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3 March 2016

**The Committee Secretariat  
Senate Standing Committees on Economics  
PO Box 6100  
Parliament House  
Canberra ACT 2600**

**By email: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au) request for submission**

Submission in response to:

**Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016**

Prepared by:

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Dear Chairman

I write to you to voice my concerns with the effects on my business and the industry as a whole as a result of the implementation of the above Bill in its current state. As an Adviser of 19 years experience and Managing Director of AFRM, a Life Risk Specialist practice employing 31 staff throughout the East Coast of Australia, we believe we are extremely well informed to raise these comments for your consideration.

I am not writing to object to change in this industry, as I have been a long time believer that change is necessary, but I write to you to express my concern at the disrespect, misinformation and lack of consideration being given to the independent adviser community through this process of review.

I am also concerned that the livelihood of my staff, as well as the affordability and therefore sustainability of advice for my clients, is being jeopardised by largely unsubstantiated allegation around conflict, product replacement and advice quality.

As an SME, it feels like there is a back agenda by the larger corporates in the life insurance industry and perhaps the Government, to force change that is not in the interests of all stakeholders, including the consumer. There seems to be little linkage between the suggested actions and the actual outcomes sought. In particular, "Clients Best Interest" being served.

I understand that there was warning given to the industry to self regulate many years ago and that it has failed. It failed because of the self interest of the product manufacturers. It also failed because there is no one voice on the advice side of the industry. Hence, I agree that in association with the interested parties, the Government needs to show leadership in change and at the same time address the ongoing issues above.

This submission for your consideration is to put forward a case for change, without ripping the entire fabric of the industry apart.

## **1 Quality of Advice**

Our perspective is that the issue is not about remuneration, but about better standards of advice, better professionalism.

We note that ASIC has drawn attention to the distinction between "strategic life insurance advice" and life insurance product advice. AFRM practices are certainly in line with strategic advice followed by product advice and believe this should be what the industry needs to concentrate on in order to reach the professionalism required.

Issue being that where does this training come from? PS 146 does nothing in terms of preparing advisers for this standard, nor will just specifying a degree qualification. Yes, the degree helps train the mind, but the practical application of skills has always come from mentoring and experience.

By my experiences, advice quality in many areas has been poor for ages and it totally frustrates me that the professional risk advisers get tarnished with the poor advice given by the part timers who try to cover risk, super and investment. Risk is a much more complicated advice process then most understand and a separation of industry advice standards should be a big consideration as part of this whole review.

Our risk advisers and paraplanners (and admin support for that matter) have been lucky enough to have access to a detailed and systemised advice process, backed up by research and experienced Directors that have given them the tools and skills to operate to the standards ASIC suggest. In this respect there has always been a great emphasis on client best interests and to meet that requires significant research and detail.

In the Accounting and most likely all professions, a new graduate/employee would be placed under a mentor and then (for accountants) complete a professional year. Perhaps that is a standard we should consider further.

Model being that you can't be licensed or authorised to give advice until you have reached a certain amount of years working in the industry and pass a professional skills examination. The current dealer group model of licensee and authorised representatives is too loose in compliance, training and standards.

To answer the question – “Do all advisers currently giving advice on life insurance have the expertise.....”, my belief is absolutely NO and some form of peer review is needed to educate the less experienced adviser to, “know what they don't know”! A sales culture is no longer appropriate.

I am a supporter of the suggestion that life insurance should be considered as a stand alone profession given the knowledge and experience required to give appropriate advice, product implementation and claims management.

#### Statements of Advice (SOA's)

We don't see the SOA as an impediment to effective communication and all clients are provided with a detailed SOA, which is discussed with them. Simply it must deal with:

1. Identifying the risks
2. Determine financial outcome required
3. Determine the client's ability to mitigate that risk.

Risk can be either controlled or transferred. Everyone needs to understand this part is not about insurance. It's about awareness and education. This lack of awareness is why we have a chronic under insurance issue.

Insurance is about transference of financial risk - mitigating catastrophic risks where there is no financial ability to control those risks. Having established need, then the adviser needs to look at solutions and this involves product analysis:

- a) Definitions
- b) Structure
- c) Tax efficiency (of premiums and receipt of benefit)
- d) Costs

We need to create certainty of outcome to the client through the transference of risk.

The SOA should be seen as part of a process of consumer education. Helping the client to make informed decisions! That's our process. Without that, there will continue to be consumer reluctance to buy and the chronic underinsurance problem will remain.

From my experience in conducting “due diligence” examination of other businesses, it is quiet apparent to me that advice quality and SOA's in general need to improve (back to mentoring and professionalism). I don't believe there is a problem with size of the SOA, as much of the rhetoric has been, I believe it's actually the short SOA's that are causing consumer misinformation and these advisers are likely linked to the churning issue. Taking short cuts with the SOA would not assist with raising the industry professionalism or consumer education.

It must be pointed out here that the ASIC review was targeted on advisers with high lapse rates and upfront commissions and they got the answers they were looking for from that market segment. I'd believe ASIC results would support the comments I've made above on quality.

Acknowledging all the above, my goal is to make sure that the more professional practices such as AFRM aren't tarnished with the same brush. The industry needs to move to a more professional footing and these poor practices need to be removed, however their needs to be an acknowledgment of the cost of giving well researched and analysed advice.

As I said, it would seem this issue is not really about remuneration, but about better standards of advice, better professionalism.

### **Outcomes**

1. Compulsory membership of a Professional Association
2. Raise adviser knowledge, experience and professionalism through an accreditation program via Professional Associations including mandatory adherence to Codes of Conduct.
3. Consider separation of Life Industry as stand alone profession.

## **2 Adviser Remuneration and Incentives**

Let's bear in mind a few thoughts before going any further:

- Business is operated for profit and profit is a mix of quality and efficiency of running a practice. It is however not necessarily a judge of a good practice and therefore we need to ensure the remuneration models fit the advice quality.
- Market forces should determine remuneration, not regulators.
- Consumer awareness is lacking and the industry bodies need to improve education to the consumer.

So, is the issue really the remuneration models or the quality of advice and education being given to earn that remuneration? I think it is the latter. The consumer needs to be more aware of what advice they getting from the adviser. Improved consumer financial literacy training needs consideration.

Every product manufacturer has a right to put a product to the market at their own price and quality, but the consumer needs to better understand why it's needed and the purpose and quality of the offering. Enter advisers.

Just like a Ford car salesman pushes Ford's, an adviser under an insurer owned licensee is likely to be encouraged to push the insurer's products. I think that is fine as long as the public understand the differentiation between products and therefore quality. Just like talking to the Ford salesman.

AFRM chose many years ago to follow a hybrid model for sustainability purposes, which is also an AFSL requirement in terms of financial capacity. We need to be financially strong enough to ensure we can meet our commitments to our clients when they need us. Particularly at claim!

Quality advice is not linked to the insurers. They are only interested in product sales, hence much of the training has withdrawn from the industry as margins tighten and costs need to be controlled. There is very much a disconnect between the obligations of advisers and the insurer incentives. It is my belief that the insurers/product manufacturers have created all the perceived conflicts, yet the blame appears to be laid at the feet of the advisers.

The models need to reflect the importance of strategic life insurance advice, yet we are all in agreement that a nil commission model won't work. We have to ensure we maintain sustainability from product and advice sides.

I don't have a problem with the abolishing of high upfront commissions as it will address sustainability issues in the insurance area, particularly replacement business. However, we need to be careful that advice costs are met and that the clients still get access to advice. AFRM have calculated many times the real cost of giving clients advice and know that the cost of resources required to provide advice and implementation are greater than the new business income. Much the same as insurance companies. Our figures show that we lose money on new business under the hybrid model. Yet we continue to give advice to all comers on the basis of pooled income across the client base.

Our profitability comes from retaining clients long term. The importance of this statement is that there is no incentive to replace client's policies as that would have client go through the new business process again creating the same loss described above. Be clear though, in the interests of client's best interest, there are many reasons that a policy still needs to be changed. Many of these reasons are caused by the insurer themselves. It is their job to keep their product relevant and they regularly fail with this task.

I believe to take remuneration models lower than the hybrid rates will see SME's struggle and this will remove the availability of advice from the consumers. A total backflip on what government and industry has been trying to achieve.

These smaller practices will then take haven under the big dealer groups (mainly bank owned), which are primarily only interested in selling their own products and then advice becomes more conflicted than ever.

The Industry solution needs to make sure that any changes made achieve the outcomes needed. Advisers have a right to be paid a fair price for the work done, and yes, there are times when a big premium causes a big commission, but those cases take longer and require more work. They also balance out with the smaller clients that we take on at a loss when providing advice, product implementation and claims management (per the pooled remuneration model mentioned above).

Be careful that advice will remain open to all and that claims management is always considered.

The greatest thing we do for our clients is manage their claims and this consumes a massive resource. We have supported our clients to receive over \$90m in claim proceeds. I'm sure none of them have an issue with the hybrid remuneration models.

Claimant's generally couldn't afford to pay for claims management and our experience is that they obtain better claim outcomes when an adviser is involved. AFRM's current remuneration model funds our claim management process.

### **Outcomes**

1. Hybrid model should continue:
  - a. It works from a cost perspective
  - b. It works from an advice perspective
  - c. It achieves sustainability and discourages "churning"
  - d. Reduces perceived conflicts of interest
  - e. It is already an industry model and therefore doesn't require expensive and time consuming system changes by insurers.
2. The most important counter balance to the remuneration is through the quality of advice and that is the biggest concern in the industry.
3. Ensure that remuneration doesn't actually cause a disincentive to act in the consumers best interest by failing to remunerate advisers for the cost of the new advice.
4. Market forces will provide innovation and will dictate the success or otherwise of the product manufactures under common remuneration guidelines.

### **3 Insurer Practices and Product Offerings**

Per comments above, the insurers as product manufactures have a right to put out whatever they like to the market. They must however be cognisant of the need for advisers to act in the best interest of their clients and that may mean they lose that policy. This is not an adviser problem; this is an insurer problem.

I have long said that the insurer needs to continue to make their product relevant to the current market. At the moment, they just keep giving advisers reasons to replace business and over the top of this, they pay them a high upfront brokerage to do so. They are happy to be the recipient of the new business no matter where it comes from, and complain when it is lost. Seems close to the definition of stupidity – to keep doing the same thing and expect a different outcome.

If we can remove the conflict around the remuneration level by mandating hybrid commission, then the only reason to move a product will be to ensure the client's policy continues to meet their needs. Insurers have over and over again closed product lines and caused the adviser to look to replace contract. Either the premiums have risen too high compared to current market or they haven't kept the product relevant to the consumer need. Usually this is outside of 5 years, but not always. We must ensure that whatever rules are introduced, they do not disadvantage the client.

Bearing in mind my previous statement about freedom for insurers to offer what they like, then market forces will drive the success or otherwise of an insurers performance.

#### **Outcome**

1. Policy replacement is primarily a result of insurer actions. Let market forces dictate product solutions and innovation under a sensible remuneration model.
2. It should be the Professional Associations Code of Conduct which determines acceptable behaviour of advisers, not insurers.

#### **4 Industry Productivity**

Keeping in line with the free market insurers operate in, I don't believe too much intervention is required here. From the adviser side, education and business skills should deal with their own productivity. If not, they should be employed by someone who can provide those skills.

Market forces should also lead the insurers towards producing product and service offerings to advisers such as: CRM; Adviser Software; online applications; underwriting processes; and information data feeds. Competition will drive productivity for that aspect of the industry.

Insurers have all spent millions on their own specific e-apps and administration models and to try to standardise this across the industry would remove some of their competitiveness. Product is not the only service we judge insurer performance by. Their ability to manage underwriting, administration and claims along with their ability to support a relationship with advice firms are all important to the appropriate outcomes for the consumer.

Further, my belief is that enforcing consistency of terms would strangle innovation to the consumer's detriment. There are other products available outside Australia that have a clear market need. We are working on developing these with insurers for the benefit of our clients. Standardisation will not improve advice, market penetration or consumer outcomes.

### **Background to AFRM**

Australian Financial Risk Management Pty Limited (AFRM) is a self-licenced risk only advice firm. Company was formed in April 1997 and we currently have 31 staff in multiple locations across the East Coast of Australia.

AFRM is driven very much by stringent process and procedures to ensure compliance with the requirements of our AFSL and provide our clients with best of breed advice and services.

Our advisers are all employees and receive a salary and bonus. We have trained risk specific paraplanners and skilled administration staff.

We are very much an advice based business and provide detailed analysis to our clients, both personal and business, on analysing their human capital risks. Insurance product is used to mitigate those risks identified. Not all clients are insurable, but all value understanding their financial risks.

We currently manage client premiums in the order of \$28m.

We have mandated using Hybrid remuneration models where available since approximately 1999 and continue that policy. We have analysed our financial models regularly and are very aware of the costs of giving appropriate advice and services to our clients. We also have a very strong compliance culture.

We therefore believe we are well informed to provide comment. For further background on AFRM, please go to [www.afrm.com.au](http://www.afrm.com.au).