companies should be at the fore front of identifying churning activity and report it and help to stop it. Vertical integration is a large part of the regulation problem that should be addressed."

"The legislation will enshrine in legislation a problem that has been created by the life offices themselves in that they have rewarded new business at the cost of in force. Life offices have created and encouraged churning by paying high commissions with a one year claw-back period. Now they want to pay about half and double the claw-back all to be

borne by the advisor. That in effect is reducing the conditions by 75%. How can new non-aligned advisors survive? near on impossible. They are in effect eliminating competition and returning to a tied agency situation whereby to survive an advisor needs to be on a salary to a life office. Where is the best interest duty to the client if you are selling only your employer's product? GONE. And the government is being complicit with this by legislating it.

E. Conclusion

The draft Bill seeks to implement aspects of the Life insurance Framework negotiated between the Assistant Treasurer, the FPA, FSC and the AFA and for the most part is consistent with that agreement.

We do not agree with the drafting that gives ASIC unilateral ability to make future changes to life insurance remuneration and can't support that as it stands. Consultation and ministerial approval are requirements that we believe must be added.

In addition we believe the Regulatory Impact Statement needs to take into consideration the likely impacts on the sustainability of financial advice small businesses, employment in the sector, effects on the underinsurance gap and also determine what the benefits are to consumers from this legislation. The legislation should not progress without these concerns being quantified and considered.

We also believe that the Life Insurance Code of Practice to be developed by the Financial Services Council must go further than has been described in the Explanatory Memorandum. It needs to also impact culture in regard to insurer activity that unreasonably conflicts an adviser in their best interest duty and induces inappropriate replacement advice. This means the code must contain commitments to the advice industry as well as to consumers.

Reflecting upon the Life Insurance Framework, it is difficult to see how consumers will benefit from these reforms, yet the costs are significant.

Creating fundamental change to the framework of an established market place so as to improve the end outputs, (in this case quality insurance advice and the adequacy of life insurance held by Australians) is extremely challenging. It is always the case that most that have operated appropriately and fairly within the existing framework will have to adjust, often significantly, but it will also be the case under these reforms that many incumbents will not survive the transition.
As a whole, the Draft Bill will create the mechanism to implement the remuneration aspects of the Life Insurance Framework which will have a profound effect on the advised life insurance market, and in particular the many life insurance risk specialist advisers and their current and prospective clients. Adjusting to a reduction in upfront

commissions from a headline rate of around 120% to 80% from 1 July 2016 will be an enormously difficult task for most advisers and small business risk practices. When combined with a two year clawback obligation the increase in business uncertainty and reduced viability will see many advisers decide to leave the industry. The loss of these experienced professionals is likely to come at great cost for Australia through the reduced access to affordable, personal life insurance advice and a consequential increase in underinsurance.

The AFA has participated consistently since October 2014 in considering the issues and the possible solutions. Remuneration structures were only ever one aspect, but it has been the easy target and has attracted the most attention – more than it has deserved relative to training, development and compliance processes.

We will continue to provide our input to the reforms, and will also continue to support our members and industry to address these other areas that drive quality advice outcomes.

Yours sincerely

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Association of Financial Advisers