Association of
Financial Advisers

FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

18 October 2019

Mr Stephen Glenfield
Chief Executive Officer
Financial Advice Standards and Ethics Authority

By email: stephen.glenfield@fasea.gov.au

Dear Mr Glenfield,

Joint Associations Life Insurance Taskforce Submission on the FASEA Code of Ethics for Financial Advisers

Thank you for the opportunity to meet with you on both 24 May 2019 and 4 July 2019 to discuss the FASEA Code of Ethics and the guidance that you propose to provide with respect to the implementation of the Code. As you are aware, we have some material concerns about how the code will be interpreted and the potential need for major business change in what is now a very limited timeframe. You have previously indicated a commitment to consult with the Code Monitoring Australia Cooperating Associations before the release of the Code of Ethics guidance. Obviously, the announcement by Government last week means Code Monitoring Bodies will not be in place to monitor the Code. However, we continue to believe that working with the Associations remains the best approach to ensure appropriate understanding of the Code therefore allowing a greater opportunity for compliance both in the meaning and in spirit. We therefore continue to look forward to this opportunity, however in advance, we wanted to make some key points related to client consent.

When we last met on 4 July 2019, one of the issues that came up with respect to Standards 4 and 7, in regard to obtaining client consent for existing clients, was the implications for advised life insurance only clients. It was expressed that consent would be expected for life insurance only clients. We would like to take this opportunity to outline our concerns with this standard, as it applies to life insurance only clients.

We have set out below the rationale for this view.

Background

We have included below the wording for Code Standard 4 and 7 and the relevant detail from the Explanatory Statement.

Code Standard 4:

> You may act for a client only with the client's free, prior and informed consent. If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.

Explanatory Statement - Standard 4

40. This standard requires that you only act for a client with the client's free, prior and informed consent.
41. This means that, before you start to act, you must have explained to your client, clearly and simply:
   - what services will be provided; and
   - the terms on which they will be provided; and
   - the records that will be made of the services, and the privacy and confidentiality arrangements applicable to them.
42. Existing clients' consent must be obtained as soon as practicable after the Code commences. Section 2 of the Code states when it commences.
43. "Informed" consent requires that the client understands and agrees to the arrangements. You will need to be satisfied of this, and have reasonable grounds to be satisfied.

Code Standard 7:

The client must give free, prior and informed consent to all benefits you and your principal will receive in connection with acting for the client, including any fees for services that may be charged. <u>If required in the case of an existing client, the consent should be obtained as soon as practicable after this Code commences.</u>

Explanatory Statement - Standard 7

51. This Standard requires the client's free, prior and informed consent to all relevant remuneration arrangements for you and your principal. To meet this Standard, the client must be given a clear and simple explanation of the fees and charges, and the benefits you or your principal will receive, that are attributable to you or your principal acting for the client. There is an extended definition of benefits in subsection 4(1), to include monetary and non-monetary benefits. The explanation can be given by you or someone else.
52. Existing clients' consent must be obtained as soon as practicable after the Code commences. Section 2 of the Code states when it commences.
53. You must also be satisfied that your client understands and agrees to these arrangements, and you must have reasonable grounds to be satisfied.

55. This standard also requires that all fees and charges payable to you or your principal, and benefits you or your principal receive, for acting for the client are fair and reasonable, and represent value for money for your client. This is an integral part of your duty to deal fairly with your client, and in his or her best interests. There is an extended definition of benefits in subsection 4(1), to include monetary and non-monetary benefits.

Context for Life Insurance Clients

Whilst we understand the importance of these consent requirements for investment and superannuation clients, who are on a contracted ongoing adviser service fee arrangement, we believe that it is important to highlight the significant differences that apply with respect to life insurance only clients. The key factors that apply to life insurance are as follows:

- Traditionally a life insurance commission only arrangement is not classified as an ongoing fee arrangement. Section 962A (4) specifically states that an arrangement is not an ongoing fee arrangement if the only fee payable under the arrangement is an insurance premium.

- Clients have already provided informed consent when the life insurance business was put in place in the past, as a result of having (generally) signed both the Authority to Proceed page in the Statement of Advice and the application form in the Product Disclosure Statement, which includes a tri-partite agreement for commissions to be paid to their financial adviser. This informed consent, included approval for the payment of the initial commission and the ongoing commissions, which was fully disclosed to the client in the Statement of Advice.
- As a result of the Life Insurance Framework, and as specifically proposed by John Trowbridge, the commission remuneration for the advice on life insurance business and the implementation of life insurance arrangements, in many cases, does not cover the full cost of providing the initial financial advice. This will become an increasingly significant factor in 2020, when the upfront commission rate declines to 60%. Thus, some of the cost of the advice is recovered from the renewal commissions that are paid in the following years.
- Renewal commission on existing life insurance business might be as low as 10% or even 5% of premiums. It is not economically viable to treat such clients on an opt-in basis, particular where the cost of obtaining and renewing consent could be many hundreds of dollars. This is clearly demonstrated in noting that the average life insurance premium of $2,500 and a common 10% renewal commission. If consent was mandated, then this would mean that many advisers would need to discontinue their relationship with some clients, and this would leave them unadvised.
- The common arrangement between a financial adviser and a life insurance only client is the availability for the client to contact the adviser when their circumstances change – which could result in a review or even in some circumstances a need to make a claim against the policy. Thus, a formal contractual commitment to undertake an annual review is not common or economically feasible for many clients.

Cross Subsidisation in Life Insurance

Life insurance is a very different product from other financial products. In a financial advice context, it is a pooled risk product that comprises a tri-partite agreement between the client, the life insurer, and the adviser (and licensee). Money is pooled by the vehicle of premiums and used to pay commissions to advisers for the provision of upfront advice, ongoing services (including episodic strategic/product review advice) to the client, administration support on behalf of the insurer and to fund adviser / support staff costs involved with claims advocacy, liaison and settlements. The commission payment comes from the life insurer out of the premium pool rather than specifically from the client. Life insurance is fundamentally a cross-subsidisation model where a large number of policyholders make payments in order for a small number to obtain a large benefit on the occurrence of a life insurance event. This also leads to advisers being paid for the advice provided to clients where insurance is placed, but often not remunerated for clients where the insurance recommendation ultimately is not implemented. This arrangement is clearly disclosed to and accepted by clients. It means that the benefit for the adviser is not as precisely defined as is the case with adviser service fees for investment and superannuation clients.

Life Insurance Claims Services

A key part of the value proposition for advised life insurance clients is that the adviser will assist and support their clients at the time of claim, and often at no additional cost. Ultimately this means that the adviser will devote a significant amount of time to the small number of clients who incur a claimable event. This fundamentally means that the clients who do not incur a claim, are subsidising those who do, however this is generally accepted as it is inherent in the nature of pooled risk management at various parts of the tri-partite value chain. It means that there is always going to be some mismatch between what clients are paying for and what services they are getting.

Adviser Service Fee Life Insurance Clients

We accept that it is not unreasonable to treat life insurance clients, who are paying an ongoing adviser service fee, on the same basis as investment and superannuation clients.

Concluding Remarks

For all of the reasons discussed above, we recommend that the guidance on the Code of Ethics clarifies that it is not expected that consent needs to be obtained for existing life insurance only clients.

We would welcome the opportunity to discuss this further, in order to better understand FASEA's objectives and expectations.

We welcome further consultation with FASEA, should you require clarification of anything in this letter.

Yours sincerely,

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd

Dante De Gori
Chief Executive Officer
Financial Planning Association of Australia Ltd