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Quality of Advice Review Secretariat
Financial System Division
The Treasury
By email: AdviceReview@treasury.gov.au

Quality of Advice Review – Conflicted Remuneration

Industry Super Australia (ISA) is a research and advocacy body for funds that carry the Industry SuperFund symbol. ISA manages collective projects on behalf of those funds and their five million members. Our aim is to maximise the retirement savings of all our members.

The focus of our submission is on commissions for advice provided in connection with the sale of life insurance.

It is ISA's view that these commissions should be banned.

Firstly, the consultation paper does not contain any clear evidence that banning life insurance commissions will contribute significantly to underinsurance. There is therefore no basis for the proposal that commissions should be retained. The threshold requirement to retain such commissions set out by Commissioner Hayne, and on which recommendation 2.5 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry is premised, has not been met.

Secondly, as long as commissions remain permissible for life insurance sold outside of super, there will always be a clear incentive for financial advisers to recommend retail life insurance products over life insurance inside super. This is despite insurance inside super providing cost effective cover to millions of Australians.

Thirdly, relying on regulatory approaches such as disclosure and consent – which numerous reports have demonstrated are ineffective – will do little to protect consumers from receiving conflicted advice and the poor outcomes that flow from that advice.

Further information is set out in the Appendix. If you have any questions, please feel free to contact me.

Kind regards

Ella Cebon
Senior Policy Manager

Appendix

Name/Organisation: Industry Super Australia (ISA)

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

Numerous inquiries have shown that there is a strong correlation between commissions being paid to financial advisers and poor consumer outcomes.[1] Commissions represent a benefit to the adviser and are therefore likely to influence the advice given to consumers. Given this conflict of interest, ISA's general view is that all commissions for the sale of financial products should be banned.

However, our submission focuses specifically on commissions in the context of life insurance (question 2). Our comments on the proposed disclosure and informed consent requirements are also relevant in this context.

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

Retaining commissions for advice provided in connection with the sale of life insurance will only lead to poor consumer outcomes. This was reflected in various case studies examined by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, where commission structures were found

[1] See for example: ASIC, *Report 413 Review of retail life insurance advice* (October 2014); Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the life insurance industry report* (27 March 2018); The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report* (4 February 2019).

to be key contributors to inappropriate behaviour by life insurers as it incentivised aggressive sales tactics, even where the consumer was vulnerable – see the ClearView and the Freedom case studies.[2]

As discussed in our submission on the Quality of Advice Review Issues Paper, commissions present a conflict of interest as they incentivise advisers to sell life insurance products outside of super – even if they are not appropriate or suitable for the client (because for example, the client's life insurance within super is more suitable to their occupation).

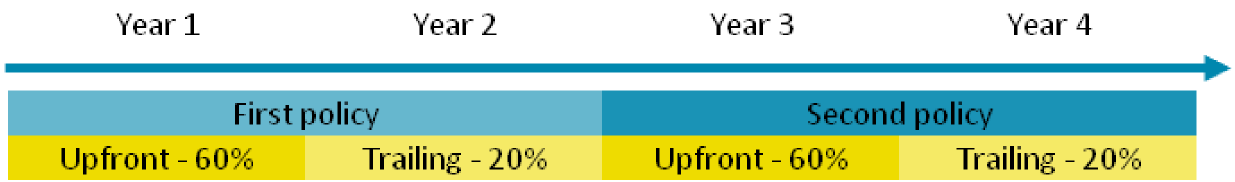
Some industry participants have stated that the Life Insurance Framework reforms and other recent regulatory reforms (such as the design and distribution obligations) have minimised the risk of poor consumer outcomes flowing from being given conflicted advice. This view is also reflected in the consultation paper. However, ISA disagrees with this view, as:

- the current caps on commissions are objectively high,
- there are still incentives to churn clients as commissions do not need to be repaid if a policy is terminated after two years, and
- there is no clear justification for having trailing commissions in the context of life insurance. In many cases, there are unlikely to be any ongoing services provided by the adviser, and if there are, they are incommensurate with the cost of the trailing commissions and are similarly tainted by the same conflicts of interest.

Example: Operation of caps
APRA statistics show that for retail consumers, the average annual policy cost for life insurance is $1,320 as at June 2022[3]. Advisers can receive $792 in commissions in the first year (60% of the policy cost – upfront commission) and $271 from the second year onwards (20% of the policy cost – trailing commission). Once the two-year clawback period ends, advisers may recommend the client take out a new policy without having to repay any upfront commissions. The whole commission process could therefore restart, with advisers receiving an upfront commission of 60% of the new policy in the third year – see the figure below. If this churning pattern is repeated over the course of a 20-year period, it would result in a total commission payable of $10,560 in today's dollars.

[2] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report Volume 2: Case Studies* (4 February 2019).
[3] APRA, *Life insurance claims and disputes statistics June 2022* (October 2022).

Given commissions are effectively paid by the client (since they are built into premiums paid by the client), this figure is up to 7 times higher than the average amount the client would otherwise pay if they sought limited advice and paid a fee to the adviser ($1,500).[4]



Both ASIC and the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry have found that commissions are key drivers of poor advice and consumer harm in the retail life insurance sector. Commissioner Hayne in particular noted that:

> *Unless the reduction in life insurance commissions can be shown to contribute significantly to underinsurance, I can see no justification for allowing this form of conflicted remuneration to continue to be paid. Any decision that commissions should continue to be paid and received in relation to life insurance products should be based on clear evidence that the harm that would flow from abolishing commissions would outweigh the harm that already flows from allowing this form of conflicted remuneration to continue.*

Yet this consultation paper on conflicted remuneration does not provide any evidence – much less clear evidence – about the risk of underinsurance if life insurance commissions were abolished. Instead, the proposal to retain commissions appears to be based on high level data collected by ASIC, which:

- is provided without any considered analysis or insight as to what the data shows, and
- does not directly address underinsurance.

For instance, the consultation paper indicates that the overall number of new life insurance policies issued between 2017 and 2021 declined. The paper implies that this shows there is an underinsurance issue and that commissions paid to financial advisers are needed to sell more insurance policies. However, this conclusion is flawed without further analysis about the value of life insurance policies. For example, the decline in new policies could instead show that the Life Insurance Framework reforms are resulting in a decrease in 'churning' or that inappropriate life insurance policies are not being sold to consumers.

[4] ASIC, *Consultation Paper 332 Promoting access to affordable advice for consumers* (November 2020).

On the possible issue of underinsurance, we agree with Commissioner Hayne that it is unlikely that banning commissions will result in underinsurance, given more than 70% of Australian insurance policies are held through superannuation funds.[5] There has been some commentary that this figure can be misleading because the coverage of life insurance held outside of super is superior or more appropriate for consumers compared to insurance held through super. Our analysis indicates otherwise. Table 1 shows that for group insurance, 65.3 cents is paid out in claims for every dollar of premiums paid in the same period for life insurance held **inside** super. This compares to only 37.4 cents for every dollar of premiums paid for life insurance held **outside** super. This indicates that insurance held inside super presents better value for members.

Table 1: Claims frequency and claims paid ratio for group insurance, June 2022

	Life insurance	Total and permanent disability
Claims Frequency		
Inside Super	0.11%	0.22%
Outside Super	0.04%	0.02%
Claims Paid Ratio		
Inside Super	65.3%	86.7%
Outside Super	37.4%	32.4%

Note: Claims frequency refers to the number of claims received as a percentage of the average number of lives insured for the reporting period. Claims paid ratio refers to the dollar amount of claims paid out in the reporting period as a percentage of the annual premiums receivable in the same period. Figures are at aggregate level, age profile may contribute to the difference.

Source: APRA Life insurance claims and disputes statistics June 2022

We recognise there are other metrics to measure the value of insurance, such as examining the unit price (i.e., the annual cost per $1,000 of default insurance) and claims handling indicators. However, the data contained in APRA's publications do not allow for clear comparisons between life insurance inside super and outside super based on these metrics.

[5] Rice Warner, *The Age-Old Debate about the Validity of Commission Payments* (2019).

We also note that insurance held through super funds is an efficient way to cover workers in specific occupations without resorting to individual tailored solutions. For example, default insurance offered through super that is specifically tailored for members in dangerous occupations can include coverage for events more likely to be faced by these members.

Further, members can seek inexpensive collectively charged (intra-fund) advice from their funds about the adequacy of their life insurance policy within super and obtain a greater level of cover than the default if needed.

In addition to recommending that the caps on commissions be retained, Proposal 2 requires advisers to obtain their client's informed consent to receive a commission in connection with the issue of a life insurance product. There are numerous reports that show disclosure can be ineffective in protecting consumers or influencing consumer behaviour, and in some cases, can actually backfire, by increasing consumers' trust in advisers and giving advisers moral license to recommend biased choices to their customers.[6] Similarly, in 2016, Peter Kell, the then Deputy Chairman of ASIC said:

> *For many, many years, the operating policy assumption was that simply disclosing conflicts of interest would deal with any problems such conflicts may create, as consumers could then factor these conflicts into their decision making. In fact, the research shows that consumers may perversely trust the conflicted adviser more after such disclosure, or at least not know how to 'adjust' for it.*[7]

In other words, it is clear that disclosure and reliance on consumers to act in their best interests – including by giving consent – are ineffective consumer protection tools. Proposing that they be used to mitigate the risk of consumers receiving conflicted advice and the poor outcomes that flow from that advice is therefore flawed.

The consultation paper also fails to properly consider the effect of retaining commissions against the background of the proposals contained in the August 2022 proposals paper, which contained sweeping changes to the way in which personal advice is delivered. The ban on conflicted remuneration introduced by the Future of Financial Advice (FOFA) reforms was part of a set of interlinked measures aimed at improving the quality of financial advice while building trust and confidence in the financial advice industry. Any changes to the best interests duty and related obligations must be taken into account when assessing whether exemptions from the ban on conflicted remuneration should continue.

Accordingly, without clear evidence that banning life insurance commissions will result in significant underinsurance, we recommend that all commissions payable in respect of life insurance products be banned. This will not stop consumers who wish to obtain life insurance advice from paying for it, including through inexpensive means such as collectively charged (intra-fund) advice from their super fund. For transparency, we also recommend that ASIC publish the life insurance data it has collected and its analysis of that data.

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[6] See for example, ASIC and the Dutch Authority for the Financial Markets, *Disclosure: Why it shouldn't be the default* (2019).
[7] Peter Kell, *ASIC and behavioural economics: Regulation for real people* (18 October 2016).

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 have no specific comments in response to this question.
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?**
We have no specific comments in response to this question.
General
5. **Do you have any other comments or feedback on the Quality of Advice Review Conflicted Remuneration Consultation Paper?**
We have no other comments or feedback.
6. Do you have any other comments on the regulation of conflicted remuneration under Chapter 7 of the Corporations Act?
We have no other comments.