



Association of
Financial Advisers

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Natasha Nguyen
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Australian Securities and Investments Commission

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Dear Ms Nguyen,

AFA Submission – Example Statement of Advice for Life Insurance

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 70 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 practicing 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.

Introduction

The AFA notes the Minister's instructions set out in a media release on 6 November 2015 with respect to ASIC undertaking a review of life insurance Statements of Advice. As one of the parties involved in the negotiations on the Life Insurance Framework, one of our core objectives was to ensure that the

production of life insurance Statements of Advice (SoA) was simplified in order to reduce the cost of producing these SoA, as an offset to the reduction in income from life insurance advice.

We therefore support ASIC's stated objective of improving the readability of SoA, however we also emphasise the importance of the efficiency of the production of life insurance SoAs. Generating succinct SoAs in an efficient manner that are clear and concise is the obvious objective. It needs to be noted that clients also need to read often lengthy Product Disclosure Statements along with other documents such as Financial Service Guides and Fact Find forms.

We further note that this is simply an example SoA and that it is not mandatory. This is an important consideration as there are many businesses that already have very effective SoAs that have been consumer tested in the real world and where changing will deliver no benefit, but result in significant cost. It is important that the financial advice sector treats this example SoA as a guide and chooses to pick from it what will improve their SoAs and not just to decide that it would be risk averse to simply replicate it. We are concerned that this may be misunderstood.

We support the strategies that ASIC has sought to employ as set out in paragraph 47 of Consultation Paper 284, and believe that these strategies should help to make life insurance SoAs easier to read and more understandable.

We also note and support the ASIC emphasis on behavioural economics and behavioural research in the design of SoAs. It appears that ASIC has concluded on the basis of behavioural research that repetition in the SoA delivers a better outcome for clients. It is our view that the SoA is not the advice, but rather a record of the advice. The SoA is primarily a document that supports and reinforces the advice that in the vast majority of cases is delivered verbally by the financial adviser and often in a face to face setting. We therefore do not support the inclusion of any repetition in the SoA and highlight that the SoA is not how advice is delivered, but rather a reference point for the purpose of review of the advice received. We suspect that the decision to include repetition may have been on the basis of consumer testing where the advice was not presented first in a verbal manner by a financial adviser. The research may have suggested a different outcome if the client had first received the advice directly from a financial adviser. In that case duplication would not be necessary and each section would not need to make sense by itself.

We recommend that the example SoA is reconsidered in the context that the SoA is not the primary means for the delivery of advice, but rather a record of the advice and a reference point for further consideration and discussion with the financial adviser. It should therefore exclude any duplication and be as succinct as possible.

Upfront Disclosure of Commissions

It is our view that the disclosure of commissions has been a prominent part of the design of SoAs since they first commenced. We suspect that there may have been some mis-understanding on the part of some parties with respect to the obligations to disclose commissions. Typically commissions are disclosed in the SoA just prior to the point where the client needs to confirm their agreement to proceed with the advice. Advisers will also brief the client on the remuneration as part of the verbal delivery of the advice. Whilst the AFA is a strong supporter of clear disclosure of remuneration and informed consent, we do not believe that the design of SoAs is improved by the inclusion of commissions on page

1 of the SoA. There is no benefit in disclosing the commissions prior to the inclusion of the recommendations. At that stage they have no context.

We believe that the current arrangements for commission disclosure are adequate and if there was a need for further disclosure then it should be added to the executive summary, in a short form. We also make the point that there has been no call to include advice fees for superannuation and investment advice at the front of the SoA and that there should not be one style of SoA for insurance advice and another for superannuation or investment advice.

Benefits of the Example Life Insurance SoA

We would like to acknowledge that the example SoA is relatively easy to read and that it does a good job of explaining the advice. In particular, the needs analysis was comprehensive and easy to understand. Designing an SoA is a particularly challenging exercise.

The example SoA is very much tailored to the clients and is very personal in nature. This is appropriate, however we expect that it would involve a noticeably greater level of effort and cost.

Response to Consultation Paper Questions

Language Used in the Example SoA

B1Q1. Do you have any comments about the way that any of the information in the example SoA is expressed? In particular, do you have any specific suggestions about how to make the language simpler and easier for customers to understand?

There are two key options in the construction of an SoA. One option is to have a very table based section by section approach. The other option is to use a more story telling approach that flows in a sensible and well ordered manner. The example SoA is of the former type. We make the point that a story telling approach might hold the interest of the consumer for a longer time and better enable the client to work through and understand the basis for the advice.

We note the objective of removing jargon and industry specific language. The style of wording is consumer friendly in large part.

We note however that the comparison of features section on page 14 does not adequately explain the difference between industry terms such as “unable to work” and “unlikely to work”. It is also noted that “own occupation – via superlink” has not been explained. Terminal illness advancement is not explained although there is an incomplete reference to it on page 19 in the “Why it is appropriate” section. In the context that the recommended product is more expensive than a modified version of the existing product, there should be a clearer plain English message as to why the recommended product’s features are superior.

Structure of the Example SoA

B2Q1. Do you think the structure of the example SoA assists customer to understand and find information? If you do not find the structure helpful, please explain why?

The flow of the document is in our view a little disjointed. This might be due to some normal sections being in a different place, the lack of a genuine executive summary and a lack of linkage from one section to the next.

As stated above, it is our view that the extent of the duplication in the example SoA is likely to confuse clients. We do not accept the premise that repeating information on the basis that clients may only read some sections of the SoA is sufficient justification for making the document longer than it needs to be. We believe that the document should be prepared on the basis that it will be fully explained in a face to face meeting and that it will be later read by the client for further reference and confirmation of the previous presentation.

The AFA strongly supports the use of an executive summary in an SoA, which presents a summary of all the key elements of the SoA and also provides a quick reference for clients. The summary on page 3 is not a genuine executive summary as it only summarises some of the recommendations, and as such does not deliver a great deal of value.

We also support the inclusion of a table of contents, although we think that this should be on a separate page rather than being crowded with other content (noting that this makes it longer).

B2Q2. Do you have any suggestions that would improve the structure of the example SoA so that it is easier for customers to follow?

We believe that the SoA should be designed to reflect the way in which the advice is presented by the financial adviser. Choosing to acquire life insurance is an important decision and one that should be presented in a sequential and sensible manner. This will start with an understanding of the client's needs and the scope of the advice, followed by details on the recommendations and explanation as to why this is in the client's best interests and then concluded by a discussion of the consequences of the advice and the cost of the advice and the insurance.

As stated above we strongly support executive summaries that clearly set out what the client should expect to cover in their review of the SoA. The full SoA should follow a similar path as the executive summary.

B2Q3. Do you have any specific comments about the order in which the information has been set out? For example, what do you think about where the information about the scope of the advice has been placed? Please provide an explanation for your comments?

We believe that the scope of the advice should be set out at the start of the document, rather than at the back as is the case with this example SoA (page 23). We have also said that we do not agree with the commissions being included on page 1.

Unless the executive summary is a genuine executive summary then we see no reason for a summary of the recommendations to be included where they are on page 3.

We also make the point that the "My advice section" is more a needs analysis, which then has in the middle some recommendations with respect to superannuation contributions (despite this not being part of the scope of the advice). This in our view seems somewhat disjointed. It is difficult to find all the recommendations in one place, despite the fact that they are covered in a number of places

Content and Length of the Example SoA

B3Q1. Have we included any information in the example SoA that you think should be excluded? Please provide an explanation for your comments.

It is our understanding that best practice in the financial advice sector for Risk SoA length is between 12 and 20 pages. Whilst there are some licensees and advice practices that produce shorter SoA documents, we believe that on a stand-alone basis something in the vicinity of 12 -20 pages presents the right balance between being concise and effectively communicating core information essential for the client's decision. This is not to suggest that the majority of clients have the capacity to read and understand a 20 page document.

The section on "Why my advice is in your best interest and appropriate" is very long, covering four and a half pages. It is our view that stating why the advice is in the client's best interest needs to be succinct and specific. Taking so many pages that includes a lot of information that has already been stated results in a less clear message. We do not believe that this section should explain every aspect of the advice in such detail. We note however that in cases it includes information that is not covered earlier, which leads to some confusion about consistency.

We believe that an SoA should include some background on the client. The draft example SoA includes a section on "About you - Brad and Zara", however this is then split into five separate sub-sections on personal details, assets and liabilities, income, expenses and current insurance. In our view, there is too much in this section and there is a need for consolidation of some of the sub-sections.

To make an SoA more readable it is appropriate to have a reasonable amount of white space. Whilst we note that this will take additional space, it may be that a smaller font will enable this without any negative impact upon readability.

As stated above, we believe the example SoA is too long, primarily as a result of the extent of duplication and the approach with respect to articulating why the advice is in the client's best interest. We also note that it is common for licensees to add some additional specific disclosures that would often extend the document for a few more pages, making this document around 30 pages long. This is too long.

B3Q2. Have we excluded any information in the example SoA that you think should be included? Please provide an explanation for your comments, bearing in mind that the SoA is only part of the advice process and that additional information can be provided to the customer in other ways.

It appears that there is no discussion of the client's goals and objectives. The section on "What you both want" is more a coverage of what was discussed in their meeting rather than a description of their goals and objectives. This then moves into a needs analysis in the "What you want Brad" and "What you want Zara" sections.

The product replacement comparison section is very brief. Commonly an adviser will include information extracted from a product comparison program in order to meet their product replacement obligations. This example SoA appears to suggest that this level of detail may not be required. We note also that there is no text in the recommendations section that specifically states why the client should choose the more expensive option.

The Authority to proceed section needs to allow some space for any variations to the advice to be recorded. It is not uncommon for the recommendations to be varied in some way and there should be a section for this to be recorded.

Upfront Disclosure of Commissions

B4Q1. Do you think the disclosure of commissions in the example SoA is sufficiently upfront and prominent? Please provide reasons?

As stated above, we do not believe that the statement of the commissions before the product advice has been delivered is beneficial for the client's understanding of the advice. It is our view that the SoA should clearly set out the need for insurance and then make the recommendations. Only after the needs, the recommendations and the benefits of the advice have been set out, is it appropriate to explain the cost.

In terms of being upfront and prominent, we do not believe that this means that the commissions should be disclosed on page 1. Commissions will be clearly explained when the financial adviser presents the advice and are also clearly set out in the Statement of Advice. If the SoA is 12 – 20 pages long, and they are referred to in the table of contents then it is very easy for the client to know what they are paying for the advice and the insurance.

It is our view that the commissions disclosure section on page 26 could be more tabular, along with the inclusion of commission percentages and totals.

B4Q2. Do you think that customer understanding of commissions is enhanced by upfront disclosure? If not, why not?

We question what is meant by upfront disclosure. It seems that there are two viable alternatives for this. One might be that it is at the front of the document. The other is that it is prominently disclosed and the client should be in no doubt as to what they are paying. It is our view that the objective here is to ensure that the client is very clear in terms of what they are paying, not that this means that it needs to be in very large font at the very front of the document.

Proposed Updates to RG 90

C1Q1. Do you have any comments about the draft updated RG90?

We believe that the draft new RG 90 clearly sets out the requirements of an SoA and also provides sensible guidance on what should be included and what not to include. It provides useful information on what information might be kept elsewhere on the adviser's client file. The new draft RG 90 clearly sets out ASIC's expectations with respect to the use of the example SoA.

As stated above, we disagree with the thinking about repetition as explained in RG 90.48.

We have provided feedback on the draft example SoA both above and below and therefore do not intend to repeat that in a discussion of RG 90.53 – RG 90.85.

As this RG is expected to be released in September this year, RG 90.80 needs to clarify that the LIF comes into force from 1 January 2018.

Whilst we note the views of ASIC on Disclaimers and Warnings in RG 90.86 – RG 90.88, we anticipate that the lawyers working in or for licensees are going to seek to provide some form of legal protections. The expectations that these disclaimers go in other documents might not be realistic in the context that it is the SoA that typically exposes the licensee to risk.

C1Q2. Are there areas where you consider further guidance is needed?

We note that RG 90 provides some clear guidance on what can be included in the client file (i.e. alternative strategies and products). It would be beneficial to provide some detailed guidance on what might be required to be retained on the client file.

Although the SoA is a legal requirement, often advice is delivered verbally with the support of other tools such as Powerpoint presentations, videos and other multimedia vehicles. We believe that it would be beneficial to provide guidance on the use of other advice presentation formats.

Adapting the Example SoA to Different Scenarios

C2Q1. What, if any, difficulties do you think an adviser might face in adapting the example SoA to different life insurance or financial advice scenarios?

Subject to the comments that we have made above, we believe that a modified example SoA could be readily used within the industry. We note however that it is an example SoA and that it is not mandatory. For that reason, we believe that some licensees and advice practices will selectively use some of it, but not all of it.

It is important to realise that the vast majority of financial advisers use financial planning software such as XPlan and Coin. Modifying SoA templates requires re-coding in the financial planning software. This can be a costly exercise and therefore sensible decisions need to be made about the merits of making the change. Licensees who already have a succinct SoA may choose to retain their existing template, rather than making wholesale changes. Licensees who feel they need to make more significant changes may more readily seek to incorporate elements of the example SoA.

C2Q2. How do you think that ASIC can assist advisers to overcome these difficulties?

There are clearly differences in SoAs depending upon the type of products recommended and whether the adviser is self employed or salaried. This example Risk SoA has been specifically built as a risk example SoA and relates to a self employed adviser. While noting that this is a draft, subject to industry feedback, however in our view it will be very difficult for this to be picked up and used in the superannuation and investment space. We think that it would be best to have both a risk example and an investment and superannuation example. In practice there is also a combined risk and investment SoA, although it might be that advisers can pick from the risk only and the investment only examples to prepare a combined risk and investment SoA.

Addressing Other Barriers to Industry Take-up

C3Q1. What organisational barriers exist for advisers to use the example SoA as a model? Please explain how these barriers might hinder industry take-up of the example SoA?

Advisers operate in different business models. Many exist in medium to large licensees where the use of particular SoA templates is mandated and the licensee leaders make decisions in terms of any changes to existing licensee templates. Any changes are run as a project and include both changes to design and also changes to financial planning software. Training is also a key part of any change. For this segment of the market, change is costly and time consuming and will only be undertaken where there is a clear benefit. Some large and medium sized licensees still provide a reasonable level of choice for financial advisers who can choose to use their own financial planning systems and templates if they wish.

Other self licensed businesses have greater say in the design of their templates and can update them where they see a benefit. Even with this group it will most likely involve changes to financial planning software, which can be expensive. There would now only be a small number of advisers who primarily use Word templates for the production of SoAs. This is the group that can most easily use the new example SoA.

C3Q2. How do you think ASIC can assist advisers to overcome these barriers and use the new example SoA as a model in producing their own SoAs?

As discussed above the key group involved in making changes to SoA templates is the licensees. We recommend that ASIC work closely with the larger licensees to provide support and guidance in implementing the key developments that come out of the example risk SoA. In this sense, we suggest that it is more reasonable to expect that implementation may involve part of the example risk SoA and not the whole thing.

Smaller licensees typically use service providers to assist with the development of templates and the provision of financial planning software. We would also recommend that ASIC work closely with these groups to support them in the incorporation of any enhancements into their standard templates.

Potential Issues to Consider

In addition to the suggestions for improvement set out above, we would also recommend that ASIC review the following issues:

- Table 8 on page 28 of draft RG 90 suggests that income protection is required for Zara “to ensure that as much of Zara’s salary as possible is replaced”, however there is no recommendation on income protection for Zara and page 7 of the SoA suggests that income protection for Zara is not a high priority. This is inconsistent.
- The defined scope is entirely life insurance, however there is a recommendation with respect to making non-concessional superannuation contributions for Zara. This recommendation is inconsistent with the defined scope.
- We note the comment on page 2 of the SoA that each PDS is about a specific financial product. In reality, the majority of risk PDS’s cover each type of risk product (i.e. life insurance, TPD, Income Protection and Trauma) and not just one product. They might also have different

versions of each product. This means that clients are looking at larger documents where it is less straight forward to find the information that they might be seeking.

- Whilst we note that Brad has 3 months of sick leave, we do not feel that this is necessarily adequate justification for a 90 day waiting period. This is because the sick leave might be consumed by a prior event or where a disability event does arise in a manner that some sick leave is consumed before going off on a longer term basis. In addition, most Income protection policies do not make the first claim payment until a month after the end of the waiting period, so at best they would go for the entirety of the fourth month without any income.
- It is recommended that Zara increase the level of life and TPD cover in her existing superannuation fund, however there is no mention of any limits that might apply and underwriting that may be required. There is also no mention of whether the fund applies a reducing insurance level as the member ages, which is common amongst industry funds. This could mean that Zara will before long, no longer have access to the required level of cover.
- On page 10, Zara's life insurance needs suggest that \$240,000 is required to replace income, however it is unclear as to how long this was expected to last. It is unclear what is meant in this section about "until the children are old enough to contribute"
- On page 15, in explaining the consequences of a partial rollover, there is a statement that "As your First Corporate Superannuation Fund is a unitised fund, there are not expected to be any buy/sell costs or capital gains tax..." This is an unusual statement as buy/sell spreads typically apply to unitised funds.
- The consequences section on page 15 and 16 should explain that the existing insurance should not be cancelled until after the new insurance has been arranged and accepted and that premiums may be paid on both policies for a short period of time. A small price to pay rather than cancelling cover only to find out you are uninsurable.
- There are references to death benefit nominations in different places. Where superannuation benefits are involved, the SoA should explain the importance of binding death nominations.
- The existing Income Protection policy is on an agreed value basis. It is however noted that Brad is employed rather than self employed and there is no information provided to support selecting agreed value over the less expensive indemnity value. On page 20, it is explained that the insured amount is \$37.50 more per month than the maximum amount that he is eligible for, however this fails to take into account his SGC that can be included in the 75% calculation. In any case access to a \$37.50 per month additional benefit might not justify the additional premium that is involved with an agreed value policy.
- There is no discussion with respect to affordability of the recommendations or analysis of the impact upon the client's cashflow position.
- The "Continuing review service" section on page 24 is drafted in a way that implies an expectation of no ongoing service. We believe that it should be drafted in a way that reflects the value of ongoing advice. We would also recommend that it should address who will provide claims support in the event of a claim.
- We note that there is no reference to the duty of disclosure. Whilst this will be covered in Product Disclosure Statements, we consider that it is sensible for financial advisers to provide their clients with information on this obligation.
- Explaining life insurance definitions and terms is very technical. We recommend that a risk specialist is used to review some of the wording in the "Why it is appropriate" section to ensure that it is all technically correct and reflective of current market practices.

Concluding remarks

The AFA welcomes the opportunity to provide feedback on the example life insurance SoA. We believe that the draft does a good job of explaining the advice, however we feel that there are a range of opportunities to reduce the size of the SoA and that the removal of duplication will ensure that the SoA can be a reliable reference document, rather than assuming that it is the primary means for the delivery of advice.

Whilst we welcome the consultation on this draft example SoA, we believe that more work needs to be done to reduce the effort required and complexity involved in the production of a Risk SoA in order to reduce the cost as an offset to the reduction in commissions payable on risk advice.

The AFA welcomes the opportunity to contribute to this consultation process. Should ASIC require any further clarification on anything in this submission then, please contact us on 02 9267 4003.

Yours sincerely,

Phil Anderson

General Manager Policy and Professionalism
Association of Financial Advisers Ltd