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Ms Helen Yu
Senior Lawyer
Financial Advisers
Australian Securities and Investments Commission

By email: Helen.Yu@asic.gov.au and Claire.Lachal@asic.gov.au

5 February 2016

Dear Ms Yu and Ms Lachal,

AFA Submission – Consultation Paper 245 Life Insurance Advice Reforms

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 69 years. Our objective 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 Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around 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.

Summary of AFA's position

The AFA is a consensus partner to the agreement on the Life Insurance reforms with Hon. Kelly O'Dwyer, Assistant Treasurer and Minister for Small Business, agreed in November 2015. We appreciate the opportunity to provide feedback on this ASIC Consultation Paper 245, which will enable implementation of the reforms as agreed between the Minister, AFA, FPA and FSC.

The AFA also acknowledges ASIC and the Minister's commitment during the discussions to a fair and transparent, wide-reaching evidential based research process, with consultation over the coming years.

Our recommendations here are intended to assist the efficacy and assessment of the implementation of the agreed reforms. The AFA recommends:

Commission

1. Any maximum cap changes post-1 July 2018 be at the Minister's direction, following a consultation process with industry, including the AFA.
2. Where higher premiums are the result of the adviser's work, additional commission should not be withheld.

Clawback

3. The clawback trigger specifics be detailed to enable assessment.
4. Clawbacks triggered by a reduction in the premium to only apply where there is also a reduction in the sum insured. This would exclude CPI indexation increases to cover.
5. Specify which adviser the clawback obligation rests with for subsequent assignment of ongoing commission rights.

Reporting

6. Replace the phrase 'policy exit' with the industry terms of 'lapse' or 'policy cancellation' to reflect that insurance is created around insurance contracts.

7. The information requested, collected and reported on the clawback arrangements and policy cancellations require greater detail to enable thorough analysis of reasons for cancellation and to identify future opportunities for framework improvements.
8. The 'reasons for cancellation' subset be further specified into underlying categories to enable better understanding.
9. That advisers have the right to review and provide cross-check information.
10. The proposed two to five years of historical data in D1(a) and D(b)(i) is sufficient but will largely depend on available records.

Feedback on ASIC's specific questions

<u>Section B - Setting a maximum level of commission</u>

B1Q1 *Are there any considerations ASIC should take into account in implementing this proposal?*

Recommendation – any maximum cap changes considered post-1 July 2018 via Class Order be at the Minister's direction, following a consultation process with industry, including the AFA as a party to the agreed reforms.

The AFA welcomes ASIC's involvement in overseeing the implementation of the framework. We recommend that any post-2018 consideration of changes to maximum remuneration level changes be at the Minister's direction rather than be unilaterally set by ASIC, and be informed by the data collected over the review period with extensive analysis and industry input and consultation. We propose that the future review assesses the health of the industry and each of its participant stakeholders, consumers and advisers.

Recommendation – clawbacks triggered by a reduction in the premium only be permitted where there is also a reduction in the sum insured.

Other than with respect to policy cancellations, clawbacks should only occur where the premium reduces within the clawback period because of a reduction in the sum insured.

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

(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?

B1Q2 *(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.*

Recommendation – where higher premiums result from the adviser's work, additional commission should not be withheld.

In each subsequent renewal period, the insurer should be able to pay a new business commission on the premium increase related to the increase in the sum insured. The appropriateness of the sum insured is a core element to the financial advice. Mitigating the risk of inflation in the sum insured is considered by the adviser and indexing the sum insured is usually therefore part of the advice. It is therefore reasonable that the CPI increase is remunerated by way of the upfront commission.

Where a premium has increased due to the sum insured being increased by more than CPI, this could be due to the client returning to the adviser to seek a higher level of cover. In such a case, to comply with the best interests duty the adviser would likely have conducted a new insurance needs analysis to consider whether the client's request for greater cover is not only appropriate for them taking into account their circumstances at that later time, but also whether they can afford any new premiums. The adviser may also have been in contact with the underwriters to clarify whether the policy would result in a new contract of insurance, changes in premiums or any new terms resulting from the insured's subsequent disclosures. If new business commission is not available for this increase it creates a conflict of interest for the adviser to consider replacing the policy.

<u>Section C – Clawback arrangements</u>

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

As outlined elsewhere in this submission, both the terms of insurance offered to the insured and the terms of remuneration offered to advisers are contractual arrangements. We expect that insurers will continue to compete with each other when offering to distribute policies through advisers. Within the bounds of the framework, we recommend insurers be constrained from applying arbitrary increases to clawback arrangements at the detriment of advisers, especially those in small business practices.

The presumption of a competitive industry underpins the minimum clawback arrangements as outlined in Table 3.

Recommendation – the clawback trigger specifics be detailed to enable assessment of unintended consequences

As the intent of the reforms is to discourage inappropriate replacement of policies, the triggers for clawback should be noted for the lapse factors that indicate this. To track unintended consequences of triggering clawback of remuneration where a client cancels their policy due to non-adviser directed issues (e.g. affordability of premiums due to insurer-led premium increases) and where a cancellation follows changing circumstances and the adviser recommends cancellation in the clients best interest. It is important for fairness and transparency to specify and capture appropriate and potentially inappropriate-replacement factors triggering clawbacks.

Recommendation – specify which adviser the clawback obligation rests with for subsequent assignment of ongoing commission rights.

We also recommend that the ASIC instrument clearly define whom a clawback obligation rests with where ongoing commissions have been transferred to another adviser during the two-year clawback period. As ASIC would be aware, current insurance arrangements allow for adviser remuneration to be transferred to another fee recipient where:

- an adviser moves to a different licensee,
- an adviser sells their client book, or
- an advising business is sold or ceases to operate.

In some of these cases, the adviser who recommended the policy to a client may no longer be servicing the client or responsible for the policy.

Clarifying within the instrument whom the clawback obligation rests with will provide clarity to fee recipients who are presented with a situation that will result in a transfer of ongoing commission. These fee recipients can then incorporate that expectation into any contractual terms with a new licensee or purchaser to ensure consistency with the instrument.

We understand that the general rule is that the risks and liability are acquired with assets purchased, unless the parties state otherwise. Accordingly, the AFA recommends that the instrument should clarify that responsibility rests with the servicing adviser (at the time of clawback) unless agreed to otherwise by the parties.

Section D – Ongoing reporting to ASIC

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

The AFA as a consensus partner to the November 2015 agreement on the Life Insurance reforms with Hon. Kelly O'Dwyer, Assistant Treasurer and Minister for Small Business appreciates the opportunity to consult closely with ASIC's team implementing and assessing these reforms. We appreciate the commitment during the reform discussions to a fair and transparent, wide-reaching evidential based research process, with strong integrity around the data and consultation in the coming years.

We restate our commitment to assisting ASIC throughout the process to enable wide-reaching, robust, fair and transparent research in preparation for future reporting on the impact of the reforms.

Recommendation – replace the phrase 'policy exit' with the industry terms of lapse or policy cancellation to reflect that insurance is created around insurance contracts.

The industry does not use the phrase 'exit' when an insurance policy ceases. Insurance policies are the creature of contract, regulated by the *Insurance Contracts Act 1984*. They come into being through an offer of insurance by the insurance provider and following underwriting or other negotiation, acceptance by the insured. When a policy ceases the industry refers to that as a policy cancellation – unless the cancellation was caused by non-payment of insurance premiums, which is then referred to as a lapse.

Although it may be accurate for investments, it is not accurate to refer to cessation of an insurance policy as an exit – see in particular Part VII of the *Insurance Contracts Act 1984.* To avoid issues with interpretation or claims of inconsistency of laws the AFA recommends that the ASIC instrument use the phrase 'lapse' or 'cancellation', which is consistent with industry language and the *Insurance Contracts Act 1984*, when referring to a policy ending.

Recommendation – the information requested, collected and reported on the clawback arrangements and policy cancellations require greater detail to enable thorough analysis of reasons for cancellation and to identify future opportunities for framework improvements.

The data should be able to be segmented in order to distinguish between the reasons for policy lapses. Collecting data without differentiating the reasons could undermine the policy objective and lead to unintended consequences.

The information groups should be reported by insurers to enable correlations to be identified, as it is not currently clear from the proposal whether the data groups will be related to each other to give substance and meaning to the information. For example, collecting data on how many policies are in force from an insurer and the types of each policy is important. Equally important is the data collected on policies sold with advice (both general and personal advice) or no advice. However, the groupings of those data sets will be less meaningful than identifying how many of each policy type was sold with advice or no advice, and less meaningful still than knowing how many policies of each product type were sold with personal advice and subsequently lapsed in the first two years due to the policyholder being unable to afford the premium.

We propose that ASIC captures information on the Adviser's experience, qualifications and professional association status.

The AFA supports ASIC requiring insurers to identify correlations between each subset of information set out in Section D1(a) to D1(d) in order to assist fulfilling the policy objective of the review.

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

Recommendation – the 'reasons for cancellation' subset be further specified into underlying categories to enable better understanding.

As outlined above, the AFA strongly supports distinguishing the types of policy lapses. This is one of the key data subsets that will underpin the policy objective. In collecting information about policies cancelled, it is important to ensure that the information collected drills down to capture the 'reasons for cancellation' in a meaningful and impartial manner. The AFA submits that the 'reasons for cancellation' to at least specify subset categories that can help to understand:

- whether it was a client-directed or other reason (e.g. age-based expiry),
- whether the cancellation was preceded by a change in any features to the policy by either the insured or insurer,
- whether any payment difficulties preceded the policy cancellation, and
- Whether the policy cancellation is relation to premium paid.

We support further definition of other types of policy cancellations and surrounding circumstances to better understand each 'reason for cancellation', and that this subset category be clearly prescribed to assist insurers report meaningfully.

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

Recommendation – That advisers have the right to review and provide cross-check information e.g. where high-risk advisers are identified from the insurer-provided information.

The AFA supports ASIC collecting some data at an adviser level where they are subject to review to assess whether any churning has taken place. It would be valuable to see consistency of information between insurers and advisers where ASIC identifies from the information provided by insurers that a particular adviser may be at high risk of cancelling policies inappropriately. Where ASIC identifies such an adviser, of the categories of information proposed by ASIC, the following information could be sought from the adviser about:

- how many are new or altered policies sold to existing policy holders
- the reasons for cancellation
- lapse rates and clawback amounts.

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

The AFA supports de-identifying all data reported publicly by ASIC. The focus would be on assessing trends and whether there are correlations between certain situations, remuneration levels or other motivations for lapses. This is consistent with how External Dispute Resolution schemes report data on disputes received.

However the AFA would support that professional associations receive individual member data, to assist with conduct monitoring, peer review and development.

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.*

Not applicable for associations.

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.*

The AFA does not hold such information and our members would have difficulty quantifying this until they know what level of information would be required of them, including whether any historical data is required.

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

Recommendation – the proposed two to five years of historical data in D1(a) and D(b)(i) is sufficient but will largely depend on available records.

For example, if advisers are sought to provide information on ‘reasons for cancellation’, it may be very difficult for them to provide retrospective data. Likewise, insurers may have difficulty providing some retrospective data.

The AFA submits that it be no less than two years if an intention of the review is to assess changing practices by both advisers and insurers.

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

We note that by the time the 2018 report is completed only part of the transition period will have passed. There will only be data and analysis for part of the transition period, and so not indicating the end state of the framework.

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

The AFA submits that the majority of the information proposed to be required from insurers is already available and collected by the insurers for underwriting and business planning purposes. If information is required from advisers as well, three months from the end of March 2016 would likely be sufficient for most advisers provided what is required of advisers is communicated no later than the beginning of April 2016. The AFA considers that twice yearly reporting is a sufficient balance between cost of reporting and monitoring changes in practices.

Further relevant feedback

To get most out of the review, the period of review will only provide partial data on lapses and cancellations. Accordingly, the AFA submits that ASIC be enabled through the instrument to deeply analyse the data in order to identify the core issue of inappropriate policy replacement caused by conflicted remuneration structures.

Further, with respect to the clawback arrangements, although not currently within the terms of reference, the AFA recommends that ASIC could consider whether any imbalances between insurers and advisers are reflected in the information reported about clawbacks. Whilst the AFA acknowledges and stands by the agreement with the Minister on the remuneration framework, that agreement did not have the benefit of the information that will be reviewed over the following three years. Accordingly, we suggest that there should be a mechanism built within the instrument to accommodate any future need for flexibility, such as to apply graduated clawback rates if the information collected supports any such changes.

Conclusion

The AFA in support of ASIC undertaking comprehensive research, is committed to raising trust and confidence with the profession, and awareness of the need for life insurance and great advice for more Australians. A growing and vibrant personal financial advice sector must be part of that vision, helping to address the underinsurance concerns for Australians with dependents.

The industry, the profession, Government, regulators and consumers will all benefit from a greater understanding afforded by fair and wide-reaching representative research to determine reasons and relationships between premium increases, lapses, remuneration structures and best interest outcomes for consumers.

Consumer needs will best be met by a vibrant market place that is strongly focused upon delivering the best possible client outcomes and ensuring that there is sufficient and appropriate incentive for advisers to want to provide life insurance advice. Similarly, insurers' needs would be best met by a growing insurance market, which will be the result, if there were more, not less, advisers providing personal life insurance advice.

We look forward to supporting all stakeholders, including ASIC, to deliver a robust life insurance market for all Australians supported by quality financial advice delivered by professionals.

If you require clarification of anything in this submission, please contact us on 02 9267 4003.

Yours sincerely,

Brad Fox
Chief Executive Officer
Association of Financial Advisers Ltd