

Chapter 6

Retail life insurance and approved product lists

Introduction

6.1 Approved Product Lists (APLs) are used by advice licensees and advisers selling life insurance to maintain a list of life insurance products that they have available to sell. APLs are also used for providing financial advice. This chapter examines issues arising from the use of APLs when they are used for providing financial product advice in relation to life insurance. The chapter begins by summarising what APLs are and how they are used. Evidence received during the inquiry that raises issues with APLs is then discussed. The chapter concludes with the committee's views and recommendation for reform.

The nature of APLs

6.2 An APL is a pre-selected product list maintained by an AFS licensee, which contains the range of financial products that advisers can sell. APLs are not mandated by the Corporations Act or ASIC regulatory policy but are commonly used throughout the industry. The best-interests duty does not prevent or require the use of APLs. However, satisfying the best-interests duty with respect to the use of an APL would depend on how the APL was used. At this juncture, there are no standards or requirements for the number of products or product issuers that must be represented on an APL. In other words, an APL may contain products from only one insurer or a large number of insurers.¹

6.3 In its submission, ASIC noted some of the potential benefits of an APL:

- APLs are often used by AFS licensees and their representatives as a risk management tool to assist licensees in meeting their legal obligations when providing financial product advice;
- APLs may facilitate the provision of higher quality or better value products if the quality of the products is assessed before their inclusion; and
- APLs may reduce the risk that information provided to consumers is incorrect, because APLs limit the number of products that advisers need to understand.²

6.4 Nonetheless, ASIC also observed that, in order to act in a customer's best interests, an adviser may need to consider products in addition to those on their licensee's APL.³ ASIC's Regulatory Guide 175 (RG 175), sets out the circumstances in which advisers are required to consider products that are not currently on their APL:

1 Australian Securities and Investments Commission, *Submission 45*, pp. 43–44.

2 Australian Securities and Investments Commission, *Submission 45*, pp. 43–44.

3 Australian Securities and Investments Commission, *Submission 45*, p. 44.

In some cases, an advice provider can conduct a reasonable investigation into financial products under s961B(2)(e) by investigating the products on their AFS licensee's approved product list.

In other cases, an advice provider will need to investigate and consider a product that is not on their AFS licensee's approved product list to show that they have acted in the best interests of the client when providing them with personal advice, for example:

(a) if the client's existing products are not on the approved product list of the advice provider's licensee and these products might be able to meet the client's relevant circumstances;

(b) if an approved product list used by an advice provider is restricted to one class of product and there are products that are not in that class that would better meet the client's relevant circumstances, considering the subject matter of the advice sought by the client; or

(c) if the client requests the advice provider to consider a specified financial product that is not on the approved product list of the advice provider's licensee.⁴

6.5 RG 175 states unambiguously the obligations that the best-interests duty places on an adviser with respect to an APL and the provision of client advice:

If an advice provider is unable to recommend products outside their AFS licensee's approved product list, and they need to do this to meet their obligations in Div 2 of Pt 7.7A, the advice provider must not provide the advice.⁵

6.6 The effectiveness of APLs was considered in the 2015 Trowbridge review. That review noted that licensees operate an APL that contains a selection of life insurers from among the 13 providers that serviced the retail life insurance market at the time of the review. Some licensees use as few as one insurer while other licensees have an 'open architecture' approach that lists all 13 insurers.⁶

6.7 The Trowbridge review noted that in order to ensure quality advice is provided to consumers and that competition between life insurers flows through to consumers, the industry needs to strike a balance between a licensee's desire to limit its APL so as to contain administrative costs and the need for advisers to meet the obligations to their clients.⁷

6.8 The Trowbridge review identified the following issues with APLs:

4 Australian Securities and Investments Commission, *Regulatory Guide 175 Licensing: Financial product advisers—Conduct and disclosure*, March 2017, p. 83.

5 Australian Securities and Investments Commission, *Regulatory Guide 175 Licensing: Financial product advisers—Conduct and disclosure*, March 2017, p. 84.

6 Mr John Trowbridge, *Review of Retail Life Insurance Advice*, March 2015, p. 9.

7 Mr John Trowbridge, *Review of Retail Life Insurance Advice*, March 2015, p. 48.

-
- Limited APLs unnecessarily restrict competition and can prevent advisers from offering their clients access to a broad range of life insurance products and services. While advisers can request to go outside the licensee's APL, doing so can be time consuming and difficult. As a result it is common for advisers to stay within the APL for most of their recommendations.
 - Limited APLs also create incentives for advisers to push products that can lead to consumer detriment. Courts have noted that limited APLs fundamentally fail to meet the objectives around the provision of advice in a client's best interest. A recent example is (*Commonwealth Financial Planning Ltd v Couper 2013*,) where it was found the advice was incomplete due to the role played by a very narrow APL.⁸

6.9 The Trowbridge review recommended that APLs in the retail life insurance advice sector should include at least half of the authorised retail life insurance providers and be prohibited from receiving benefits from insurers and potentially influence advice.⁹

6.10 ASIC agreed that the Trowbridge recommendation could lead to improvements in the industry. ASIC submitted that expanded APLs may address the following risks that are associated with narrow APLs:

- Lower quality/poor value products—Advice providers who can only recommend a limited number of products from an APL will be less able to give quality advice which complies with their conduct obligations if the products on the APL are too restricted, not suitable, or of poor quality.
- Conflicts of interest—APLs that favour products issued within the vertically integrated group will not allow effective management or avoidance of conflicts of interest, which can lead to poor outcomes for consumers.
- Lack of innovation—APLs that are too narrow or static may prevent consumers from accessing new and innovative products with features that are better for them.¹⁰

6.11 However, ASIC also informed the committee that expanded APLs would not be a sufficient reform by itself to improve the quality of advice, because:

- advice providers operating within a vertically integrated group tend to recommend in-house products over non-related products even where their APL includes a wide range of non-related products;
- a wider APL may not protect consumers from the poor outcomes that can result where the adviser has a conflict of interest; and

8 Mr John Trowbridge, *Review of Retail Life Insurance Advice*, March 2015, p. 49.

9 Mr John Trowbridge, *Review of Retail Life Insurance Advice*, March 2015, p. 9.

10 Australian Securities and Investments Commission, *Submission 45*, pp. 44–45;

- the drivers of poor quality retail life insurance advice also include adviser incentives and failure to consider the relationship between life insurance and superannuation.¹¹

6.12 In November 2015, the Government announced as part of the LIF Reforms that industry would be responsible for widening APLs through the development of a new industry standard.¹²

6.13 The FSC noted in its November 2016 submission to this inquiry that it is currently developing a life insurance APL Standard to encourage high standards in life insurance APL construction practices that support quality consumer outcomes.¹³

6.14 In April 2017 the FSC released a draft standard for life insurance APLs for consultation until 10 May 2017. The FSC is seeking to finalise the standard in the coming months. The FSC indicated that the standard:

- is intended to be compulsory for all FSC members once approved;
- requires a reasonable basis for APLs to be formulated with the best interests duty in mind;
- requires life insurance APLs to contain a choice of multiple life insurance providers and to be supported by robust off-APL processes so alternative products can be recommended; and
- would encourage disclosure of how many products and providers are on the APL.¹⁴

6.15 At an ASIC Oversight hearing in October 2017, ASIC confirmed to the committee that it is 'looking at how APLs work in practice and whether advisers do use the full range of products on approved product lists'.¹⁵

Arguments supporting the use of APLs

6.16 The FSC suggested that APLs are an important element in the advice process that facilitates the delivery of advice based on quality researched products for licensees and advisers. Licensees review and assess products for inclusion in an APL for advisers to offer their clients. APLs serve as a risk management tool for advisers and licensees whereby products have been assessed for suitability prior to being

11 Australian Securities and Investments Commission, *Submission 45*, p. 45.

12 The Hon Kelly O'Dwyer MP, Minister for Revenue and Financial Services, *Government announces significant improvements to life insurance industry*, 6 November 2015, <http://kmo.ministers.treasury.gov.au/media-release/024-2015/> (accessed 8 November 2017).

13 Financial Services Council, *Submission 26*, p. 29.

14 Financial Services Council, *Submission 26.1*, p. 16; Financial Services Council, *FSC releases draft APL standard for consultation*, 12 April 2017, <https://www.fsc.org.au/entity/annotation/38dbc220-2b2e-e711-80fc-c4346bc5c274> (accessed 16 October 2017).

15 Mr Peter Kell, Deputy Chairman, Australian Securities and Investments Commission, *Committee Hansard*, 27 October 2017, p. 4.

included on the list. The FSC argued that this facilitates appropriate products being recommended to clients. The FSC noted that the development of APLs commonly involves assessments of experience with underwriting, claims and other services which are likely to impact the customer or adviser experience.¹⁶

6.17 MLC informed the committee that, in its view, APLs function as a way for licensees to manage risk by supporting their recommendation with products that have undergone qualitative research. Further, MLC argued that because an APL ensures products meet agreed minimum standards and are issued by a reputable manufacturer, they function to protect both the advisor and their client. In addition, if the products on an APL do not suit the specific needs of a customer, most licensees have a process in place to gain approval for the use of an alternative, non-APL product.¹⁷

6.18 At a hearing in March 2017, Mr Brad Cooper, Chief Executive Officer of BT Financial Group (BT), confirmed that BT only has their own life insurance products on the APL used by their financial advisers.¹⁸

6.19 Mr Cooper explained how a vertically-integrated business with such a narrow APL meets the best interests test under the FOFA regulations. In particular, Mr Cooper noted that BT has very highly-ranked products tailored to the needs of their customers, as well as an off-APL process whereby advisers can select a competitor's product as necessary:

Perhaps I can explain for a moment about the APL and how that works—

...and how we use that to ensure that we deliver on that best interests test. Our salaried financial advisers work for our group. Predominantly their customers are customers of the bank. You would imagine that we know those customers very well and we use our knowledge of those customers in making sure that the development of our products suits the vast majority of those needs. By way of example, our products are one of the only products that would have income protection for homemakers; it is one of the only set of products with a SME segment that has a key personal insurance policy that covers the revenue at risk to the business if that person was ill. So there are a range of covers that our products have that others do not.

As I said earlier, IRIS rates our product No. 1 in six out of eight times and it is second on the other two. Both Investment Trends and Strategic Insight also rate our product No. 1 in the market. In the vast majority of cases, our product is most suitable for those customers, and that is the product on our APL. But we do recognise that it does not meet every circumstance. So we have what we call an off-APL process that, if one of our advisers meets a customer and they do not believe that our product meets that customer's best interests, they can use a competitor's product that is not on our APL. In 2016, our advisers did that over 1,200 times, which was one in 20 of our

16 Financial Services Council, *Submission 26*, p. 29; Financial Services Council, *Submission 26.1*, p. 15.

17 MLC, *Submission 30*, pp. 8–9.

18 Mr Brad Cooper, *Committee Hansard*, 3 March 2017, p. 43.

claims, and they used some seven providers off the APL. I am the licensee, if you like, of the AFSL and I am responsible for meeting that best interests test.

The way we do that for our customers of our salaried financial advisers is by making sure that, where appropriate, they use the products that we know well and which are best suited for the customer. When they choose to go off that APL, we have a process where it goes into our research team and we are making sure in those circumstances that the ultimate product better meets that customer's requirements.¹⁹

6.20 In November 2017, BT announced that it intended to add other insurers to its APL by March 2018.²⁰

Arguments for widening or banning APLs

6.21 The committee received a substantial body of evidence that argued for increasing the number of life insurance companies, and the number of non-affiliated products, represented on an APL as a matter of some urgency.

6.22 Berrill & Watson Lawyers suggested that mandating a minimum number of insurance companies to be included in APLs would have the advantage of substantially diluting the ability of advisers to guide clients towards particular products for commission-driven motives.²¹

6.23 Clearview argued against APLs as, in its view, APLs result in a 'pay to play' model which enables many product manufacturers to effectively buy access to advisers and distribution. Shelf space and other fees mean that the products on these restricted APLs are not necessarily the best products available, nor would they necessarily be best-suited to the customer's needs.²²

6.24 Clearview advocated for open APLs to be a regulatory requirement if industry failed to immediately move voluntarily to open APLs. Clearview acknowledged that the FSC had a process underway, but was critical of the time being taken.²³

6.25 TAL supported further reform of APLs, suggesting that a requirement to have a range of products and suppliers in any APL would return the focus of such lists to being about quality and choice. TAL also supported the introduction of a new APL standard to widen APLs.²⁴

19 Mr Brad Cooper, *Committee Hansard*, 3 March 2017, p. 44.

20 Insurancenews.com.au, *BT to expand life product offerings*, 6 November 2017, <http://www.insurancenews.com.au/life-insurance/bt-to-expand-life-product-offerings> (accessed 8 February 2019).

21 Berrill & Watson Lawyers, *Submission 19*, pp. 6–7.

22 Clearview, *Submission 10*, pp. 4–7.

23 Clearview, *Submission 10*, p. 8.

24 TAL, *Submission 31*, p. 7.

6.26 AIA also supported the Trowbridge recommendation that APLs in the retail life insurance advice sector should include at least half of the authorised retail life insurance providers. AIA argued that the benefit of broader market coverage in APLs is that it will increase the level of product choice, competition, and consumer access to life insurance products. AIA suggested that this will allow consumers to compare and select the best product.²⁵

6.27 ANZ informed the committee that it supports a minimum of three providers being offered on APLs. ANZ advised the committee about the size of its APLs, indicating that:

- ANZ Financial Planning has four providers on its APL, one of which is OnePath; and
- ANZ dealers groups have nine providers on their APL, which also includes OnePath.²⁶

6.28 Maurice Blackburn Lawyers (Maurice Blackburn) were critical of APLs, noting that dealer groups utilising a vertical integration model are not obliged to have any retail life risk insurance product on their APLs other than their own affiliated product. Vertically-integrated advice is where an adviser recommends purchase of a financial product (including life insurance) from entities with which they are associated. This is often to the exclusion of more suitable non-affiliated products. Maurice Blackburn suggested that this inherent conflict has given rise to much litigation in recent years, the most notable case being Commonwealth Financial Planning Ltd v Couper. Maurice Blackburn noted that these inherent conflicts were highlighted by Roy Morgan research which stated that over a three year period, these dealer groups allocated an average of over 70 per cent of their sales to their own products.²⁷

6.29 Maurice Blackburn argued that the recent LIF Reforms have not addressed the issues arising from APLs, suggesting the Explanatory Memorandum to the Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016 (the Bill) did not discuss these issues directly nor propose any substantive reform.²⁸ Maurice Blackburn suggested that potential reforms could include a requirement that:

- APLs include a balance of affiliated and non-affiliated products, and/or a minimum proportion of non-affiliated products; and
- if affiliated products are recommended, the affiliation should be disclosed, and the customer should be given a comparison with non-affiliated products.²⁹

25 AIA Australia, *Submission 32*, p. 33.

26 ANZ, *Submission 44*, pp. 2, 17.

27 Maurice Blackburn Lawyers, *Submission 12*, pp. 10–11.

28 Maurice Blackburn Lawyers, *Submission 12*, pp. 10–11.

29 Maurice Blackburn Lawyers, *Submission 12*, p. 11.

6.30 The Australian Lawyers Alliance argued for a legislated solution informing the committee that the government previously entrusted the industry with responsibility for widening APLs through the development of a new industry standard. The ALA suggested that a passive response is inappropriate given the industry's poor track record of self-regulation and its manifest commercial interest in continuing to sell in-house products.³⁰

6.31 The Association of Financial Advisers informed the committee that reduced licensing fees have been used by licensees to incentivise advisers to select narrow APLs over boarder APLs, further compromising an adviser's capacity to meet their best interests duty.³¹

6.32 The committee received evidence from Mr Stephen Perera, Director of advice firm Perera Crowther, who advocated banning the use of APLs within retail life insurance primarily because an APL is used to manipulate distribution and money flows by artificially restricting choice for no discernible consumer benefit:

APLs are used among AFSL holders to control distribution of insurance products where they (the AFSL) have profit share arrangements.

The above-mentioned behaviour is particularly concentrated among vertically integrated AFSLs. By way of example, one vertically integrated AFSL excludes over half of the insurers that currently manufacture Life Insurance products.

APLs inhibit choice for consumers for the benefit of AFSL holders who are interested in meeting their Key Performance Indicators to meet their volume based bonuses.

There is no benefit for consumers to retain APLs.³²

Committee view

6.33 A large body of evidence to the inquiry recommended substantial reform to the way that APLs are currently constructed and used. As discussed in both this chapter and the previous chapter with respect to shelf space, education, and training fees, the committee received evidence that the way APLs operate lacks transparency and generates conflicts of interest that lead to mis-selling, that is, selling a life insurance product on the basis of misleading advice.

6.34 The risks of mis-selling arise from the potential for APLs to be used:

- to herd customers to the insurer that is prepared to pay the most to be on the APL; or
- to herd customers to in-house products through vertically integrated arrangements.

30 Australian Lawyers Alliance, *Submission 20*, p. 29.

31 Association of Financial Advisers, *Submission 22*, p. 16.

32 Mr Stephen Perera, Director, Perera Crowther Financial Services, *Submission 58*, p. 5.

6.35 The committee notes that the following recent developments could address some issues with APLs:

- the Trowbridge recommendation that APLs must contain at least half of the authorised retail life insurance providers; and
- the draft APL standard developed by the FSC.

6.36 In spite of these recent developments, the committee has the following reservations:

- firstly, the relationship between the APL standard and the Life Insurance Code of Conduct is not clear;
- secondly, the draft standard may only cover FSC members who hold AFS licenses, thus leaving out many other industry participants; and
- thirdly, the voluntary self-regulatory nature of the standard means it lacks rigor and enforceability.

6.37 The committee is particularly concerned about the risk of conflicts of interest that arise when an APL is used as the basis for giving financial product advice. In this situation, a customer should be able to expect that the advice they are given is independent, genuinely in their best interest, and has not been influenced by deals and secret payments to get a product onto an APL.

6.38 The committee considers that, in order to satisfy the Future of Financial Advice (FOFA) best-interests test, an adviser must be able to select products from a broad APL that contains a balance of non-affiliated products, and freely give, without encumbrance, financial product advice that may include a recommendation that the best product for a customer is a product that the adviser does not sell.

6.39 In this regard, the committee notes that BT, a vertically-integrated life insurance business, appeared before the committee and confidently asserted that their own in-house products are ranked the best on the market and, on that basis, they see no need to stock any other products on their APL. The committee accepts that a business may indeed be capable of producing the best products on the market for a year or even for a few years. But it stretches credulity that a company would be able to do so indefinitely. As a corollary, therefore, a question arises as to how a vertically-integrated business that only stocked its own products on its APL could meet the duty to act in the best interests of the client under the FOFA regulations on an ongoing basis. In other words, it may be possible for that business to meet the FOFA requirements for a year or even several years, but it seems unlikely that such a business arrangement could be deemed to meet the best-interests duty indefinitely. The committee is not persuaded that the ability to occasionally select an off-APL product is sufficient to counter-balance the hazards of continuing to maintain such a narrow APL.

6.40 The committee notes the arguments of some industry participants that APLs reduce risks by removing poor quality products. However, the committee is not convinced that restrictive APLs influenced either by vertically integrated arrangements or by a secretive array of shelf space fees, and various other fees such as

training fees, are the best way to protect consumers from poor quality products. Indeed, the committee has heard many persuasive arguments to the contrary from a range of consumer groups that the prevalence of hidden fees that shape APLs are detrimental to consumers because consumers may end up being sold an inferior product merely because a life insurer has paid a fee to enable that product to be put on an advice providers shelf.

6.41 In light of these circumstances, the committee considers that, as currently configured, APLs are severely lacking in transparency. At a bare minimum, an APL should have a balance of affiliated and non-affiliated products, and if affiliated products are recommended, the affiliation should be disclosed, and the customer should be given a comparison with non-affiliated products.

6.42 Beyond this, however, the committee is not convinced that the draft APL Standard being proposed by the FSC will adequately address the full range of concerns articulated by the committee in this and the previous chapter. The committee is of the view that the life insurance industry should be transitioning to open APLs. The committee considers that the advantages of open APLs in terms of transparency and improved consumer outcomes far outweigh any risks to consumers.

6.43 While the committee is prepared to allow the industry some flexibility in making this transition, the committee draws attention to Recommendation 5.2 from the previous chapter in which the committee recommended that ASIC conduct a systematic review and risk assessment of all payments and benefits (monetary and non-monetary) flowing between participants in each sector of the life insurance industry with a view to advising the government of any outstanding risks and regulatory gaps.

6.44 Based on both the findings of that review and the extent to which industry has taken the initiative to move towards open APLs, the committee suggests that the government may like to consider whether further regulation in this space is required to enforce greater transparency and improve consumer outcomes.

Recommendation 6.1

6.45 The committee recommends that the life insurance industry should have, as a matter of urgency, a balance of affiliated and non-affiliated products on their approved product lists, and if affiliated products are recommended, the affiliation should be disclosed, and the customer should be given a comparison with non-affiliated products. Beyond this, the committee further recommends that the industry transition to open approved product lists.

6.46 The committee observes that the manner in which APLs have been configured may potentially breach competition laws. The committee therefore considers that it is appropriate that ASIC and the ACCC jointly investigate whether the past use of APLs in the life insurance industry breaches any competition laws they administer including, but not limited to, anti-competitive agreements.

6.47 The committee also considers that the report of the above joint investigation should also inform government whether the current legislation inappropriately

constrains the capacity of ASIC or the ACCC to investigate anti-competitive behaviour in the financial service sector, including life insurance.

Recommendation 6.2

6.48 The committee recommends that ASIC and the ACCC jointly investigate whether the past use of APLs in the life insurance industry breaches any anti-competitive laws they administer. The report of the investigation should also inform government whether the current legislation inappropriately constrains the capacity of ASIC or the ACCC to investigate anti-competitive behaviour in the financial service sector, including life insurance.

