Australian Government
The Treasury

TSY/AU

Quality of Advice Review – Conflicted Remuneration Consultation Paper

Response – Association of Financial Advisers

14 November 2022

Consultation process

Request for feedback and comments

Interested parties are invited to provide feedback on the proposals for reform listed in the Quality of Advice Review Conflicted Remuneration Consultation Paper using the template in Appendix 1. Consultation will close at 11:59pm on Monday 14 November 2022.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses in a Word or RTF format via email. An additional PDF version may also be submitted.

Closing date for submissions: 14 November 2022

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Appendix 1: Consultation template

Name/Organisation:

General Insurance and consumer credit insurance (Proposal 1)

1. **Do you support Proposal 1, which requires financial advisers or insurance brokers to obtain informed consent from their clients in order to be able to receive a commission from a product issuer for the sale of a general insurance product or consumer credit insurance?**
    a) **If you do not support this proposal, please state your reasons**

We support the retention of commissions for General Insurance brokers, and financial advisers advising on general insurance products. Whilst we note the proposal with respect to a new requirement to obtain client consent, we recommend that should this proposal be implemented, that this is kept as administratively simple as possible. The experience in the Superannuation and Investment space has been that this client consent obligation has been a big driver of additional cost, which ultimately needs to be paid by the client. Thus, efficiency and sensible pragmatism need to be carefully built into the design.

Life risk insurance product (Proposal 2)

2. **Do you support Proposal 2, which requires financial advisers to obtain informed consent from their clients in order to be able to receive a commission from a product issuer for the sale of a life risk insurance product?**
    a) **If you do not support this proposal, please state your reasons**

We strongly support the retention of life insurance commissions, which we argue provides a mechanism for many Australians to access financial advice on life insurance protection that they would not otherwise have access to, or be able to afford. There is much historical and anecdotal evidence to show that Australian consumers, elect to pay for their life insurance advice through commissions, even when offered the alternative of paying by an upfront fee. We welcome them having the option and the right to choose.

We must emphasise that financial advisers already have a requirement in place to disclose any commissions, and as a result, obtain informed consent from clients, in order to be able to receive a risk commission. We believe that the disclosure of commissions should continue to be an important control, even in the light of the proposal to remove the requirement to provide Statements of Advice.

This debate needs to carefully look at what has happened to the retail advised life insurance market since the time of the LIF reforms. This analysis would highlight that new business volumes have declined by more than 50%, new client numbers have declined by more than 50% (since average premiums have increased), financial advisers offering risk advice have fallen at a greater rate than the overall adviser population and everyday Australians now have substantially reduced access to affordable advice on life insurance. Those who argue against commissions and suggest that insurance through employer superannuation funds is enough, are not advocating on behalf of consumers. They are oblivious to the impact that has already been experienced in the marketplace, what clients actually choose when given the choice, the fact that insurance in group super is often less than a quarter of the insurance the client needs and more recently substantially more expensive than the retail advised product. In this debate, the decision makers need to look at the facts and understand what is best for consumers, not what is being espoused by those who lack the understanding, but have embedded historical views and broad access to the media. They are not helping consumers, and if they were listened to, then the outcome would be disastrous.

It is also essential to understand the value that financial advisers provide in the life insurance space. Life insurance products are complex. Understanding a client's life insurance needs requires detailed analysis and expertise. Responding to a client's particular needs and dealing with the implications of existing health conditions are also critical parts of the service. A skilled risk adviser provides substantial value in finding the right product at the right price to meet the needs of the client. They also play a key role in assisting the client through the underwriting process, and ensuring that the cover is eventually put in place. People who think obtaining insurance is a simple exercise and that group super life insurance should meet the needs of most people, simply do not understand the life insurance advice process or the risk market. As the underwriting process can be drawn out and issues emerge, often there is a delay before the adviser is paid for the work that they do. It is also important to make the point that there is inevitably a level of risk for the adviser in providing life insurance advice, as the client may not ultimately be able to get cover, or exclusions or premium loadings may mean that it is no longer suitable to them. Advisers often wear this risk, with no fee paid to cover their costs.

The reduction in the number of advisers providing life insurance advice has been substantial over recent years. This has also been made more serious by a wide ranging exit from the market by those who would be called generalists (i.e. advisers who provide life insurance advice as part of comprehensive advice or on a less frequent basis). These advisers no longer see it as being viable to operate in this space on a part time basis, and many now either avoid providing life insurance advice, or outsource it to a risk specialist. This does not mean that they will have taken the step to remove their authorisation for Life Risk Insurance Products, so looking at the Financial Adviser Register, to assess who is providing life risk advice, is unreliable. The life insurers know the number of active risk advisers has fallen substantially. We are particularly concerned by this reduction in advisers providing life insurance advice. We expect this number to continue to decline, however we are more concerned about who will come in to replace the existing risk advisers, when they exit in the future. It seems highly improbable that many younger advisers will choose to become risk specialists, in the context of the current regulatory regime and the difficult economic position faced by risk specialists who operate in the everyday Australian market space. This is the challenge faced by new advisers coming into the risk space. They are less likely to have access to higher premium paying clients and would very much struggle to survive financially if they were servicing everyday Australians who generally pay much lower premiums. This issue with where the risk advisers of the future will come from is a huge problem that requires a dedicated investigation and specific action to address.

We welcome the retention of commissions, however we believe that more needs to be done to better enable everyday Australians who need access to life insurance advice to be economically viable for financial advisers. This is the lower and middle market where a maximum commission of 60% of their premiums (it is often less than 60%) is not sufficient to cover the cost of providing life insurance advice. We would hope that the cost of providing life insurance advice (and other forms of advice), will be substantially reduced by the other proposals put forward by the Quality of Advice Review, however we cannot take that for granted. At this stage, there is no reliable estimate of the likely reduction in costs and no certainty that it will eventuate. There are already enough vocal opponents to these proposals speaking against them, that we have grounds for concern that these sensible proposed reforms will be watered down to counter the criticisms of the so-called consumers groups. Thus, we fear that ultimately we may see relatively minor reductions in the cost of providing financial advice. For this reason, we believe that more needs to be done on the revenue side, to address the issues constraining everyday Australians from accessing financial advice on life insurance.

We are conscious that there are a range of proposed solutions in the market place, including our previous proposal to increase the cap on upfront commissions to 80%, which we continue to support. In responding to this consultation paper, we are also motivated to seek a better solution for everyday Australians, where currently their premiums do not generate sufficient commissions for them to be economically viable to service. Other participants have advocated solutions to address this problem, such as proposing a minimum level of commissions of $2,400, which would apply to all clients with premiums of less than $4,000. We are proposing another possible solution, where advisers would be paid a flat fee on top of the existing commission to improve the market dynamics. We have recommended that this could be a flat fee of $300 per product type (Life, TPD, Trauma and Income Protection) that is recommended. If the adviser recommended all four product types to the client, and they were all implemented, then the adviser could stand to receive a fixed payment of $1,200, on top of the existing commission. This would mean that the adviser could be paid $3,000 for a client with a $3,000 first year premium, and $2,400 for a client with a $2,000 first year premium. This would only impact the upfront payment to the adviser, and not the ongoing renewal commission. When combined with the prospect of some reductions in the cost of providing financial advice, this would make it much more economically viable for advisers to work with younger clients and those with lower needs and thus lower premiums. Adding more younger lives into the life insurance pools would also be particularly beneficial for the overall life insurance market, helping to make these pools more viable in the longer term, and limiting the prospect for sizable premium increases in the future. We want to emphasise the importance of the continual refreshing of life insurance pools. In the absence of this, it is inevitable that the risks within the pools will grow substantially. For this reason, we argue that taking action to address the decline in retail advised new business and the current predominant focus on older new clients is a problem that must be taken seriously by all participants, including the Government.

When considering what is appropriate revenue for a risk adviser to earn, it is essential that thought is given to the significant costs of running a risk adviser practice, including support staff, licensee costs, systems costs, premises, professional indemnity insurance and a broad range of regulatory costs.

We note the proposed requirement for the adviser to obtain informed consent from the client. We believe that this is appropriate, however note that this has been the long standing practice, in that both initial and ongoing commissions are disclosed in a Statement of Advice and the client provides consent by signing the Approval to Proceed page. Commissions are also disclosed in Financial Services Guides and other documentation, such as engagement letters. We further note that the type of relationship that exists between a risk adviser and their client is different from that of an investment or superannuation client. There is not so much of a need for a formal annual review, but instead a need for regular interaction to assess whether the client's personal circumstances have changed, and whether the insurance arrangements need to be updated. This interaction may be less frequent than annual and may also be less formal (i.e. telephone or in some cases email). The important thing is that this interaction does happen and that where important changes arise, further advice is provided. We also note that a key part of the risk adviser's value proposition is support, assistance and advice at the time of claim. Only a small fraction of risk clients are the subject of a claim, however the model works in a fashion where the cost of this support is effectively subsidised by the other clients. This is a key premise in financial advisers being able to provide claims support at what is typically no additional cost. The alternative might be for the client to engage a lawyer, who could charge a fee of up to 40% of the claim proceeds. The consent model needs to take all of this into account.

We note that the proposal paper was short on detail about the nature of the consent, however we make the following important points, which we understand are consistent with the intent:

- It should only be a once-off exercise at the time of the provision of the initial advice.
- The disclosure of ongoing commissions should be limited to the renewal commission percentage and the dollar amount calculated on the basis of the first year's premiums. We strongly oppose any more detailed calculation of the cumulative amount over multiple years. This is often particularly unpredictable, and thus we would not want advisers to be held accountable to this by clients in any form of precise manner.
- We believe that advisers should be able to rely on the consent that they have previously obtained for existing clients, and not be forced to obtain this consent again whilst the client continues to hold their insurance policies. For older policies, where historical records may no longer exist, there should be no requirement to prove the existence of this client consent.

- We are very conscious that from time to time, the adviser servicing a client might change, or that a business or book of clients is sold from one adviser to another adviser. We believe that the new adviser should be entitled to rely upon the consent that was provided to the previous adviser and not be forced to seek a further consent.
- We believe that it should be possible to obtain this consent in multiple different forms, including via email, social media or text message.
- We strongly oppose any requirement for a copy of the consent to be provided to the life insurer. This will only cause substantial additional cost and complexity for the adviser and the life insurer, which would ultimately need to be passed on to the client. Financial advisers, advice practices and licensees would be held accountable for obtaining this consent and that should be the point at which records must be retained.

We are happy to support this new consent obligation, however within the constraints listed above, and noting that processes already exist for obtaining client consent.

We recognise that this proposal needs to be viewed in the context of the other important proposal to remove the requirement to provide a Statement of Advice. We thus note that some new form of record of consent might be required for circumstances where an SoA is not provided. We note that this disclosure would also need to confirm what, if any, services will be provided.

Time-sharing schemes (Proposal 3)

3. Do you support Proposal 3, which recommends that the Government conduct a separate holistic review of time-sharing schemes and the way they are promoted?

a) If you do not support this proposal, please state your reasons

We support proposal 3.

Other Conflicted Remuneration exemptions (Proposals 4-7)

4. Do you support Proposals 4 -7, which remove or modify the existing exemptions to the ban on conflicted remuneration?

a) If you do not support any of these proposals, please state your reasons

b) Do you consider there to be any unintended consequences related to the implementation of Proposals 4 -7?

Proposal 4. We support proposal 4. It is recognised that Section 963B(1)(d) of the Corporations Act lacks explicit clarity that a benefit given by a client includes circumstances where the client directs a product provider (i.e. a superannuation fund) to pay a fee to a financial adviser on behalf of the client. This was recognised early on in the Future of Financial Advice (FOFA) reforms and was addressed through Note 2 to Regulation 7.7A.12, which states "A reference in this Division to giving a benefit includes a reference to causing or authorising it to be given (see section 52 of the Act)". This amendment through Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014 - Select Legislative Instrument No. 102, 2014, was seen at the time to address this issue, which is a common practice that existed before FOFA and has continued since that time. We nonetheless support addressing this through the legislation.

Proposal 5. We support proposal 5. This exemption, which is known as the Execution Only exemption, is most likely redundant anyway, as it would only be relevant for investment and superannuation products, however these products no longer enable the payment of a commission. It was not intended for life insurance products, where there was a separate exemption, and their exclusion is specifically noted. The inclusion of the requirement not to have provided personal advice in the last 12 months, was more than likely to ensure that this was not used as a loophole mechanism to avoid the ban on conflicted remuneration. We see no practical reason for the retention of this exemption.

Proposal 6. We support proposal 6. We agree with the key premise that the employees of Australian ADIs should be treated in exactly the same way as the employees of other financial institutions.

Proposal 7. We support proposal 7. It is correct that the Conflicted Remuneration provisions, as set out in Section 963A of the Corporations Act, are entirely focussed upon the provision of financial product advice. By implication, it makes sense that the provisions in Section 963B and 963C and the Corporations Regulations that are related to activity other than the provision of financial product advice (i.e. the issue or sale of financial products and dealing) are redundant.

The broader implication of this is that activity that is not related to the provision of financial product advice, is not covered under the Conflicted Remuneration provisions, and this opens up some interesting questions, as to whether commissions can be paid for financial services such as dealing. We note the potential interdependency with the other QAR recommendations, including the proposal that only relevant providers could be paid for providing ongoing advice.

General

5. **Do you have any other comments or feedback on the Quality of Advice Review Conflicted Remuneration Consultation Paper?**
With respect to the discussion on the full list of conflicted remuneration exemptions in Attachment A, we offer the following additional comments: • We note the proposal to retain the exemptions related to information provided to a client about a life risk insurance product and dealing in a life risk insurance product under Regulations 7.7A.11C and 7.7A.11D of the Corporations Regulations, however, make the point that this is also not financial advice, in that it is the provision of information or dealing services. In the context of Proposal 7, we raise the question as to whether this is redundant. • We support the Exemption in Regulation 7.7A.12EA on “Application of ban on conflicted remuneration--purchase or sale of financial advice business”, known as Buyer of Last Resort arrangements, which remains important, however this is a declining feature of the financial advice environment. • We support the retention of the small non-monetary benefits exemption. This enables the ongoing interaction of financial advisers and product provider representatives in a social context, where the development and maintenance of these relationships will not inappropriately influence financial product advice and can be utilised for the benefit of clients. • The genuine education and training exemption continues to have an important role in allowing financial advisers to attend education and training events arranged by product providers. Often these events include specific financial advice knowledge, however even when the content is specific to the product provider, and relates to product knowledge, this is still an important knowledge area for advisers. The retention of this exemption remains important in ensuring that advisers have continuing access to education and training relevant to their profession and area of specialisation. • We also believe that it is appropriate to retain the exemption for the provision of information technology software and support, as some product providers do provide software and systems that are used by advisers in the operation of their practices, including add-on features as part of product systems.
6. Do you have any other comments on the regulation of conflicted remuneration under Chapter 7 of the Corporations Act?
The AFA supports the conflicted remuneration regime that applies in the financial advice sector. We believe that the current balance is largely appropriate, although we believe that there is room for sensible enhancements, including those that have been recommended in this consultation paper. Given that the risk of some benefits, that are currently classified as conflicted, such as life insurance commissions, causing client detriment has been substantially mitigated and that the availability of this form of payment for life insurance advice continues to provide a social benefit in enhancing the level of life insurance cover, we believe now is a sensible time for some of these issues to be seen in a clearer light. The retention of the mindset by some stakeholders that all conflicted remuneration is automatically bad for consumers, needs to be challenged. That is simply not the case. We believe that many of the existing exemptions do more good than they

do harm, and this often results in better outcomes for consumers. These exemptions have been carefully considered in the past, and subject to these proposals and our comments above, we believe that the remaining exemptions have an important role to play.

Clawback

One important subject that has not been addressed is the issue of clawback, where the commissions paid on the implementation of recommendations with respect to life insurance products, must be recovered from the adviser, if the client discontinues or reduces the policy within the first two years. The regulatory regime involves the clawback of 100% of the commission, if the policy is discontinued in the first year, and 60% if it is discontinued at any stage in the second year. The model does not include any tapering down in the second year. A reducing clawback ratio is more common in other jurisdictions.

Risk advisers never accepted that a two year clawback was fair, however this has clearly been demonstrated as unfair for two key reasons:

- We have witnessed particularly substantial increases in premiums in recent years, and advisers have been required to work hard to retain impacted clients, often working with the client on options to reduce the premium, including through reducing the level of cover or changing some of the features. Where a substantial premium increase arises on the first anniversary, advisers could end up facing a clawback, because the client can no longer afford the policy and chooses to cancel or reduce the level of cover, which will also result in a clawback.
- During COVID, many Australians experienced a sudden loss of income. In the case of small businesses, this might have led to a very sudden change in circumstances and an inability to meet current living costs. As a result of this, some clients were forced to cancel their life insurance cover, and this could have resulted in a clawback penalty being applied to the adviser.

We are also very conscious of the increasing discussion in the media and amongst economists about the risk of a recession, where many clients might be forced to reduce their level of cover or even discontinue their cover entirely. If this eventuates, it will place great pressure on life insurance advice practices.

Clawback was intended to act as a disincentive to inappropriately moving clients to a new life insurer within two years. It was not designed to penalise an adviser because the life insurer abruptly applies a substantial increase in premiums, or because the client suffered a substantial loss of income. In both of these cases, this outcome is not the responsibility of the adviser, and it is unfair that they have taken such a high level of responsibility.

We note that a two year clawback is stipulated in the legislation (Section 963BA of the Corporations Act). Whilst we would prefer that this be reduced to a one year period, in the absence of changes to the legislation, we propose that the clawback that is stipulated in the ASIC Legislative Instrument should be amended such that in year two it would be reduced to 50% for the first half of the year and 25% for the second half of year 2.