FINANCIAL
SERVICES
COUNCIL

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Subject: ASIC Consultation Paper 245 – Life Insurance Reforms

Dear Ms Yu

The Financial Services Council (FSC) thanks the Australian Securities and Investments Commission (ASIC) for the opportunity to provide feedback on Consultation Paper 245 – Life Insurance Reforms.

The FSC has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than $2.6 trillion on behalf of 11.5 million Australians. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

This submission provides feedback to assist with implementation of the legislative elements of the reform package. This package and the legislative elements were determined by agreement between the Government, and the FSC, Association of Financial Advisers, and Financial Planning Association, announced by the Minister for Small Business and Assistant Treasurer on 6 November 2015.

The FSC would welcome the opportunity to discuss its submission. Please contact if you have any further questions in relation to this submission.

Yours sincerely

1. GENERAL COMMENTS

Timing

There is a risk that if the final ASIC instrument is not released until April, there may not be sufficient time for implementation (including systems changes communication/training to advisers, and testing and refinement of the manner in which data will be transferred to ASIC) by 1 July 2016, e.g. if the clawback processes implemented by the life industry do not match the final terms of the instrument, these will need to be adjusted and a transition period would be required.

Timing is particularly relevant for the lapse reporting requirements. Industry is supportive of collecting some of the requested **lapse data from 1 July 2016** however believes **the reporting requirements** (i.e. the provision of information to ASIC) should start on **1 July 2017**. This is necessary to provide the industry with sufficient time to make necessary system changes and test transfer protocols to ASIC for lapse reporting requirements and to collect the experience data.

ASIC RG246 on conflicted remuneration

Industry expects that the current approach on grandfathering and volume based benefits and performance bonuses for employees as set out in RG246 on Conflicted Remuneration will extend to life insurance remuneration.

2. RESPONSE TO ASIC CONSULTATION QUESTIONS

B. SETTING MAXIMUM LEVEL OF COMMISSON

<u>B1Q1 Are there any considerations ASIC should take into account in implementing this proposal?</u>

In its submission to Treasury of 24 December 2015, which is attached, the FSC makes a number of points relevant to the implementation of this proposal, including, but not limited to:

- The current ratios were determined after extensive consultation with industry and that any future changes to these ratios by ASIC should be based on industry agreement and appropriate consultation.
- ASIC should also have the power to set a cap on level commissions in the future should any unintended consequences or perverse outcomes occur as a result of leaving level commission uncapped.
- Stamp duty in the first year for term life insurance products should be allowed to be part of the relevant amount used to calculate commission payments. If not, there would be a substantial cost to industry of unbundling the stamp duty in the first year for term life products of approximately 100 million dollars across the industry. We also do not believe, that with impending tax reform, that this complexity should be required of life insurer’s systems.

- Industry seeks confirmation that fee for service collected by insurers on the adviser's behalf will not be treated as commission or conflicted remuneration.
- Clarification with respect to grandfathering of pre-existing remuneration arrangements. Generally, and as pointed out in recommendation 11 of the FSC Submission to Treasury, a 3 month transition period is required at each change over to new first year commission terms to allow for applications that have been submitted prior to 1 July 2016 to pass through the underwriting process and complete post implementation date.

B1Q2 How do you think any increase in premium should be dealt with under the proposed commission structure?

The FSC has outlined its views in its paper to Treasury on 24 December 2015, which is attached.

Generally speaking premium increases should have the commission structure applied for the incremental amount. However, some distinction is required between customer directed increases and automatic/contractual increases.

Customer directed increases would entail a change to the cover which is requested by the policy owner or financial adviser on behalf of the policy owner. This includes the following changes:

- sum insured increase
- decrease in waiting period, or increase in benefit period
- benefits, options and definition changes which would result in an increase to the premium rate (e.g. addition or removal of a benefit/option, addition or removal of a linked policy addition, change in definition or option)
- premium structure which would result in an increase to the premium rate (e.g. stepped to level).

However, commission should not be paid for automatic policy contractual increases. Automatic increases would include, but are not limited to:

- age based increases;
- premium rates increased by the insurer
- changes in premium rate due to CPI, stamp duty and policy fee increases, or an increase in premium due to the expiry of level premium and the client moving to stepped premium.

(a) For example, if the premium increases in the second year because the amount insured has increased, should the maximum upfront commission apply to the amount by which the premium has increased?

If the cover is increased by application (other than CPI or reinstatement following a claim), then yes initial Commission should be paid based on the increase in premium at that time.

<u>(b) Are there any circumstances where the maximum upfront commission should or should not apply where there is an increase in premium in subsequent years? Please specify those circumstances.</u>

Please refer to the answer to B1Q2 above.

C. CLAWBACK REQUIREMENTS

C1Q1 Are there any considerations ASIC should take into account in implementing this proposal?

On December 24, 2015 The Financial Services Council (FSC) responded to Treasury on Life Insurance Reform Legislation. Please refer to pages 16 to 22 of the FSC submission to Treasury, which contains relevant considerations.

The first paragraph of the proposal in C1 on page 17 of CP245 should be **amended** as follows:

> "…if the policy is cancelled or the cover is reduced (other than for **death or if the product is terminated or reduced because a claim is paid under the terms of the policy**)…"

This is in the context of FSC Recommendation 9 (FSC submission to Treasury page 17) which would provide an appropriate exclusion from clawback on an industry wide basis, specifically when a claim is paid or in the circumstances of death.

The note under (b) in C1 of the proposal on page 17 of CP245 should be **amended** as follows:

> "Note: Clawback will be required if, within two years of a life insurance policy being issued, the policy is cancelled or is not **continued**(other than because of **death or if the product is terminated or reduced because a claim is paid under the terms of the policy**), or the premium or a non-contractual change in cover as a result of the action or direction of the policy owner that results in a reduction to the premium: see the 'clawback requirements' in s963BA of the draft legislative amendments."

This is in the context of FSC Recommendation 9 (FSC submission to Treasury page 17) about providing an appropriate exclusion from clawback on an industry wide basis, and the FSC comment 1 (FSC submission to Treasury page 17) about renewals not being appropriate for life insurance, so the term "continued" should be used.

Direct Insurance

We submit that while the clawback arrangements have been designed in respect of the retail adviser business models, there may be unintended consequences for direct models where employees are selling a single product under a general or no advice model.

We would welcome further discussion with ASIC with respect to direct insurance, noting that these reforms were designed with the retail advice segment in mind, with general/no advice models captured for integrity reasons.

There is considerable risk that the reforms to reduce high upfront commissions could lead to advisers offering consumers digital only general advice solutions as a substitute for personal advice life insurance products in a way that does not meet the spirit of the intended changes.

This concern needs to be balanced against the need for both a competitive retail and direct life insurance market.

We would appreciate additional ASIC guidance in this area, and believe more consideration should be given to unintended consequences on direct distribution methods.

D. ONGOING REPORTING REQUIREMENTS TO ASIC

D1Q1 Are there any considerations ASIC should take into account in implementing this proposal?

Industry has developed a proposal on lapse reporting, provided in attachment A that outlines our views on appropriate lapse reporting requirements consistent with industry agreement with the Government.

The Trowbridge review **did not recommend lapse reporting requirements for life insurers**. This was offered by the industry as an integrity measure as part of the industry reform proposal.

The intent was for better enforcement and monitoring by ensuring ongoing reporting by life insurance companies of policy replacement data to ASIC. Furthermore, in the context of ASIC Report 413, it was believed this was for retail insurance only.

The requirements outlined in the consultation paper are much broader than just replacement data. This will cause unnecessary regulatory burden. We note the following concerns with the proposal as it currently stands:

1. Under the current proposal there will be a high cost to report on legacy products and therefore a significant financial impact to insurers which will eventually be passed onto consumers via higher prices.

2. There is a lack of reporting capability within policy administration systems and short time frame to implement the required changes.

3. Industry has little information on customer movements across different products and the reason for policy exits. In some cases, advisers may no longer be engaged to provide advice and will not know the reason for a policy exit. In other cases it is difficult to determine the reasons why a customer has exited as many do not wish to be contacted, and those that are contacted do not wish to divulge information.

4. We believe it will be difficult to determine if a customer is a "first time insured". We note that many individuals may already have life insurance via their superannuation fund, making this data category redundant or meaningless in practice.

5. Industry has little information on 'data on policies sold' regarding the advice model the customer has chosen. As with collection of customer exit reasons we expect collection of this information to be difficult and costly. It may be difficult to divulge salary/bonus/incentive arrangements of non-commission & non-fee for service advisers.

6. Industry position is that lapse reporting should not occur for CCI products and Group Life business.

The purpose of lapse reporting is to facilitate ASIC's monitoring and enforcement of the law

Government noted that it will ensure that the industry develops appropriate lapse reporting data to provide clear evidence for the review and that ASIC works with industry to ensure strong integrity around the data.

The Consultation Paper discusses the review in 2018 and suggests this is the primary purpose of life insurers providing the lapse reporting data to ASIC.

We submit that the primary purpose is actually to assist ASIC with increased and improved monitoring activity of advisers while the model is in operation to provide a deterrent for inappropriate behaviour. We further submit that the review in 2018 should focus on the change in behaviour at an adviser level, supplemented with quality of advice reviews consistent with ASIC Report 413.

In 2013, ASIC requested significant and detailed data from life insurers in relation to lapses which ASIC used as a basis for its Report 413: Review of retail life insurance advice (Report). Following receipt and analysis of this data, ASIC investigated a number of adviser licensees and determined that there was a high correlation between upfront commissions and poor financial advice. In addition to using this information for the Report, ASIC investigated even further and identified a number of advisers who were responsible for high lapses and poor financial advice.

Without the further investigation by ASIC of advisers licensees who have a high proportion of lapsed policies, it is impossible for ASIC to tell the difference between those advisers 'churning' policies and those advisers acting in the best interests of their clients. Failure to conduct this additional investigation will lead to significant data integrity issues as lapses do not automatically mean poor advice has been provided.

The lapse data requested by ASIC does not seek to identify those adviser and licensees who have a high proportion of lapses. This will mean that there is no scope for ASIC to conduct further investigation to determine whether the lapses could be considered 'churning' or alternatively are the result of a proper and comprehensive review and advice process. Failure to conduct this review will render the lapse data provided by life insurers meaningless as there is no basis for ASIC to determine whether poor advice has been provided.

It also means that ASIC will not have the opportunity to continue their very good work in exiting those advisers from the industry with poor practices. These advisers who 'churn' policies are not only giving a bad name to other advisers, they are skewing the lapse data significantly so that the lapse data looks much worse than it actually is.

ASIC needs to continue to monitor advisers and take action where advisers are 'churning' policies and providing poor advice. The removal of these problem advisers will ensure that the ASIC review in 2018 is a fair reflection of advisers across the industry and is not unduly influenced by a minority of advisers not acting in their client's best interests.

Table 1: Areas life insurers cannot report on

Information[1]	**Comment**
iii. how many have exited the policies (and reasons for the exit); ii. the cause of exit for all policies; and (ii) the reasons for policies being exited (see also	The only 'exit' reasons that life insurers can report on are: • Policy cancellation and internally replaced • Lapse due to non-payment • Cancelled by the insurer at policy holder request when so directed to do so • Claim payable • Expiry

[1] For ease of reference numbering matches the Consultation Paper.

information required for policies in D1(a)(iii));	Any further information regarding reason for exit would necessarily involve calling the customer (for lapses and cancellations) and asking them. There could, obviously, be a myriad of reasons, and there would be no rigour around the reported responses. Implementing this option would involve considerable additional human resources solely for the provision of data which may not itself be accurate. This would serve to increase the cost of insurance to consumers.

Table 2: Information that may be available but industry seeks clarity

Information	**Comment**
- how many policies are to 'first time insureds';	As most working Australian's have group cover through their superannuation, the answer to this will be close to zero. We request that this requirement is removed. Even if 'first time insureds' was defined more narrowly, there would be significant problems in identifying such persons.
- how many are new or altered policies sold to existing policy holders;	Need clarity on definition of 'internal replacement business' (e.g. transfer of ownership) and whether these should be included in Lapse and New Business figures (currently these are excluded). Also, clarity is needed on what is an existing policy holder. For example where policy holder is an SMSF, if a new member/insured joins, we query if this counts as first time insured or if this is a policy sold to an existing policy holder. Another example is if the insurer has the client under a group life scheme for death cover with an employer arrangement, and the. insured subsequently takes out an individual retail policy. Increases in sums insured are counted as new business if they are not CPI increases. Further discussion with ASIC is required to resolve some of the issues raised above.
– any trends in the structure of policies over	This is unclear and greater clarity would need to be provided. The example is confusing. We could certainly comment on whether

time (e.g. an increase or decrease in premiums relative to the sum insured)	policies are inside or outside of superannuation or on structures including single and multiple benefit types (i.e. death, TPD, trauma).
d) data on policies sold: (i) with personal advice; (ii) with general advice; or (iii) with no advice.	Industry does not collect this information f. This question would be better structured to require data on the following different channels: • through a financial adviser; • through a direct channel:
(i) Historical data on commissions (where relevant)	This request is unclear. For example, does this refer to types of commissions offered/paid in the past by the insurance company, regardless of take up by advisers; how long commission has been paid for on a particular policy; whether there has been any variance in the level of commission or type of commission etc. This may be obtainable but will depend on what is actually required.

D1Q2 Is there information we have not covered that you think we should require? If so, please specify.

No. Industry believes that the lapse reporting requirements as currently outlined are onerous and not in line with the original purpose and intent of the industry proposal regarding lapse reporting. The level of detail and information sought is also not necessary to determine whether or not industry practices and the quality of personal life insurance advice have improved. We have outlined above what we consider the purpose of the data to be and highlighted the importance of ASIC undertaking further investigation to determine whether lapses are the result of appropriate advice or the result of churning.

D1Q3 Do you think we should also collect data at an adviser level?

The FSC proposal on lapse reporting required information to be collected by life insurers. However, we note that information, and in particular lapse rates, could be provided at an adviser level. We would welcome any further consultation with ASIC to address data collection at the adviser level.

The proposals envisage life insurers being required to collect/report data set out in consultation paper 245, thereby placing system changes/cost imposts on the life insurance sector. It would seem redundant to ask life insurers and advisers/licensees to report on the same data and result in unnecessary cost to businesses.

D1Q4 Do you have any feedback on our proposal to remove identifying details before we publish the information?

Industry agrees that data should be de-identified, including such data provided to ASIC. Industry has concerns over data security and customer privacy. Industry would seek information from ASIC as to data security measures and privacy policy they intend to put in place to collect and store the relevant data.

D1Q5 What will be the costs for you to provide all of the information we have set out in this proposal? Please provide amounts in dollars, if possible. Are there particular types of information that are more difficult or costly to collect? If so, please provide details.

Industry has estimated that the total cost to implement these changes would be $36.78 million to implement, and $0.39 million per year on an ongoing basis to meet ongoing reporting requirements on an industry wide basis.

These estimates do not include the impact of reporting on financial advice businesses, and given requirements are at the early stage of assessment may underestimate the overall impact on industry.

Industry is concerned that additional costs associated with the scope and breadth of reporting proposed by ASIC in the Consultation Paper would have a material impact on premiums in the hands of the consumer.

D1Q6 What would be the costs for you to provide data on lapse rates and clawback arrangements only? Please provide amounts in dollars, if possible.

These costs would be significantly lower than $36.78 million on an industry wide basis.

D1Q7 Do you think we should be collecting historical information? If so, how many years of historical data should we collect?

Historical data may be difficult to report given that information may not currently be collected or available to life insurers. To obtain data that is not already collected/available can be difficult to obtain in certain circumstances, as well as being a costly exercise. It may require additional staff to be employed or work allocated solely for the purpose of data collection and data entry which would result in additional costs to business which serve to increase costs to consumers. Further, even where additional resources are allocated to undertake this task, all of the information may not be obtainable, reportable or accurate.

Further, for the cancellation reasons, compliance relies on customers complying with requests for information from an insurer that they no longer have policies with. We would expect low quality of data for this reason.

D2Q1 Are there any considerations ASIC should take into account in implementing this proposal?

We submit that ASIC requests details of those adviser licensees with the highest lapse percentages and conducts further investigations.

Lapse figures will in and of themselves not provide sufficient information to determine whether product lapses are the result of churning. ASIC will need to undertake further investigations to determine the impact of the changes.

D2Q2 Does this timing allow you to adequately prepare your systems to start reporting on the specified data from 1 July 2016?

Industry cannot meet the proposed first reporting period of 1 July 2016 as it is unclear at this stage what final reporting requirements will be, and our understanding is that ASIC will not be in a position to finalise these until 30 April 2016.

Project planning, approvals and funding cannot be obtained prior to final system requirements being clearly defined. Further, given legacy system issues, the number of systems that will be impacted, and resourcing constraints it would not be feasible to recruit more staff to implement the reporting requirements. Specifically, new staff would require significant training before being able to commence IT projects involving legacy systems.

Industry believes that lapse reporting can commence from 1 July 2017, with the first report covering data from 1 July 2016 and 1 January 2017, with each subsequent report to include another 6 months' worth of data.