

Chapter 1

Background to the inquiry

1.1 On 25 February 2016, the Senate referred the provisions of the Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016 to the Economics Legislation Committee for inquiry and report by 15 March 2016.

1.2 This bill would better align the interests of consumers and those providing advice.

Consideration of the bill by parliamentary legislative scrutiny committees

1.3 The bill was considered by the Senate Standing Committee for the Scrutiny of Bills¹ and the Parliamentary Joint Committee on Human Rights.² Neither committee raised concerns about the proposed amendments.

Conduct of the inquiry

1.4 The committee advertised the inquiry on its website and wrote to relevant stakeholders and other interested parties inviting submissions. The committee received a similar form letter from 209 stakeholders, which are divided into three groups, and 56 other submissions. They are listed at Appendix 1.

1.5 The committee thanks all those who participated in, and assisted the committee with, the inquiry.

Background

1.6 The bill is the product of a number of reviews and a lengthy consultation with industry. In particular, the Australian Securities and Investments Commission (ASIC)'s review of retail life insurance advice, the Financial Systems Inquiry and the work of the Life Insurance Advice Working Group (also known as the Trowbridge review) were influential in the formation of the reform proposals captured in the bill.

Australian Securities and Investments Commission review

1.7 In October 2014, ASIC published *Report 413: Review of retail life insurance advice*. As part of its review, ASIC sought to understand the personal advice consumers were receiving about life insurance and to identify opportunities to promote personal life insurance advice that is in the best interests of consumers.

1.8 ASIC highlighted that life insurance:

1 Scrutiny of Bills Committee, *Alert Digest No. 2 of 2016*, p. 63, http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Scrutiny_of_Bills/Alerts_Digests/2016/index (accessed 1 March 2016).

2 Parliamentary Joint Committee on Human Rights, *Examination of legislation in accordance with the Human Rights (Parliamentary Scrutiny) Act 2011: Thirty-fourth Report of the 44th Parliament*, 23 February 2016, p. 1, http://www.aph.gov.au/Parliamentary_Business/Committees/Joint/Human_Rights/Completed_inquiries/2016/Thirty-fourth_Report_of_the_44th_Parliament (accessed 1 March 2016).

...is of critical importance to the long-term financial wellbeing of Australian consumers. Life insurance is a key product through which consumers manage risk for themselves and their families.

Quality financial advice helps consumers identify their life insurance needs and find appropriate and affordable products that meet those needs.³

1.9 ASIC noted that consumers purchase life insurance in one of three ways:

- through an advice provider (adviser);
- directly from an insurer; or
- through their superannuation fund and the group life cover offered by the fund.⁴

1.10 ASIC's report, like the bill, focused only on distribution through personal advice.⁵

1.11 ASIC found unacceptable levels of poor quality advice, which showed a strong connection between high upfront commissions, policy lapse rates and poor consumer outcomes.⁶ Overall, 37 per cent of consumers whose files were reviewed received personal advice about life insurance that failed to comply with the law.⁷ This percentage was higher where the adviser was paid an upfront commission, with 45 per cent of such advice failing to comply.⁸

1.12 ASIC identified a number of factors that affected the quality of advice. These factors were:

- adviser incentives;
- inappropriate scaling of advice;
- lack of strategic life insurance advice;
- weak rationales for product replacement advice; and

3 Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, p. 4, <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/> (accessed 29 February 2016).

4 Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, p. 4, <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/> (accessed 29 February 2016).

5 Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, p. 4, <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/> (accessed 29 February 2016).

6 *Explanatory Memorandum*, p. 16.

7 Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, p. 40, <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/> (accessed 29 February 2016).

8 Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, p. 43, <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/> (accessed 29 February 2016).

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- failure to consider the relationship between life insurance and superannuation.⁹

1.13 ASIC concluded that the way advisers were paid influenced the likelihood of their clients receiving advice that did not comply with the law, with large upfront commissions and ongoing commissions the prevailing form of remuneration.¹⁰

1.14 Following the publication of ASIC's report, the government called on industry to review remuneration practices in the life insurance industry.¹¹ Mr John Trowbridge was engaged by the Association of Financial Advisers (AFA) and Financial Services Council (FSC) to chair the Life Insurance Advice Working Group (LIAWG). The working group undertook to consult with key industry stakeholders, consumer groups, regulators and the Parliament, and provide an interim report by mid-December 2014 and a final report by the end of March 2015.¹²

Financial Systems Inquiry

1.15 In the meantime, the report of the Financial Systems Inquiry (FSI) was published in November 2014. The FSI Committee was tasked with examining how the financial system could be positioned to best meet Australia's evolving needs and support Australia's economic growth.¹³

1.16 The FSI report made a number of recommendations in relation to life insurance, including that:

- industry should raise standards of conduct and levels of professionalism to build confidence and trust in the financial system;
- government should amend the law to provide ASIC with an enhanced power to ban individuals, including officers and those involved in managing financial firms, from managing a financial firm. This would enhance adviser and management accountability;
- government should amend the law to require that an upfront commission for life insurance advice is not greater than ongoing commissions. This would reduce incentives for churning and improve the quality of advice on life insurance; and

9 Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, p. 40, <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/> (accessed 29 February 2016).

10 *Explanatory Memorandum*, p. 16.

11 *Explanatory Memorandum*, p. 6 and *House of Representatives Hansard*, Second Reading Speech, 11 February 2016, p. 10.

12 Mr John Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, 26 March 2015, p. 2, <https://www.afa.asn.au/life-insurance-reform> (accessed 1 March 2016).

13 Financial Systems Inquiry, *Final Report*, November 2014, p. vii, <http://fsi.gov.au/> (accessed 1 March 2016).

- ASIC should review the effect of current stockbroking remuneration structures on the quality of consumer outcomes. If this review raises significant concerns, ASIC should advise Government on the need to remove the sector's exemption from the ban on conflicted remuneration.¹⁴

Trowbridge review

1.17 It was in the wake of the ASIC report and the FSI report that Mr Trowbridge released the final report of the LIAWG on 26 March 2015. Mr Trowbridge accepted the findings of the ASIC review and stated:

There is a need to balance improving the quality of advice and consumer understanding of remuneration arrangements, along with removing misaligned incentives, with sustaining a viable and competitive retail life insurance industry. Failure to do so could adversely affect the retail life insurance distribution segment leading to increased underinsurance and a lack of consumer access to life insurance advice.¹⁵

1.18 Accordingly, the Trowbridge review recommended a package of reforms, including a significant reduction to upfront commissions to limit the incentive for advisers to churn—that is, to sell new products to consumers where the circumstances did not warrant it.¹⁶

1.19 Specifically, Mr Trowbridge made the following policy recommendations:

- that the remuneration model move to a system of level commissions, supplemented by a client-based Initial Advice Payment available at a client's first policy inception and then no more often than once every five years;
- that there be a three year transition period where the five year rule is applied on a best endeavours basis immediately and, from a suitable date in 2016 for a period of two years, the industry operate according to the current hybrid commission arrangements with a cap on initial commissions;
- that licensees be prohibited from receiving benefits from insurers that might influence recommended product choices or the advice given by the licensees' advisers;
- ensure competitive access and choice for all advisers and their clients to available life insurance products by means of every licensee including on its Approved Product List at least half of the authorised retail life insurance providers;
- that all licensees, in conjunction with their advisers, re-examine their culture, behaviours and practices regarding the advice process with the aim of raising

14 Financial Systems Inquiry, *Final Report*, November 2014, p. 217, <http://fsi.gov.au/> (accessed 1 March 2016).

15 Mr John Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, 26 March 2015, p. 26, <https://www.afa.asn.au/life-insurance-reform> (accessed 1 March 2016).

16 *House of Representatives Hansard*, Second Reading Speech, 11 February 2016, p. 9.

consumer understanding of life insurance, ensuring informed consent from clients and reducing the administrative burden on advisers; and

- that a Life Insurance Code of Practice be developed that is modelled on the General Insurance Code of Practice and aimed at setting standards of best practice for life insurers, licensees and advisers for the delivery of effective life insurance outcomes for consumers.¹⁷

1.20 This bill reflects the above recommendations and the comprehensive consultation with industry that took place.¹⁸

Purpose of the bill

1.21 In the second reading speech, the Minister for Small Business and Assistant Treasurer, the Hon. Kelly O'Dwyer, stated that:

The life insurance sector is vital for our community. Life insurance advisers and product manufacturers help to provide essential financial security to Australians and their families. However, recent inquiries have shown that there is a clear need for change in the sector.¹⁹

1.22 The stated purpose of the bill is to better align the interests of consumers and those providing advice.²⁰ The government argues that, as a result of this alignment of interests, consumers will benefit through improved quality of advice, more product choice and enhanced competition.²¹

1.23 Minister O'Dwyer acknowledged the contribution of the financial planning and insurance industries, stating that the bill is the product of hard work and compromise on the part of the industry. The reforms have the support of the FSC, Financial Planners Association (FPA) and AFA.²²

1.24 The FSC has also been tasked with creating a Life Insurance Code of Practice. The Code will be similar to existing codes for banking and general insurance and would set out best practice standards for insurers, including in relation to underwriting and claims management.²³

17 Mr John Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, 26 March 2015, pp. 7–11, <https://www.afa.asn.au/life-insurance-reform> (accessed 1 March 2016).

18 *House of Representatives Hansard*, Second Reading Speech, 11 February 2016, p. 10.

19 *House of Representatives Hansard*, Second Reading Speech, 11 February 2016, p. 9.

20 *Explanatory Memorandum*, p. 3.

21 *House of Representatives Hansard*, Second Reading Speech, 11 February 2016, p. 9.

22 *House of Representatives Hansard*, Second Reading Speech, 11 February 2016, p. 9. See also, Financial Services Council, *Submission 37*; Financial Planning Association, *Submission 35*; Association of Financial Advisers, *Submission 44*.

23 The Hon. Kelly O'Dwyer MP, *Government announces significant improvements to life insurance industry*, 6 November 2015, <http://kmo.ministers.treasury.gov.au/media-release/024-2015/> (accessed 29 February 2016).

Commencement

1.25 These provisions commence on 1 July 2016 or the day after Royal Assent, whichever occurs later.²⁴

1.26 Transitional provisions apply to certain arrangements, which are outlined below.

Financial impact

1.27 The bill is not expected to have an impact on federal revenue.²⁵ However, the committee notes that the estimated increase in annual compliance costs for the industry is \$27.8 million.²⁶

Key provisions of the bill

1.28 The bill has one schedule comprising six items.

1.29 The bill removes the exemption from the ban on conflicted remuneration; confers a power on ASIC to make a legislative instrument; provides for the collection of data by ASIC; and puts in place transitional arrangements.

Removal of the exemption from the ban on conflicted remuneration

1.30 The *Corporations Act 2001* (Corporations Act) contains a ban on conflicted remuneration. Conflicted remuneration means any benefit, whether monetary or non-monetary, given to a financial services licensee, or their representative, who provides financial product advice to persons as retail clients that, because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the choice of financial product recommended or the financial produce advice given to retail clients.²⁷

1.31 Currently, paragraph 963B(1)(b) of the Corporations Act provides a broad exemption from the conflicted remuneration ban for benefits paid in relation to certain life risk insurance products.²⁸ The bill will remove the exemption and substitute two new paragraphs. Instead, benefits paid in relation to life risk insurance products (including commissions and volume-based payments) are subject to the ban on conflicted remuneration, unless they satisfy the criteria in the ASIC instrument.²⁹

1.32 The components on which a commission may be payable are introduced under a concept of 'policy cost'.³⁰

24 *Explanatory Memorandum*, p. 12.

25 *Explanatory Memorandum*, p. 3.

26 *Explanatory Memorandum*, p. 20.

27 *Corporations Act 2001*, section 963A.

28 *Explanatory Memorandum*, p. 5.

29 *Explanatory Memorandum*, p. 7.

30 *Explanatory Memorandum*, p. 7.

ASIC's power to make a legislative instrument

1.33 The bill will also give ASIC the power to make a legislative instrument to set out:

- the maximum level of upfront and ongoing commission payments permitted in relation to life insurance products; and
- the amount of upfront commissions to be repaid to life insurers ('clawback').

1.34 ASIC has released a consultation paper detailing its proposed response.³¹ Comments were required by 29 January 2016 and ASIC is currently considering the 15 submissions that it has received.³²

Maximum level of upfront and ongoing commission

1.35 As part of the powers conferred on it, ASIC will specify maximum upfront and ongoing commission amounts. There will be a transitional period of three years to allow the industry to adapt to the new regulatory environment. In respect of commissions, ASIC will prescribe:

- maximums permissible between 1 July 2016 – 30 June 2017;
- maximums permissible between 1 July 2017 – 30 June 2018; and
- maximums permissible from 1 July 2018 onwards.³³

1.36 Where a life insurer adopts an upfront or hybrid commission model, the government proposes that the commission levels would be set at:

- from 1 July 2016 – 80% of the premium in the first year of the policy;
- from 1 July 2017 – 70% of the premium in the first year of the policy; and
- from 1 July 2018 – 60% of the premium in the first year of the policy.³⁴

1.37 The level of maximum ongoing commission would be set at 20 per cent of the premium in all subsequent years.³⁵

31 Australian Securities and Investments Commission, *Consultation Paper 245: Retail life insurance advice reforms*, December 2015, <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2015-releases/15-384mr-asic-consults-on-implementation-of-retail-life-insurance-advice-reforms/> (accessed 7 March 2016).

32 Australian Securities and Investments Commission, *Submission 36*, p. 4.

33 *Explanatory Memorandum*, pp. 10–11.

34 The Hon. Kelly O'Dwyer MP, *Government announces significant improvements to life insurance industry*, 6 November 2015, <http://kmo.ministers.treasury.gov.au/media-release/024-2015/> (accessed 29 February 2016).

35 The Hon. Kelly O'Dwyer MP, *Government announces significant improvements to life insurance industry*, 6 November 2015, <http://kmo.ministers.treasury.gov.au/media-release/024-2015/> (accessed 29 February 2016).

Clawback arrangements

1.38 The bill also confers power on ASIC to prescribe 'clawback' arrangements, which apply to a situation where a certain portion of the upfront commission is paid back to the life risk insurer from the financial adviser.³⁶

1.39 Clawback occurs in the first two years of a policy where the product is cancelled or is not continued, other than because a claim is made under the insurance policy or because other prescribed circumstances exist.³⁷ ASIC has the power in the ASIC Instrument to determine the amount, or a way of working out the amount, that is an acceptable payment under the clawback arrangements.³⁸

1.40 The government indicated that, from 1 July 2016, the following clawback arrangements will apply:

- when a policy lapses or the premium decreases in the first year of the policy, 100 per cent of the commission on the first year's premium to be clawed back; and
- when a policy lapses or the premium decreases in the second year of the policy, 60 per cent of the commission on the first year's premium to be clawed back.³⁹

Reporting data to ASIC

1.41 The government has requested that ASIC undertake a review in 2018 to assess whether the reforms embodied in the bill have succeeded in better aligning the interests of advisers and consumers.⁴⁰ In order to complete this review, ASIC will need access to policy replacement data.

1.42 A new paragraph will be inserted at the end of subsection 912C(1A) of the *Corporations Act 2001* to allow ASIC to collect this information.⁴¹

Transitional arrangements

1.43 The removal of the exemption applies to benefits that are given under an arrangement that was entered into on or after the date of commencement.⁴²

1.44 This amendment will also apply where an arrangement was entered into before the date of commencement but the life product was not issued within three months after the commencement date.⁴³

36 *Explanatory Memorandum*, p. 11.

37 Schedule 1, item 5, subsections 963BA(3) and (4).

38 Schedule 1, item 5, subsections 963BA(3) and (4).

39 The Hon. Kelly O'Dwyer MP, *Government announces significant improvements to life insurance industry*, 6 November 2015, <http://kmo.ministers.treasury.gov.au/media-release/024-2015/> (accessed 29 February 2016).

40 *Explanatory Memorandum*, p. 11.

41 Schedule 1, item 1, paragraph 912C(1A)(e).

42 Schedule 1, item 6, section 1549A and subsection 1549B(1).

1.45 The effect of these transitional arrangements is to grandfather commissions and volume-based payments that are made under pre-existing arrangements in relation to pre-existing policies.⁴⁴

43 Schedule 1, item 6, paragraphs 1549B (2)(a) and (b).

44 *Explanatory Memorandum*, p. 13.

