30 January 2015

By email: submissions@trowbridge.com.au

John Trowbridge
Independent Chairman
Life Insurance and Advice Working Group

Dear Mr Trowbridge

Interim report on Retail Life Insurance Advice

The Consumer Action Law Centre, Financial Rights Legal Centre, Choice and Maurice Blackburn Lawyers welcome the opportunity to comment on Interim report on Retail Life Insurance Advice. Background on each of the contributing organisations is in the appendix.

In summary:

Remuneration:

- We welcome the interim report's recommendation to remove full upfront commissions and comments that the life insurance industry takes the problems with commission-based selling seriously.
- However, we do not think the report has taken the problem of commission sales seriously enough, and we are disappointed that all remuneration options considered are commission based.
- We do not agree that commissions are necessarily required to sell life insurance advice. The challenge of moving away from commissions is a problem with the culture of advisers, not necessarily a problem with consumers.
- We acknowledge that the remuneration options must be considered in the context of improving the underinsurance problem in Australia.
- We recommend that the final report consider non-commission based remuneration options in more detail.

Code of practice

- We strongly support the development of an industry code of practice that is approved by either ASIC or the ACCC.
- A code should be developed in compliance with the guidance in ASIC Regulatory Guide 183, and through an open, consultative process.
- A code should set standards for the entire industry (including insurers, licensees and advisers, with additional tailored standards for licensees and advisers).

- A code should deal with selling practices, claims processes, dispute resolution and compliance.

Quality of Advice

- A well designed 'standard cover' regime will offer part of a solution to the concerns about quality of advice raised in ASIC Report 413.
- We are concerned that Approved Product Lists will tend to limit effective competition and mislead consumers. We are especially concerned about the continuing practice of vertically integrated advice whereby advisers recommend investment products of entities to which they are associated to the exclusion of better performing non-affiliated products.
- We have made recommendations to respond to the problems caused by vertical integration.
- We support the adoption of ASIC's Life Insurance and Advice Checklist by the life insurance advice industry.

Disclosure

- The over-elaboration of compliance requirements has resulted in economic risk shifting from the providers of financial products to consumers. There has been no consumer testing of whether current Statements of Advice (SOA) are effective, and significant risks are not adequately explained to consumers.
- A short form SOA should be developed as an industry standard through a consultative process and informed by consumer testing.

Product Offerings

- ASIC report 413 suggests that stepped premiums lead to consumer misunderstanding about how the cost of insurance will increase over time.
- We suggest that the industry could develop standard modelling software (in consultation with ASIC) which can be used to explain the differences between stepped and level premiums over time while giving advice.

Our comments are detailed more fully below.

Adviser remuneration

We welcome comments in the interim report suggesting that the life insurance industry takes the problems with commission-based selling seriously[1], and that the industry is willing to take this opportunity to create industry wide change. We also welcome the view that commissions of 100% or more of the year one premium should be dismissed.

However, we do not think the interim report has taken ASIC's damning critique of the life insurance industry in ASIC Report 413 seriously enough. We are disappointed that all of the remuneration options considered in section four of the paper are commission based. The report accepts without any real discussion that remuneration which is not commission-based is not practical[2], and also seems to accept without question that commissions are necessary to sell life

[1] For example, at page 22.
[2] At pages iv and 6

insurance.[3] We do not accept either of those propositions, nor has any evidence been provided by the report to support them.

The perceived necessity for commission-based selling

We have never been convinced by the argument that upfront commissions are necessary to address underinsurance, principally because today there is considerable underinsurance in life despite many years of very high commissions being paid to life insurance advisers. It is usually the life insurance industry itself noting how prevalent underinsurance is. For example, research by the Financial Services Council and KPMG released in early 2014 found that around 60 per cent of Australians are underinsured, rising to 77 per cent of those aged 45-64, and the problem costs $304 billion per year[4]. The Financial Planning Association's Dante de Gori was reported as saying that underinsurance was the industry's biggest problem in December 2013[5]. We fail to see why commissions should now be expected to fix the problem of underinsurance which they have never been able to fix in the past.

Commissions (or any incentive to advise a customer to replace existing cover) create the additional problem in life insurance that a customer with a pre-existing condition may lose protection altogether as a result of an innocent non-disclosure. Existing disclosure of this risk is not sufficient to alert consumers, and in any case we do not believe that even well designed disclosure is an appropriate response to a problem which can lead to such far-reaching consequences for consumers.

Case Study: Loss of accrued benefits when new policy taken out

Leroy is 23 years old, and works as a carpenter. He joined a superfund and had insurance arranged after purchasing his first home in 2010. He saw an accredited insurance adviser. He had coverage for Income Protection of 75% of his pre-disability income and a 4 week waiting period

In 2012 he saw a doctor who advised him that he would need shoulder surgery. He rang his insurance adviser to inform him of his need to claim and in the course of the conversation inquired whether it was possible if he could reduce his waiting period. Leroy, not knowing anything about how insurance worked, was expecting to be informed by the insurance adviser as to whether this was possible. The advisor said it would be “no problem”.

Leroy was subsequently informed his surgery would not be for a further 18 months, and so he contacted his insurance advisor to let him know that he would not need to reduce the waiting period.

18 months later Leroy’s surgery was planned, and he took time off work. He lodged his claim.

His claim was in the process of being rejected on the basis he had failed to disclose a pre-existing condition when making the application in 2012. It turns out, when Leroy believed he was simply making inquiries and permitted amendments to his existing policy (with the assistance of his insurance advisor) he was actually being signed up to a new policy (with

[3] At page 24.

[4] "Underinsurance 'costs $304 billion a year'", Life + Health Insurance News, 12 March 2014. Accessed from http://www.lifehealthinsurancenews.com.au/local/underinsurance-costs-304-billion-a-year

[5] "Industry urged to tackle 'biggest problem' of underinsurance", Life + Health Insurance News, 11 December 2013. Accessed from http://www.lifehealthinsurancenews.com.au/local/industry-urged-to-tackle-biggest-problem-of-underinsurance

commissions being paid to the adviser). He was not aware, and not informed that new policy would be arranged on his behalf or he may lose accrued benefits (what he had signed up to in 2010).

Leroy raised a dispute with his insurer and his claim was approved.

Case Study: Risks of policy changes and new disclosure requirements

Mario is having his first baby. His wife is keen to update their insurance policies. Mario has had income protection for the last 7 years, it has increased with CPI and it was equivalent to his monthly income. He sees his insurance adviser who provides advice that includes bundling his income protection with life and trauma, the premiums are competitive and he is advised it is good value.

Before deciding to change his policies he sees his massage therapist who tells him he has a fatty tissue deposit in his neck he might want to get checked out. He sees his GP a few weeks later to update his vaccinations and at the end of his appointment he mentions what his masseuse said. The GP agrees it's probably a fatty lump but writes a referral to an ultrasound.

Mario never takes up the referral. His baby is born and he has his hands full. He accepts the advice of the insurance advisor, and his IP is cancelled and replaced with a new policy. He obtains life and trauma cover. He is exhausted when he fills out his disclosure forms.

A few months later, he has a persistent cold, and he is diagnosed with lymphatic cancer. He makes a claim. The claim is paid for several months. Mario also develops vision impairment, but the cause is unknown. It may be the cancer treatment or it may be unrelated. The specialist is baffled. Mario is worried he may be on claim indefinitely, but he is actively re-training and is keen to return to the work force.

The insurer writes to him, the underwriters have reviewed the doctor's files and found the referral Mario never took up. The payments are suspended.

They ask him to show cause as to why the policies should not be avoided.

Remuneration by commissions also creates a disincentive to provide quality advice in some cases. If advisers only get paid when they sell products bearing commissions, they are required to work for free whenever they:

- provide 'strategic advice'[6];
- advise a customer to keep their existing level of cover, or reduce their cover; or
- advise a customer to take up group life cover through a superannuation fund.

Finally, the conflicts of interest created by commissions can mean that even those who do buy insurance through commission-based sales stand a good chance of remaining underinsured. ASIC report 413 found that 55% of advices failed to meet legal obligations where upfront

[6] ASIC notes on page 7 of its Report 413: "Strategic life insurance advice includes advice on the type, level, structure and affordability of life insurance cover based on the client's cash flow position and which prioritises the client's insurance needs. Strategic advice can be stand alone or, where appropriate, provide the framework for product advice."

commissions were present, compared to 7% where upfront commissions were not present[7]. We acknowledge that the interim report has recommended abandoning these kinds of full upfront commissions. However, any commission, especially those containing an upfront commission like the Hybrid model, is still going to misalign incentives in that it rewards advisers for selling a product, but not necessarily for selling the most appropriate product.

Consumer problems created by commission-based sales

ASIC's report showed that full upfront commissions create the biggest problems in life insurance. However, commission sales in general create problems for consumers and should be avoided wherever possible.

The clearest argument against commissions is that they are not transparent, so it is hard for consumers to understand how much advice is costing them, or to compare different offers before buying. Commissions that are built into insurance premiums also make it hard for consumers to compare insurance products. Simply disclosing the existence of commissions should not be expected to solve this problem. US research found that rewriting mortgage disclosure information to disclose broker commissions actually increased trust in the broker when it should have led customers to be more critical about the advice.[8]

A lack of transparency also means that the cost of advice is not susceptible to normal competitive pressures. Commissions can actually drive prices up, as manufacturers offer higher commissions to attract advisers[9], who then sell the product to consumers who do not have a clear idea of how much they are paying or whether they are getting value for money. ASIC report 413—which indicates that a comprehensive financial plan should cost around $2,500-$3,500,[10] but also gives examples of advisers earning commissions of between $8,000 and $25,000 for legally compliant work[11]—is an example of this concern.

In our discussions with the working group, industry representatives have said that the $8,000-$25,000 commissions are extraordinarily rare and well above industry average. Industry representatives also explained that commissions need to be set at a level to remunerate advisers for a lot of unpaid work assisting clients which does not lead to sales.

We do not doubt that this is true, but the fact remains that consumers are not in a position to determine whether commissions are paying advisers too much, too little, or about right the right amount for the work they do. We recommend that the final report give some detail on the typical range of commissions advisers receive and how many hours they usually work to earn a commission. We also recommend that the final report considers how effective any proposed remuneration model will be at matching adviser remuneration to the value of work done.

[7] ASIC Report 413, “Figure 18: Percentage of advice rated a pass or fail by commission structure in our sample” Page 43

[8] James Lacko and Janis Pappalardo, 2004, The effect of mortgage broker compensation disclosures on consumers and competition: A controlled experiment, *Federal Trade Commission Bureau of Economics Staff Report* referenced in Financial Services Authority, 2008, Financial Capability: A Behavioural Economics Perspective.

[9] The ASIC report touches on this at paragraph 145.

[10] At paragraph 197

[11] Pages 65-67.

The perception that consumers will not willingly pay for life insurance advice

It seems to be a truism in the advice industry that consumers will not buy life insurance advice if they are confronted with the true cost upfront. This is considered to be a problem because underinsurance leads to greater reliance on the welfare system, and this problem is used to justify obscuring the cost of advice by paying it through commissions and by bundling payment for the advice with payment for the insurance.

Little evidence has been provided to support this theory, and the growth of the direct life industry seems to counter the idea that people are reluctant to spend money insuring their life and income.[12] This truism should be tested. Consumer behaviour is influenced by a number of complex factors and assumptions about behaviour should be tested using behavioural economics research.

While it is likely that people will be more reluctant to seek advice if they are confronted with the true cost than if it is hidden, this is by no means a bad thing. Properly disclosing the price of a product exposes traders (and industries) to competitive pressure and makes markets work better for everybody. The cost of advice only really presents a problem if it is actually unaffordable, such as if consumers are required to pay for it in a lump sum before receiving the product. This is not a hard problem to overcome, and is as simple as allowing consumers to pay for the advice in instalments over a long period, just as they do with other products they couldn't afford upfront—cars, phones, and insurance itself. The fact is that consumers are already paying for life insurance advice through instalments now. The only difference we propose is to remove commissions from the picture and make the cost of that advice more transparent.

The challenge of moving away from commissions is not a problem with consumers so much as it is a problem with an ingrained culture of advisers that refuses to believe the industry can survive without commissions. This is an opportunity to move the industry away from that culture or at least test its validity.

The role of the 'best interests' duty and culture in re-aligning incentives

Industry representatives at working group meetings we have attended have put the view that misaligned incentives created by commissions can be corrected by the 'best interests' duty. The interim report also says much about the influence of industry culture in driving responsible behaviour by advisers.

The best interests duty and adviser culture are important, but they can only do so much. The law will have more influence on some advisers than others, and will have little impact unless regulators have the resources to enforce it. Industry culture will dampen financial incentives for misconduct, but by the same token, financial incentives will influence industry culture. Commission-based sales models which reward the sale of inappropriate products and fail to reward strategic advice will work against the best interests duty and good culture.

Remuneration is not the only factor guiding adviser conduct, but we think that it is by far the most significant factor. This is a view that has been greatly reinforced by ASIC’s findings in

[12] We note though that the direct life insurance industry has its own problems with sales of inappropriate products.

Report 413. We encourage the working group to focus on addressing problems in remuneration and seeing culture and the law as complementary fixes.

<u>A vision for adviser remuneration</u>

We agree that life insurance is an important product, and that there is a role for advisers in helping consumers find the life insurance that suits their needs. We also agree that there are significant upfront costs in providing that advice and arranging insurance for consumers, and that advisers should be properly remunerated for their work.

However, we do not believe that commissions are necessarily a part of adviser remuneration, and indeed we think that commissions may create more costs than benefits for consumers.

ASIC report 413, and broader movements in financial services suggested through inquiries into the Future of Financial Advice (FoFA) reforms and the Financial Systems Inquiry, have created momentum for a significant change in how the life insurance advice industry does business. The fact that this working group has been created indicates the industry's willingness to change. We would like to see the final report offer a bolder set of remuneration proposals, including some which are not commission based.

We agree that underinsurance is a serious problem in Australia and that life insurance advisers have a crucial role in addressing the problem. Accordingly, remuneration options should be aimed at encouraging Australians to seek expert advice and assistance, or put another way, not to discourage consumers to seek advice. However, we query the orthodoxy that commission-based advice is the only model that can work and encourage debate and consideration of other remuneration models.

Recommendation

We recommend that the final report should:

- consider in more detail other remuneration options such as one-off fee for service and payment in installments, or at least an incorporated model of some consumer-paid fee for service with a level commission;
- explain why any commission based options proposed will:
    - be better at aligning adviser fees to the cost of providing advice
    - provide reasonable incentives for advisers to provide strategic advice; recommend that clients keep current cover or reduce cover; or recommend products that currently do not attract commissions where this is in the client's best interests; and
- provide some detail on the typical range of commissions earned by advisers, and how many hours of work usually needs to be done to secure a commission.

<u>Response to options</u>

In responding to the remuneration options presented in part four of the interim report, we are keeping a few broad principles in mind. The first is that upfront commissions (whether 'full' upfront or as part of a hybrid model) create the biggest incentives for inappropriate sales[13] and churn and should be avoided. Another is that remuneration should be transparent, easy to understand and open to competition. We also support the criteria listed on page 24 of the interim report.

For those reasons, we favour the 'level' models over the 'hybrid' models because they spread the remuneration over a longer period, meaning there is more reward for placing the client into a policy which is appropriate over the longer term.

We prefer fee based models over percentage based models, as these are more transparent, more likely to match remuneration to work performed, and less likely to create incentives to sell unnecessarily expensive cover. However, the 'level plus fees' model strikes us as being much like a hybrid, in that it creates a higher upfront payment followed by trailing payments over the longer term, creating more incentives for the upfront sale of products rather than the long-term sustainability and suitability of products.

It is worth noting that only the first and fifth proposed remuneration models ('Level Commissions Only' and 'Level Funded') meet the recommendation made by the Financial System Inquiry that

> Government should better align the interests of financial firms with those of consumers by... amending the law to require that an upfront commission for life insurance advice is not greater than ongoing commissions.[14]

This should be the minimum level of change that the life insurance industry aims to achieve in its remuneration models. Any model that provides greater upfront commissions will fail to reduce incentives for churning and fail to improve the quality of advice on life insurance.

This leaves us with a preference for the 'Level Funded' and 'Level Commissions Only' models. We reject the two hybrid models. While we would prefer to avoid commissions altogether, we do think the 'Level Funded' model offers an innovative way to cover an adviser's upfront costs while still spreading the incentive over a longer period.

The Level Funded model demonstrates that there is space in the life insurance industry for more innovative commission plus consumer-paid fee for service. For example, another innovative model might involve consumers paying some fee for service for advice at the front end whether or not they choose to adopt a new insurance strategy. Under such a model advisers could still get some of their remuneration through level commissions and consumers are not hit with an enormous fee in order to get retail life insurance products, but commissions do not have to be so high as to make up for hours of unpaid work advisers might have done.

Life Insurance Industry Code of Practice

Consumer advocates strongly support the development of an industry code of practice that is approved by either ASIC or the ACCC.

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[13] In that they reward the sale of an inappropriate product as much as an appropriate product.

[14] Financial System Inquiry, Chapter 4: "Consumer outcomes", Recommendation 24. 7 December 2014. Available at: http://fsi.gov.au/publications/final-report/chapter-4/align-interests/

Industry codes of practice play an important part in how financial products and services are regulated in Australia. When an industry is committed to developing and enforcing a code of practice, it can deliver real benefits to both consumers and those who are bound by the provisions of the code to which they subscribe.

We believe that the primary role of a financial services sector code is to raise standards and to complement the legislative requirements that already set out how product issuers and licensed firms (and their representatives) deal with consumers. An industry code should be seeking to set standards of best practice and deliver tangible outcomes for consumers.

The Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry was superseded with the coming into force of the *Financial Services Reform Act 2001*. What this means is that, since 2001, the advising, selling, training and competencies for life insurance are governed only by the regulation imposed by the Act and any other regulatory guides. There are no standards of "best practice" or industry benchmarks to improve customer experience.

The introduction of the FSR regime was not intended to replace industry codes. An industry code was considered to have a role in the new financial services industry to establish best practice in areas not covered by the law, and clarification and processes and procedures for meeting the requirements of the Law[15]

The lack of an effective system of self regulation inevitably means that where issues arise, the result will be coercive regulation. The life insurance industry is lacking any effective system of self regulation in absence of a code and code monitoring system. For any form of self regulation to be effective a code of practice is required.

<u>Scope of a Life Insurance Code of Practice</u>
To us, an industry code is essentially a set of enforceable rules that sets out a progressive model of conduct and disclosure for industry members that are signatories. Codes should therefore improve consumer confidence in a particular industry or industries. A successful industry code responds to identified and emerging consumer issues and delivers substantial benefits to consumers.

ASIC has published a Regulatory Guide (RG 183)[16] that sets out its expectations for financial services sector codes of conduct. Although it is not mandatory for the life insurance industry to seek ASIC's approval of its Code of Practice, the criteria set out in RG 183 serve as a very useful set of criteria in developing a code.

For example, ASIC expects an effective code to do at least one of the following:

(a) address specific industry issues and consumer problems not covered by legislation;
(b) elaborate on legislation to deliver additional benefits to consumers; and/or

[15] Financial Services Reform Bill 2001 Explanatory Memorandum (Circulated by authority of the Minister for Financial Services & Regulation, the Hon Joe Hockey, MP paragraph 17.12-17.17
[16] Regulatory Guide 183: *Approval of Financial Services Sector Codes of Conduct*, March 2013, available at: http://download.asic.gov.au/media/1241015/rg183-published-1-march-2013.pdf

(c) clarify what needs to be done from the perspective of a particular industry, practice or product to comply with legislation.

A number of codes of practice have been developed in the financial services sector including Code of Banking Practice, Customer Owned Banking Code of Practice, FPA Code of Professional Practice, General Insurance Code of Practice, and Insurance Brokers Code of Practice.[17]

A Life Insurance Code of Practice would set out the standards that life insurers, licensees and advisers must meet when providing services to their customers, such as being open, fair and honest. It would set out timeframes for insurers to respond to claims, complaints and requests for information from customers. For advisers it would also set out standards for strategic advice, adviser competencies, client engagement and suitability of product recommendations.

The Code would cover many aspects of a customer's relationship with their insurer and adviser, from buying insurance to making a claim, to providing options to those experiencing financial hardship, to the process for those who wish to make a complaint.

Ideally all life insurers, licensees and advisers should be subscribed to the same Code to ensure consumer confidence of their rights under the Code.

Consumer advocates envision that a life insurance Code of Practice would include the following in its scope:

<u>Standards for Entire Industry Including Insurers, Licensees and Advisers</u>

1. <u>Buying Insurance</u>
2. <u>Claims</u>
3. <u>Financial Hardship</u>
4. <u>Complaints and Disputes Handling</u>
5. <u>Promotion of Code</u>
6. <u>Professional Obligations</u>
7. <u>Independent Code Governance</u>
8. <u>Code Monitoring, Enforcement and Sanctions</u>

<u>Additional Standards for Licensees and Advisers</u>

9. <u>Client Engagement</u>
    - 9.1. Life Insurance Advice and Adviser Competencies
    - 9.2. Can the Adviser Meet Client Needs?
    - 9.3. Define Scope Of Engagement
    - 9.4. Disclosing Remuneration Information and Limitations of Product Offerings
10. <u>Collecting the Client’s Information</u>
    - 10.1. Identify Client’s Objectives, Needs and Priorities
    - 10.2. Collect Quantitative & Qualitative Information and Documents
11. <u>Analyse and Strategically Assess the Client’s Insurance Needs</u>
12. <u>Identify Suitable Life Insurance Strategies and Develop Recommendations</u>
    - 12.1. Identify and Evaluate Life Insurance Strategies

[17] See ASIC website: http://asic.gov.au/for-consumers/codes-of-practice/

    12.2. Develop Recommendations
    12.3. Identify Products and Services Suitable for Implementation
13. Implement Recommendations
    13.1. Agree Implementation Responsibilities
14. Review The Client's Situation
    14.1. Agree Terms and Responsibilities
    14.2. Assistance in Claims Process
    14.3. Review and Re-Evaluate Client's Situation

Effective Governance and Enforceability of a Code of Practice

As a voluntary code the best practice for developing an effective system of code governance includes an industry-funded independent Code Compliance Committee. Such a Committee would be funded and empowered to

- monitor compliance with the code;
- publicly report on code compliance;
- hear complaints, investigate and make determinations about industry breaches of the code;
- impose sanctions and remedial measures as appropriate for determinations of non-compliance;
- report systemic code breaches and serious misconduct to ASIC; and
- ensure that there is a regular, independent review of the content and effectiveness of the code and its procedures.

Such a Committee would be funded by Code subscribers, including life insurers, licensees and advisers. An independent and industry supported Code Compliance Committee benefits both industry and consumers because non-compliance will be reduced, systemic problems can be identified more quickly and industry and consumer awareness of the code will be higher. We prefer that any Committee is governed by an independent chair with an equal number of consumer and industry representatives.

Developing an Industry Code of Practice

The process for developing the code should be open and consultative. The life insurance industry should fund a process for gathering input from its clients and consumer advocates to ensure that all voices are heard in the development process.

Some of ASIC's key criteria for the development of an approved financial services Code include:

- Freestanding and written in plain language;
- Consultative process for code development; and
- Code content addresses stakeholder issues.

Recommendation
Industry self-regulation needs to be formalised by way of a code of practice. The code should be developed in accordance with ASIC's Regulatory Guide (RG 183), and upon completion should be approved by either ACCC or ASIC.

Consumer groups should be consulted in the development of a new code along with other life insurance industry stakeholders to ensure an open and inclusive self-regulatory regime.

Quality of advice

A 'standard cover' regime

We believe that a 'standard cover' regime offers part of a solution to the quality of advice concerns raised by ASIC and also the persistent problem that consumers find insurance products to be complex and difficult to compare.

A standard cover system already exists in general insurance. Sections 35 and 37 of the Insurance Contracts Act seek to prevent insurers from relying on non-standard or unusual terms without informing the insured of the effect of those terms before the insured enters into an insurance contract. The rationale for this provision was to counter widespread consumer ignorance and presumptions regarding the extent of their policy coverage[18]. The limitation of this system is that insurers can satisfy the requirements of sections 35 and 37 by simply giving written notice of unusual terms before the consumer enters the contract—even if that notice is buried in the policy's fine print. A life insurance standard cover regime would need to be better designed to avoid this limitation.

We expect standard cover provisions, either in an industry code or in relevant law, would have two effects. The first is that it would make it easier for consumers to assess value and compare different insurance policies on the basis of whether they offered more or less than 'standard cover', and have confidence that a 'standard' policy would cover most risks. The more significant impact is that it would create an incentive for insurers to produce policies which compete on quality, as a policy offering more than standard cover would be recognised more easily by consumers as a premium product justifying a higher price.

Currently the Insurance Contacts Act standard cover provisions do not include life insurance products, only general insurance. We are of the view that there is no good reason why this anomaly shouldn’t be corrected. There have been suggestions of a review of the standard cover terms under the Act and if this was to occur, that would be an opportune time to amend the Act and Regulations to incorporate life insurance standard cover. However, we acknowledge that any legislative amendments may take a number of years. Accordingly we suggest that consideration should be given in the interim to developing life insurance standard cover terms to be included as part of a voluntary industry code.

Recommendation

We recommend the final report consider the practicality of introducing a standard cover regime in life insurance, perhaps as part of an industry code pending amendments to the Insurance Contracts Act and Regulations.

[18] Australian Law Reform Commission (1982) *Insurance Contracts*, Report No. 20, p 44.

Approved Product Lists

We believe that Approved Product Lists (APLs) will tend to:

- limit effective competition by discouraging advisers from considering products outside of the APL; and
- mislead consumers—many consumers will not expect advisers to be limited to providing advice about products from certain providers.

We accept there may be legitimate risk management reasons for having APLs, as discussed in the interim report. However, there is a reasonable middle ground between limiting products through APLs and providing advice which genuinely considers the best options for the client.

We are particularly concerned about the continuing practice of vertically integrated advice whereby advisers recommend investment products of entities to which they are associated to the exclusion of better performing non-affiliated products. A 2014 Roy Morgan study found that 55 per cent of clients of Financial Wisdom, owned by CBA, thought their adviser was independent. Similarly, 50 per cent of clients of Godfrey Pembroke (NAB), 48 per cent of clients of Charter FO (AMP) and 37 per cent of clients of RetireInvest (ANZ) perceived their adviser to be independent. Further, 13 per cent of ANZ, 20 per cent of St George and 14 per cent of CBA clients perceived their advisers to be independent even though they clearly work for a major institution.[19]

We do not think that improving disclosure will provide a lasting solution to this problem. Even if the disclosure is noticed by consumers, it may have the effect of increasing trust in advisers rather than making consumers more wary, as discussed above. Skilled salespeople will also be able to deflect concerns about vertical integration. Peter White of the Finance Brokers' Association of Australia has recently said that finance brokers can use disclosure obligations to their advantage:

> I actually believe that if a broker is upfront about ownership—let's say they are owned by Commonwealth Bank, for example—then they can sell that as a positive. It can allow them to change the discussion around bank ownership—isn't it a good thing that they have somebody so strong sitting behind them that has enabled them to grow as a brokerage and a business?
>
> ..now they have opened up the discussion with their client and they are able to explain what bank ownership really means and how the [National Consumer Credit Protection Act] governs a broker's independence.[20]

These arguments may make clients more comfortable, but they do not address the conflicts of interest that come with vertical integration.

To address this problem, we suggest that:

- Advisors be required to demonstrate that they consider and recommend both affiliated and non-affiliated products. A measure could be that they must have APLs that include a balance of affiliated and non-affiliated products or perhaps a minimum proportion of non-affiliated products.

[19] Roy Morgan Research, August 2014, *Confusion with Financial Planner Independence Continues:* http://www.roymorgan.com/findings/5716-confusion-with-financial-planner-independence-201408040221

[20] 'Disclosure can work in Brokers' favour', *Broker News*, January 2015, p 17.

- If a Statement of Advice recommends a product affiliated with a firm that employs or pays a financial adviser, that should be disclosed and the SOA should show a comparison with a non-affiliated product to demonstrate that the affiliated product is more appropriate.
- The life insurance industry moves to structurally separate product manufacturers and advice.
- If there is no move to structurally separate manufacturers and advice, the minimum step needed is that advisers not be permitted to only offer products from only one provider unless this limitation is clearly disclosed to clients. Increased disclosure should occur in prominent documents beyond the Statement of Advice including on business cards, letterheads and in marketing material

Recommendation

The final report should provide data on how prevalent APLs are in life insurance advice, and what a typical APL looks like (for example, how many providers and products it will cover, and typical options for an adviser who wants to recommend products outside of the APL).

Recommendation

The final report should make recommendations to respond to the problems caused by vertical integration, including that:

- advisors be required to demonstrate that they recommend both affiliated and non-affiliated products;
- SOAs recommending affiliated products should disclose the affiliation and explain why that product is more appropriate than a similar, non-affiliated product;
- The life insurance industry move to structurally separate product manufacturers and advisers; and
- APLs should never be permitted to limit an advisor to the products of only one provider, unless this limitation would be obvious to any consumer.

<u>ASIC Checklist</u>

We support the adoption of ASIC's Life Insurance and Advice Checklist[21] by the life insurance advice industry. This checklist seems to us to be a common-sense and uncontroversial guide to avoiding conflicts and providing advice in the best interests of clients. The checklist could be introduced through the proposed industry code.

Disclosure

The over-elaboration of compliance requirements has resulted in economic risk shifting from the providers of financial products to consumers[22], with much of the disclosure that is considered best practice in fact 'going over the head' of a consumer. The complicated compliance and

[21] Contained in ASIC report 413

[22] Risk and the Consumer in Australian Financial Services Reform GAIL PEARSON*SYDNEY LAW REVIEW [VOL 28: 99

regulatory system consequently may have exposed consumers to greater risk, rather than providing the effective consumer protection that was intended.

Negative reference has been made in both ASIC's Review of retail life insurance advice and the working group's interim report to SOAs that exceed 30-90 pages. Consumer advocates agree that lengthy and comprehensive SOAs may 'cover the back' of the advisor through meeting 'disclosure' and regulatory requirements, but they do not meet the spirit of the consumer protection laws or the Best Interests duty. We note that in RG 90 ASIC provided an example of a 13 page SOA illustrating what a short and concise but still legally compliant SOA may look like, but the industry continues to produce lengthy disclosure documents. The industry could make changes now to ensure that consumers are effectively engaged by SOA's and understand the advice provided to them. Reliance on overly long SOA's is not in the interests of consumers, nor is it cost effective.

There has been no consumer testing of whether the current SOA is effective in providing meaningful advice. Consumer testing has generally been left to the advisor[23] as to the form that the SOA should take. Consumer testing of effective disclosure is paramount to determine what changes are required to improve the effectiveness of SOA's and what modification (if any) of the current regulatory regime is required.

Consumer advocates are particularly concerned that the following risks are not being adequately communicated to consumers through the life insurance advice process or the SOA:

a) Loss of continuous coverage when replacement policies are suggested;
b) Robust duties of disclosure for the consumer when new policies are entered into; and
c) Those who switch to a new policy may lose cover for pre-existing symptoms or conditions even for innocent non-disclosure.

Currently, replacement policy advice is subject to section 947D of the Corporations Act 2001. However, such warnings can be largely hidden in SOA's and consumers Financial Rights Legal Centre generally have instructed that they have not read the SOA or the importance of the information not highlighted to them.

Considerations should be given to industry funding consumer testing of a short form document which conveys key elements as to the advice provided. What constitutes the key elements of such advice should also be tested. To be clear, industry should be funding research which will then be made publicly available so it can guide sensible policy discussions. Paul O'Shea's research from 2010 (attached)[24] is the benchmark for this.

Consideration should also be given to consumer testing of life insurance product disclosure statements more broadly, although this may be out of the scope of the current report.

A short-form SOA should be developed as an industry standard and implemented by industry and it should be produced through a consultative process, and be open to continuous

[23] ASIC Media Release 04-236 'ASIC provides further guidance on Statements of Advice', 21 July 2004.
[24] O'shea, Paul. *Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign.* 12 March 2010, Uniquest Project No: 14808.

improvement. This would have the long term benefit of reducing costs in preparation, but this would not be a replacement of the Best Interest duty which requires the extensive documentation of steps taken when forming the advice. The intention is to move away from the current uneconomic provision of lengthy SOA's that cover the back of an advisor but are not clearly informing consumers or disclosing risks. Such consumer testing should be broad to encompass other innovative designs, such as interactive electronic methods of informing and capturing data.

Consumer advocates would agree that clients can be 'informed' in methods other than written disclosures, and such alternative avenues should be explored to find a better symmetry of the risks.

Recommendation Industry should take the lead in funding consumer-testing of new shorter form SOAs. This testing should be made publicly available to guide sensible policy discussions with all stakeholders.

Product offerings

Our experience with stepped premium products in direct life insurance (namely funeral insurance) is that they can be used to hide the true cost of the product. ASIC report 413 found a strong correlation between stepped premiums and high lapse rates[25], suggesting that the same problem—products being sold to consumers who do not understand how much the price will increase over time—also exists when stepped premium products are sold through advisers.

We accept that stepped premiums are a legitimate pricing model in that they allow the insurer to increase the premium over time to deal with increasing risk, rather than reducing the sum insured or cancelling cover altogether. However, the capacity for confusion that stepped premiums create means they should be avoided whenever possible, particularly with some life insurance products. It is certainly not appropriate to market a low premium to attract customers in the knowledge that those customers may not understand how premiums will rise in future. In our view this borders on misleading or deceptive conduct.

The interim report notes on page 36 that explaining the differences between stepped and level premiums can be complex and time consuming. We suggest that the industry could develop standard modelling software (in consultation with ASIC) which can be used to explain these differences while giving advice. A similar requirement is now in place for providers of reverse mortgages.[26]

[25] ASIC Report 413, pages 28-33.
[26] Australian Government requirements under the National Consumer Credit Protection Act 2009 become operational on 1 March 2013. Under the amendments the holder of an Australian Credit Licence must, before providing entering into a credit contract for a reverse mortgage, provide projections of the borrower's projected equity in the property. How the licensee does so is to be prescribed by the Regulations. The projections are to be calculated using an ASIC approved website. See sections 133DA – 133DE of the NCA.

Thank you again for the opportunity to contribute to this process. If you have any questions about this submission please contact Julia Davis, Policy and Communications Officer, Financial Rights Legal Centre (julia.davis@financialrights.org.au or 02 8204 1384) or David Leermakers, Senior Policy Officer, Consumer Action Law Centre (david@consumeraction.org.au or 03 9670 5088)

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About the Contributors

Financial Rights Legal Centre

The Financial Rights Legal Centre (formerly known as the Consumer Credit Legal Centre (NSW)) is a community legal centre that specialises in helping consumer's understand and enforce their financial rights, especially low income and otherwise marginalised or vulnerable consumers. We provide free and independent financial counselling, legal advice and representation to individuals about a broad range of financial issues. Financial Rights operates the Credit & Debt Hotline, which is the first port of call for NSW consumers experiencing financial difficulties. We also operate the Insurance Law Service which provides advice nationally to consumers about insurance claims and debts to insurance companies. Financial Rights took over 22,000 calls for advice or assistance during the 2013/2014 financial year.

In the last three years the Insurance Law Service has taken a total of 1,322 calls regarding consumer disputes over life insurance products. The majority of issues were when products did not meet client expectations, including operation of conditions, exclusion clauses, delays in claims handling and non-transparent claims handling. Some of the issues identified were that clients were put in unsuitable products.

Financial Rights also conducts research and collect data from our extensive contact with consumers and the legal consumer protection framework to lobby for changes to law and industry practice for the benefit of consumers. We also provide extensive web-based resources, other education resources, workshops, presentations and media comment.

Consumer Action Law Centre

Consumer Action is an independent, not-for-profit, campaign-focused casework and policy organisation. Consumer Action offers free legal advice, pursues consumer litigation and provides financial counselling to vulnerable and disadvantaged consumers across Victoria. Consumer Action is also a nationally-recognised and influential policy and research body, pursuing a law reform agenda across a range of important consumer issues at a governmental level, in the media, and in the community directly.

Choice

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.To find out more about CHOICE's campaign work visit www.choice.com.au/campaigns

Maurice Blackburn

Maurice Blackburn is a national law firm acting for consumers, unions, workers, the disabled and the disadvantaged.

Maurice Blackburn's areas of practice include Superannuation and Insurance, Class Actions, Asbestos, Consumer Law, Medical Negligence, Financial Advice Disputes, Employment Law, and Worker's Compensation.