

Review of Retail Life Insurance Advice

Final Report

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Foreword

This report recommends extensive reform to the life insurance and financial advice sectors in Australia.

The catalyst for this report was the ASIC Review of Retail Life Insurance Advice of October 2014 which criticised quality of advice and misaligned financial incentives. In an immediate industry response, the Association of Financial Advisers and Financial Services Council engaged me to chair the Life Insurance Advice Working Group in order to develop a set of independent recommendations on these issues.

This review comes after five years of discussions on life insurance advice practice and regulation, so the time has come to act. The industry needs some transformational change and the recommendations in this report will deliver such change. They are the culmination of a five-month review into life insurer and advice practices.

Life insurance is a very important financial product for our community. It protects Australians against disastrous financial outcomes when people unexpectedly die, sustain a serious illness or accident, or lose their ability to earn income. Yet underinsurance in Australia remains at very high levels.

As a result of poor practices in the financial advice industry as a whole, the financial advice laws have recently undergone substantial reforms (the Future of Financial Advice or FoFA reforms). These reforms prohibit conflicted payments (particularly commissions) but, when announced in 2010, life insurance was exempted. Hence, while the remainder of the financial advice industry was subjected to transformational reforms, life insurance was excluded.

Australians who seek personal financial advice when taking up life insurance generally achieve more appropriate levels of insurance cover, a better quality policy or contract and the benefit of thorough medical underwriting at the time of the advice. Nevertheless the advice industry has dented its standing following a series of instances of poor advice, conflicts and mis-selling.

These problems have been well ventilated in recent years. This report now delivers a package of reforms designed to place the consumer at the centre of what life insurers and advisers do. It is intended to –

- ensure there is trust and confidence in the retail life insurance market;
- encourage consumers to seek personal life insurance advice, being the best way to purchase insurance if the advice is professional and effective;
- achieve the aim of more Australians having appropriate levels of life insurance protection;
- remove misaligned financial incentives being offered to advisers and licensees;
- contribute to the sustainability of adviser businesses and a competitive life insurance industry;
- encourage the industry continually to adapt and to become more efficient and productive.

The recent Financial System Inquiry made a clear recommendation that these issues now be acted upon and resolved. This report is an opportunity to present a broader and more comprehensive package of reforms than suggested by the FSI. The report deals with conflicts, incentives and industry structure across the complete value chain from insurer to licensee to adviser to consumer.

The package as recommended may be the last chance for the industry to shape the future of retail life insurance through a genuinely “co-regulatory” approach. Taking account of the thoroughness and timeliness of this review, now is the time for the life insurance industry and life insurance advisers to act on these recommendations.

John Trowbridge
Independent Chairman, Life Insurance Advice Working Group

Executive Summary

Background to the Life Insurance and Advice Working Group

Quality advice and improved life insurance coverage across the community are essential to the wellbeing of all Australians. This is recognised by the financial advice and life insurance industries who are determined to rebuild trust and confidence in the life insurance sector.

ASIC's *Review of retail life insurance advice* (October 2014) urged the development of industry-wide solutions for the misaligned incentives that ASIC found were influencing the quality of life insurance advice.

In immediate response, the Association of Financial Advisers and the Financial Services Council established the Life Insurance and Advice Working Group (LIAWG) in October 2014, with myself as its independent Chairperson with the following objectives:

"The LIAWG will review ASIC's report and make recommendations on how the industry can respond to the issues identified to ensure that Australians are adequately insured and receive world class financial advice."

The full Terms of Reference are reproduced in Appendix 1.

Background to this report

This report succeeds an Interim Report that was issued in December 2014. It was prepared after extensive consultation and it invited submissions from interested parties. A total of 137 submissions were ultimately received by early February 2015. These submissions contain a wealth of information, suggestions, ideas, opinions and analyses associated with the four subject areas of the Interim Report, namely *quality of advice; remuneration and other adviser incentives; insurer product offerings; and industry productivity*.

This report includes a set of recommendations that have been prepared after due consideration of all the submissions and of consultation with selected authors of submissions.

Independence

This report was sponsored by the AFA and the FSC. Both parties pledged at the outset that my role as chairman of the Working Group was to act independently and not as an advocate for the interests of the AFA or FSC.

It is important that I acknowledge the efforts of Brad Fox and Sally Loane, CEOs respectively of the AFA and the FSC, other members of the Working Group and others associated with both organisations. They have all contributed to protecting my independence and the integrity of my work throughout this process. Accordingly, the recommendations in this report are mine and mine alone.

It will be a matter for each of the AFA and the FSC and their respective members to decide how they wish to respond to the recommendations. The issuing of this report does not imply its endorsement, in whole or in part, by the AFA or the FSC or anyone else associated with the project.

The ASIC Review and the FSI Report

In its Review of Retail Life Insurance Advice released in October 2014, ASIC expressed concerns about high lapse rates in life insurance and the quality of advice being given by some financial advisers. It went on to recommend that insurers –

- address misaligned incentives in their distribution channels;
- address lapse rates on an industry-wide and insurer by insurer basis;
- review their remuneration arrangements to support good-quality outcomes and better manage conflicts of interest;

and that licensees –

- ensure remuneration arrangements that support good-quality advice and prioritise client needs;
- review business models to provide incentives for strategic life insurance advice;
- review the training and competency of advisers;
- increase the monitoring and supervision of advisers.

The Financial System Inquiry (FSI) report was released in December 2014, just one week before the Interim Report. It included as Recommendation 24:

“Better align the interests of financial firms with those of consumers ... and ensuring remuneration structures in life insurance ... do not affect the quality of financial advice”

The FSI report acknowledged the high initial arranging costs of insurance and, notwithstanding this acknowledgement, it recommended *“a level commission structure ... that is sustainable and that considers the findings of the LIAWG process during the development and implementation phases”*. It was also explicit that it was not recommending banning all commissions.

The industry challenge – transformation needed?

The ASIC Review and the subsequent FSI report are challenging, even confronting, for the industry, which comprises life insurers, financial advisers and their licensees.

There are several strands running through the overall task of trying to improve the quality of life insurance advice and simultaneously to remove or minimise misaligned incentives.

Recognising that these various strands need tying together and that this review presents a rare opportunity to put forward an integrated solution, I have approached it by reference to an overarching goal. This goal is to improve the *alignment of interests across the life insurance value chain*, from insurer to licensee to adviser to consumer (where the licensee is the dealer group that engages and is responsible for the conduct of advisers).

In identifying the various elements of the value chain that might be modified to improve the alignment of interests, I have come to understand that there are numerous interests and conditions to be satisfied if there is to be the kind of life insurance industry transformation that is indicated by the ASIC Review, the FSI report and the interest of the general community in seeing improved advice standards, minimisation of conflicts of interest and improved outcomes for consumers.

The primary industry challenges are -

- To introduce modified remuneration arrangements for advisers and licensees that minimise conflicts inherent in existing arrangements, especially the perverse incentives or temptations associated with high initial commissions and the replacement policy or “churn” problem, whereby under existing commission arrangements there can be a large financial reward to the adviser for replacing an existing policy with a new one.
- To improve customer value through reducing or removing some of the inefficiencies and conflicts in the industry, so as to enable advisers to operate with lower costs and for consumers to receive the benefits by way of improvements in access to advice of high quality, accompanied if possible by some price reductions.
- To improve advice standards through the upgrading of education, training and professional requirements, better client engagement and a more streamlined process through the three stages of the advice and sales process, which are strategic advice, product advice and product placement.

In seeking to minimise conflicts of interest, the most important element is restructuring the remuneration that advisers receive from insurers.

For reference, standard commission arrangements are:

Upfront commissions” or “Full upfront commissions”:

120% of the Year 1 premium and 10% of all subsequent premiums

“Hybrid commissions”

80% of the Year 1 premium and 20% of all subsequent premiums

“Level commissions”:

30% of each year’s premiums.

Recommendations

In response to the ASIC review, the FSI report and the submissions received following the Interim Report, this report makes recommendations on -

- adviser remuneration;
- licensee remuneration;
- quality of advice; and
- insurer practices including a Life Insurance Code of Practice.

This suite of recommendations is a “package” which, taken as a whole, is designed to achieve improved alignment of interests, including the removal of conflicts of interest over remuneration and advice, along with efficiency gains in the life insurance and advice sectors. These steps are expected to generate culture changes and also to deliver improved quality of advice, better value for consumers and greater trust and confidence in the industry.

Adviser remuneration

The recommendations on adviser remuneration are the cornerstone of the package and can be referred to as a Reform Model supported by a three year Transition Plan.

The Reform Model can be described as level commissions supplemented by an Initial Advice Payment available at a client's first policy inception and then no more often than once every five years, where:

- the level commission is a maximum of 20% of premiums;
- the Initial Advice Payment (IAP) is paid by the insurer to the adviser **on a per client basis** (usually the insured life);
- the IAP is available to the adviser when a client first takes out a life insurance policy and then no more often than once every five years (the "five year rule"); and
- the IAP is a maximum of \$1,200 or, for customers with annual premiums below \$2,000, no more than 60% of the first year's premiums.

Further, to support the integrity of the Reform Model, it is recommended that:

- the IAP be available only on advised business (i.e. for personal advice only and not available for general advice, either through direct sales or other agency sales or through group life policies inside superannuation funds);
- existing arrangements for retention periods ('clawbacks') apply to commission on the first year's premium and to the IAP if there is one;
- all commission or other payments from insurer to adviser be fully transparent to the client with the adviser disclosing clearly whether any insurer payments represent full, partial or nil commissions; and
- the adviser and client remain free to agree on fees for service that are additional to the insurance premium.

The single IAP is intended to address the problem of an adviser having a financial incentive to replace a client's existing policy with a new one, often referred to as "policy churn", because it will mean that when new policies are written for existing advised clients, no payments beyond the level commission are made until at least five years after the last IAP was paid.

Setting the IAP at \$1,200 is intended to make a contribution to cost recovery for advisers while falling short of full cost recovery, which is variously estimated at between about \$1,500 and \$3,500 per client. It is aimed at delivering a balance between acknowledging the initial costs of advisers and eliminating any behavioural doubt as to whether the client's interests are being placed ahead of the adviser's own interests.

The overall financial effect of this Reform Model has been estimated, through some preliminary actuarial work, to reduce aggregate costs of life insurance protection by between 5% and 10%. It will take some time for cost reductions to emerge but, if and when they do, it is reasonable to expect in a competitive market that they would manifest themselves through price reductions.

Some will question the wisdom of allowing any IAP at all, especially in the light of the FSI report advocating level commissions only. If, however, there were no initial payment to advisers beyond renewal commission, there would be a substantial mismatch between initial advice costs and initial adviser revenue. This degree of mismatch would be debilitating to the advice industry because, although there is a case for advisers achieving less than full cost recovery when taking on new life insurance clients, in the absence of any such initial payment at all -

1. the funding of advisers' initial costs would be problematic and would likely concentrate the market in the hands of the larger institutions;
2. it is highly likely that large numbers of financial advisers, including representatives of most of the independently owned adviser groups and perhaps as many as half altogether, would cease to offer life insurance advice. The diminished supply of such advice would likely exacerbate greatly the underinsurance problem in Australia;
3. the withdrawal of so many advisers from the market would most likely have the greatest effect on supply of advice to lower and middle income families and businesses rather than to higher income earners; and
4. the mismatch between adviser costs and revenues would likely create a "client churn" problem where advisers would find it financially attractive to persuade clients of other advisers to change allegiance instead of pursuing the goal of introducing new consumers to the benefits of life insurance protection, thereby having the effect of reducing competitive advice services to the community and exacerbating further the advice supply problem.

It is also worth noting that, given that it is not feasible in the foreseeable future to operate the life insurance advice business exclusively on a fee for service basis, this Reform Model with its reduced initial payments for large policies and the "anti-churn" single IAP, should give ample encouragement for more advisers to introduce fees for service for their clients, especially those with larger policies.

The transition to a *per client* basis in place of a *per policy* basis for the IAP can be expected to cause a progressive adjustment in the thinking of insurers, licensees and advisers towards a client or consumer orientation rather than a product mindset.

The imposition of these maximum commission terms for advisers can be expected to sustain a competitive life insurance industry and a competitive financial advice industry. It would oblige the insurers to compete on products, prices and services to consumers through advisers and licensees instead of, as at present, by competing for the favours of licensees and advisers.

This regime would also assist advisers to continue to compete for customers through the quality of their own services and the support they can receive from their licensees and from insurers, but without the terms of their own remuneration interfering with either the competitive offerings of life insurers to customers or the quality of advice and services they offer to their clients.

The combination of level commissions with a client-based IAP and the five year rule represents a major change from current arrangements. It is designed to be the primary contribution towards industry transformation.

Policy Recommendation 1: That the Reform Model for adviser remuneration, being 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, be adopted by the life insurance industry with progressive application through a transition period.

The Transition Plan has two phases –

The first phase is where the five year rule is to apply on a best endeavours basis by insurers and licensees. It is recommended to commence as soon as possible, say 30 June 2015. In all other respects current arrangements would remain in place pending the second phase.

The second phase will require some form of regulation, to begin from a suitable date in 2016 and is where –

- the maximum commissions are to be on the current hybrid basis with a cap, so that the maximum initial commission is 80% of premiums capped at \$8,000 and maximum renewal commission is 20%;
- for the purposes of the five year rule, the initial commission is to be treated as a recurring component of 20% and an IAP of 60% of premiums; and
- this arrangement is to continue for two years pending full introduction of the Reform Model.

With all but approximately 20% of business currently being written on upfront commissions of the order of 120% of premiums, it will be a major adjustment for many advisers to move into this second phase of the transition with maximum initial commissions of 80% of premiums.

Nevertheless, with limited administrative disruption to existing arrangements during the transition period, a total of 3 years to prepare for the Reform Model should allow enough time for insurers, licensees and advisers to modify their systems, procedures and practices to accommodate the Reform Model.

At the end of the transition period, all business written in the preceding two years will have a 20% renewal commission and will therefore already be well adapted for the Reform Model.

Policy Recommendation 2: 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 2 years, the industry operate according to the current hybrid commission arrangements with a cap on initial commissions.

Licensee remuneration

It is important that non-commission remuneration and other benefits granted by insurers to licensees do not contain any incentives that might compromise the effectiveness of the Reform Model for adviser remuneration or otherwise compromise the ability of advisers to choose freely, in their clients' interests, the most suitable providers of insurance protection for their clients.

Examples of the non-commission benefits commonly available to licensees are volume-based payments, free or subsidised business equipment and services, hospitality-related benefits, shares or other interests in a product issuer or dealer group, marketing assistance and some 'buyer of last resort' arrangements.

These practices can create conflicts of interest for licensees that affect advised clients because in effect the conflicts are transmitted to their advisers. The advisers themselves may not always be aware of these practices of their own licensees.

These practices are currently prohibited under the FoFA legislation in respect of investment products but life insurance products have been exempted from this prohibition. The relevant legislative clause prohibits benefits to licensees that can be expected to influence recommended investment product choices or the investment advice given by the licensee's advisers.

The integrity of the adviser remuneration recommendations in this report depends in part on these licensee conflicts being eliminated. The recommended method of achieving this goal is to arrange for the element of the FoFA legislation that deals with these same licensee conflicts for investment products to be applied also to insurance products.

In addition, to contribute to the viability of independent licensees, it is recommended that licensees be able to receive from life insurers Licensee Support Payment (LSPs) equal to a maximum of 2% of premiums in force. These payments are for the purpose of providing services to advisers and would not be allowed to be passed on to advisers in the form of extra commissions.

Policy Recommendation 3: That licensees be prohibited from receiving benefits from insurers that might influence recommended product choices or the advice given by the licensees' advisers.

Approved Product Lists and choice of insurer

All licensees operate an Approved Product List (APL) that contains a selection of life insurers from among the current list of 13 providers that service the retail life insurance market. Some licensees use as few as one insurer while some licensees have an "open architecture" approach that lists all 13 insurers.

An APL that provides good market coverage across life insurance providers will increase the level of product choice, market competition and consumer access to life insurance products and services including pricing, underwriting, administration and claims management.

Licensees need to strike a balance between a licensee's desire to limit its APL so as to contain risk and administrative costs on the one hand and, on the other hand, the need for advisers to have adequate choice to meet their Best Interest Duty to their clients. Accordingly, it is recommended that all licensees include at least half of all retail life insurance providers on their APLs.

This recommendation is aimed at improving access to life insurance products for all advisers whose licensees currently have a narrow APL and encouraging all licensees to review their insurance APLs regularly.

Policy Recommendation 4: 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 (APL) at least half of the authorised retail life insurance providers.

The Advice Process and Statements of Advice

To raise consumer understanding of life insurance, ensure informed decision-making from clients and reduce the administrative burden on advisers, this report recommends that culture, behaviours and practices regarding the advice process be re-examined and modified where appropriate. This means addressing, client engagement and client education elements of the advice process as well as ensuring that documentation is appropriate to achieve the stated objectives.

ASIC's recent review of life insurance advice suggests that consumers are not receiving appropriate levels of strategic advice. Advice processes with a narrow focus on product advice arguably cannot

achieve the required levels of informed client decision-making required to achieve high quality consumer outcomes.

There also appears to be an emphasis on compliance by some licensees that can overshadow the need to promote client service and effective client decision-making. The length of SoAs highlighted in many submissions is one symptom of this emphasis. This approach may be thought to protect licensees and advisers but can detract from real consumer engagement and understanding. This balance needs to be redressed so that the needs of the client are at the heart of each advice interaction and that the advice process supports informed client decision-making.

To achieve this outcome, it is recommended that the life insurance advice industry, in consultation with ASIC and relevant stakeholders, develop a best practice advice process supported by proven or well researched approaches to client engagement, education and advice delivery. This report considers measures that may form part of the process including enhanced adviser training and education, high standards of client engagement and education, shorter SoAs and clearer regulatory guidance from ASIC.

Policy Recommendation 5: That all licensees, in conjunction with their advisers, re-examine their culture, behaviours and practices regarding the advice process with the aim of raising consumer understanding of life insurance, ensuring informed consent from clients and reducing the administrative burden on advisers.

Insurer practices

A Life Insurance Code of Practice, if embraced by industry participants including insurers and advisers, can lead to improved standards of service and advice to consumers and thereby to improved trust and confidence in the industry. If realised, these benefits can be expected to flow on to a greater interest by consumers in seeking life insurance advice and improved life insurance coverage across the community.

The general insurance industry and the banking industry, among others, have had codes of practice in force for some years. These codes have added discipline and fairness to the product providers and have been favourable for consumers. These experiences in developing and applying the codes can and should now be drawn upon by the life insurance industry.

Policy Recommendation 6: 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.

Implementation

The above suite of recommendations can be implemented only if most elements of the recommendations are the subject of some form of regulation, whether that is self-regulation or externally imposed regulation.

Regulation can take several forms. The Government can introduce legislation or regulations; or ASIC can impose conditions or requirements on insurers, licensees or advisers; or the ACCC can authorise activities or arrangements that might otherwise be deemed anti-competitive; or the industry can impose its own self-regulatory mechanisms.

Adviser remuneration and licensee remuneration

It is essential for the integrity of the recommendations on adviser remuneration and licensee remuneration that there be some kind of externally imposed regulation on the industry. An effective form of this regulation, given the nature of the regulation required and the ability of ASIC to maintain an associated compliance regime, is likely to be the imposition by ASIC of licensing conditions on life insurers. These conditions would oblige all life insurers, and through them all licensed adviser groups (generally referred to as licensees in this report) by means of the contractual relationships between insurers and licensees, to conform to the Reform Model, the Transition Plan and the avoidance of conflicts of interest by licensees.

Implementation Recommendation 1: That ASIC be asked to endorse Policy Recommendations 1, 2 and 3 relating to adviser remuneration and licensee remuneration and, on the basis of that endorsement, to impose a suitable set of licensing conditions on life insurers that would give effect to these three recommendations.

Approved Product Lists

Implementing a minimum APL of half of the retail insurance providers and undertaking regular reviews of the list, perhaps annually, could be undertaken voluntarily by all licensees. It is also, however, a matter that could usefully be included in the proposed new Life Insurance Code of Practice where it would have more force and would give consumers greater confidence that all advisers were in a position to select insurance products from a good cross-section of the market.

Implementation Recommendation 2: That the recommendation that all licensees include at least half of the authorised retail life insurance providers on their APL be implemented by all individual licensees as soon as practicable and that ASIC review APL practices in order to provide suitable guidance to licensees in this area.

The Advice Process and Statements of Advice

This report recommends that the life insurance advice industry, in conjunction with ASIC and relevant stakeholders, develop a best practice advice process supported by proven or well researched approaches to client engagement, education and advice delivery. This process should enhance the delivery of strategic life insurance advice and product advice.

Implementation Recommendation 3: That a task force representing professional associations, licensees and advisers be established to explore and make recommendations to the advice sector, in conjunction with ASIC, for improving the advice process and associated documentation.

Life insurance code of practice

The creation of an industry code of practice needs to be a well-constructed consultative process that involves the primary interested parties, namely the life insurers, licensees, life insurance advisers and consumers.

The code will represent a self-regulatory arrangement and it is possible to have it endorsed by ASIC. Its scope needs to be carefully considered, as well as the details of each topic that is included in the scope. Its sound development will not be an easy task but it will be an important step towards achieving improved standards and practices across the industry.

Implementation Recommendation 4: That a Life Insurance Code of Practice as at Policy Recommendation 6 be developed by the life insurance providers in a consultative process that embraces licensees, advisers and consumers.

Post-implementation review

The recommendations in this report, if implemented as proposed, will generate behaviour change, culture change, business model change and overall a life insurance industry and advice industry environment which in a few years' time will be rather different from now. It will take some time to see how the recommendations play out in practice and it is possible that not every aspect will evolve as intended. Given also the magnitude of the changes involved, it is recommended that all the changes made be reviewed in five years' time, in 2020, with a view to assessing their effectiveness against the goals and, if then appropriate, reoriented.

Review Recommendation 1: That changes made in the life insurance industry as a result of the recommendations in this report be reviewed in 2020 to assess their effectiveness and, if then appropriate, to make further changes for the benefit of consumers and the industry.

As already noted, this suite of recommendations is a "package" which, taken as a whole, is designed to achieve improved alignment of interests, including the removal of conflicts of interest over remuneration and advice, along with efficiency gains in the life insurance and advice sectors. These steps are expected to generate culture changes and also to deliver improved quality of advice, better value for consumers and greater trust and confidence in the industry.

1. Overview

This independent report responds to the objective in the Life Insurance and Advice Working Group's Terms of Reference to make recommendations on how the industry can respond to the issues identified in the ASIC Report 413 – Review of Retail Life Insurance Advice in a way that ensures that Australians are adequately insured and receive world class financial advice.

This Final Report makes six policy recommendations relating to the retail life insurance and advice industry. It also makes four implementation recommendations and one post-implementation review recommendation. These recommendations reflect my views as independent chairman of the Working Group. They have been developed after taking into account the extensive written submission in response to the Interim Report and through consultations which began in October 2014 and continued until March 2015. In total 137 submissions were received from a wide range of interested parties including insurance companies, adviser groups, individual advisers, consumer advocates and other interested parties. A brief indication of the range of these submissions is in Appendix 3.

This chapter provides an overview of this Final Report. It outlines the views taken on how the retail life insurance and advice industry can strengthen trust and confidence in the life insurance sector. It includes outlining the context in which the recommendations have been made and discusses what the industry needs to achieve. It also outlines the package of recommendations and discusses how the recommendations are expected to improve industry productivity and innovation. Finally, it outlines how the recommendations respond to the ASIC Review.

Context

The FoFA legislative reforms (“Future of Financial Advice” reforms) represent the then Government's response to the recommendations of the “Ripoll Inquiry”, a Parliamentary Joint Committee on Corporations and Financial Services (PJC) inquiry into financial products and services in Australia. The Ripoll Inquiry recommended a ban on remuneration payments that influence the advice provided to the client and it specifically considered whether life insurance products should be exempted from any ban on remuneration (and other additional regulatory obligations). This consideration indicated an implicit view from the Ripoll inquiry that underinsurance was a significant issue and that the positive benefits that life insurance provides to individuals and the broader community merited considering how to encourage consumers to take up these products. Further, it reflected concerns that removing insurer payments to advisers would substantially increase the costs to individuals of acquiring insurance. The recommendations included in the report had bi-partisan support.

In the final implementation of the FoFA reforms, the Government decided that the ban on commissions for investment products should not apply to retail risk insurance advice. However, it was noted by the then Government at the time that:

“The Government considers that other aspects of the FOFA reforms, such as the introduction of a best interests duty, will ensure that clients are only advised to switch policies when it is in their best interests. However, ‘churn’ and the broader impact of the

ban on commissions within superannuation are areas that the Government will continue to monitor closely into the future.”¹

Initially, the life insurance and advice industry appeared to have escaped major structural change. Its exemption from the Future of Financial Advice regulation against conflicted remuneration meant that adviser remuneration for life insurance sales remained untouched. Nevertheless, the industry was well aware that inappropriate policy replacement that attracts substantial commissions was a problem that had to be tackled.

As a result, the life insurance and advice industry in 2012 attempted to deliver a solution to the Government’s concerns relating to this problem. Unfortunately by 2013 this process failed to yield any outcome.² At the time, it was made clear by the Government and ASIC that the Government expected the industry to go back to the table on this problem.³

Subsequently, the prominence of this replacement policy problem has become more pronounced, with industry failing to take action to develop a self-regulatory response in the interim. High profile cases leading to consumer detriment, such as Commonwealth Financial Planning v Couper 2013, have adversely affected consumer trust and confidence in retail life insurance advice.

The recent ASIC Review, which was instigated after the failure of the industry to self-regulate since 2012, has compounded consumer concerns. Statements made by ASIC in its report suggest that remuneration arrangements create an incentive to offer advice that may not be in the best interest of the client (notwithstanding the legal requirements of the best interests duty), for example -

“High upfront commissions give advisers an incentive to write new business. The more premium they write, the more they earn. There is no incentive to provide advice that does not result in a product sale or to provide advice to a client that they retain an existing policy unless the advice is to purchase additional covers or increase the sum insured.” –Para.147

and –

“A remuneration arrangement tied to a product sale creates an incentive for the adviser to make a sale, rather than provide non-product-specific advice or strategic advice for which the adviser may not be paid.” – Para. 161

ASIC’s overall view is that current practices appear to be entrenched and an industry-wide solution is required to improve adviser incentives and their impact on the quality of advice and noted that:

“...an individual insurer may change its remuneration arrangements to mitigate the effect of conflicts of interest amongst advisers selling their policies, but is likely to lose business to competitors.” –Para.21

A ‘first mover’ disadvantage for insurers attempting to unilaterally change commission structures has prevented the industry to date from solving misaligned incentives due to commission structures. This type of competition is detrimental to consumers as it perpetuates existing commission arrangements and associated incentives.

¹ Commonwealth of Australia (2011) ‘*Future of Financial Advice Information Pack*’, available at

<http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf>

² riskinfo (2013) ‘*FSC Abandons ‘Churn’ Policy*’, available at: <http://riskinfo.com.au/news/2013/02/14/fsc-drops-churn-policy/>

³ riskinfo (2013) ‘*Government Pressures FSC to Re-Open Churning Debate*’, available at

<http://riskinfo.com.au/news/2013/05/29/government-pressure-fsc-to-re-open-churning-debate/>

The ASIC Review, in not specifying a preferred policy option and instead focusing on identifying and contextualising the misaligned incentives in the industry, has laid down the gauntlet to the industry to find an alternative to commission arrangements that create conflicts of interest for advisers. Since its release, a growing chorus of interested parties including consumer, regulatory and political representatives has called for an end to high front-loaded commission payments for life insurance products. Many of these commissions are currently around 120 per cent of the first year's premium.

The Financial System Inquiry also weighed into the issue, recommending a level commission structure, where the first year's commission is no greater than renewal commissions. Although the issues regarding financial advice go beyond commissions, current commission structures represent one of the more obvious areas for reform to restore consumer trust in the industry.

Structural change is firmly on the agenda. The life insurance and advice industry is looking at a major opportunity to develop on its own a package of reforms that will deal with the misaligned incentives within the industry. In the current climate of heightened consumer concern over the quality of financial advice, a failure on the part of the industry to act will almost certainly lead to a solution being imposed on the industry by the Government.

What the retail life insurance and advice industry needs to achieve

The consumer needs to be placed at the centre of what insurers and advisers do. Strong consumer outcomes are the key. An effective response to the ASIC Review will likely herald a transformation of the life insurance and advice industries.

The process initiated by the AFA and the FSC, and of which this report is the final stage, has been characterised by a collective focus on enhancing consumer outcomes and improving trust and confidence in the life insurance industry through the overcoming misaligned financial incentives, improving the quality of advice, addressing underinsurance and maintaining healthy competition in the industry.

Trust and confidence

Ensuring Australian consumers have access to quality life insurance advice and life insurance products that place consumer interests first is imperative.

Improved standards of practice and service will lead to improved trust and confidence in the industry including its products and advice practices. If realised, these benefits can be expected to flow on to a greater interest by consumers in seeking life insurance advice and improved life insurance coverage across the community.

Addressing underinsurance

Life insurance helps protect Australians against the social and economic impacts of premature death and also long term or short term illness, injury or disability that might affect their ability to earn an income. Such insurance coverage is arguably the most important financial protection available to individuals, families and businesses. Yet statistics show that many Australians have either no insurance or insufficient insurance to protect their or their families' financial position.

In responding to the issues raised in the ASIC Review of Retail Life Insurance Advice, we need to keep in mind the significance of life insurance protection, the underinsurance problem that exists in Australia and the role of life insurance advisers. Life insurance is poorly understood and not readily purchased. A key component in addressing these issues is the service provided by financial advisers and life insurance advice specialists. Due to this lack of community awareness around life insurance

and the level of complexity of products, an intermediary is necessary to help provide these products to consumers, unlike other areas of insurance where sales are essentially demand driven.

Also, unlike direct sales of life insurance and group life insurance, the retail sector offers insurance cover tailored specifically to an individual's circumstances and it has other benefits also –

- cover is underwritten;
- advice can span both the superannuation and non-superannuation sectors; and
- advice can include tax-effective strategies to help make insurance more affordable.

In addressing the underinsurance issue in Australia it is important not only to make sure the amount of cover for an individual is appropriate but also to select the right products for the individual's needs. Since a financial adviser is privy to the complete financial picture of a customer, he or she is able to take a holistic approach to offering the best financial protection.

In order to address life insurance penetration and adequacy it is essential that consumer trust and confidence in financial advice and life insurance products be strengthened.

Improving the quality of advice

Retail life insurance advice is particularly important in ensuring that consumers obtain the insurance that they need. It usually takes a consultation with a financial adviser for consumers to understand the financial risks that they are exposed to and the valuable role that life insurance can play in providing them with financial certainty at times of medical crisis or death. The advice discussion can educate clients to understand their own risks, their financial needs should these risks eventuate and the types of insurance that can fund the solution. Without receiving financial advice, most consumers will fail either to identify what is the appropriate life insurance to hold or to persuade themselves to pay for an appropriate amount of insurance cover.

Improving financial and other incentives

Customers need quality advice and so it is important that conflicts of interest do not prevent consumers from receiving this advice. Incentives that create conflicts of interest between the advisers' and consumers' interests need to be minimised.

Maintaining competition and innovation

Better consumer outcomes can be achieved when the life insurance and advice industries and the corresponding regulatory environment are conducive to innovation and competition. The rationale for making changes to the life insurance and advice sectors has been set in the context of thorough consideration of broader competition issues (which may not always be obvious or apparent) and unintended consequences that may ultimately impact on the quality of life insurance coverage available to consumers.

An industry continually looking to adapt, change and become more efficient and productive, will likely deliver substantially better consumer outcomes.

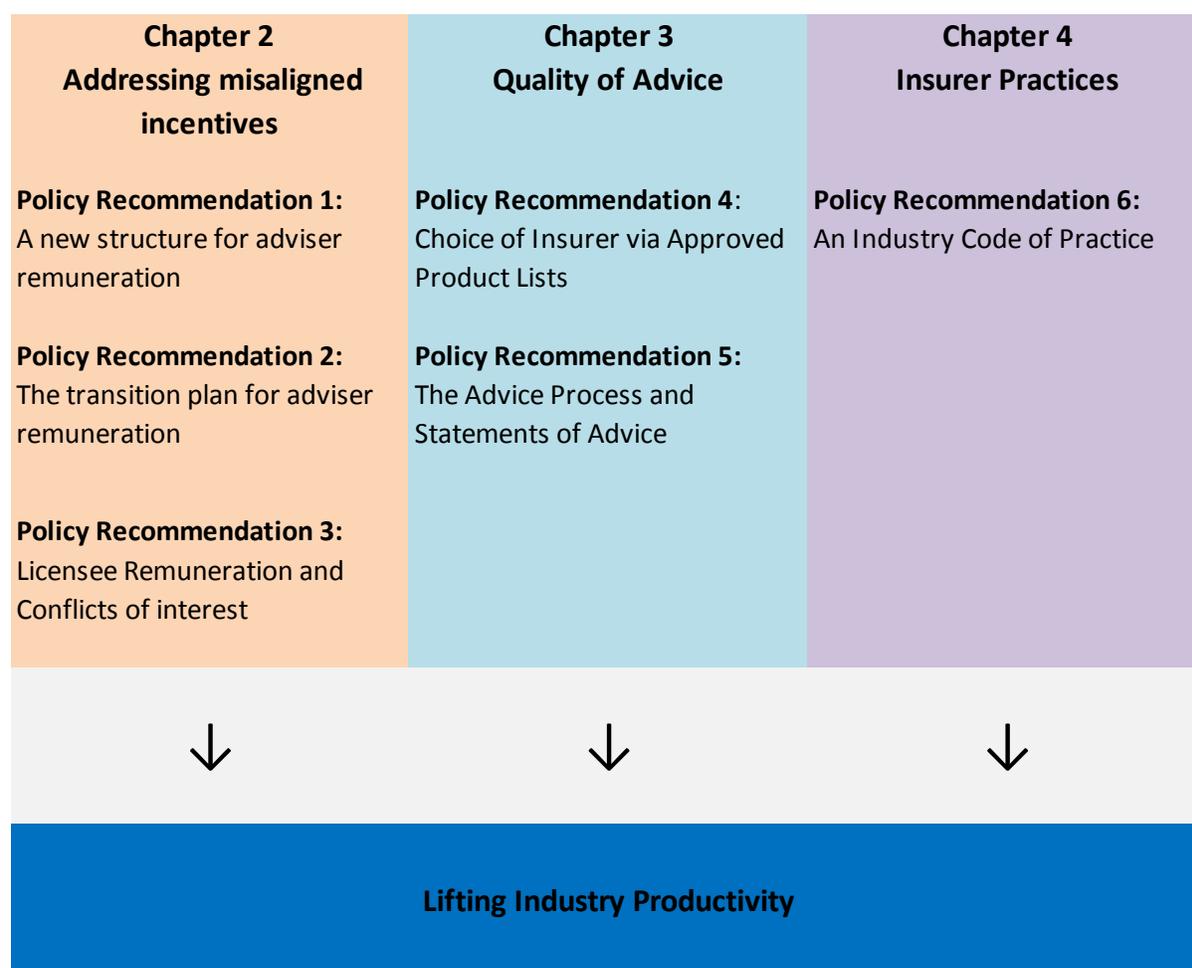
The approach to the issues and how the recommendations address them

This Review has made recommendations across three major themes which comprise the next chapters of this report:

- addressing misaligned incentives;
- improving the quality of advice; and
- improving insurer practices.

Productivity benefits that should support the industry in transition flow from the recommendations relating to these three themes of the report.

Figure 1: Guide to the Final Report



There are two types of recommendations in this report:

- **Policy Recommendations**, which describe the initiatives recommended for the industry in order to address policy objectives identified in the review.
- **Implementation Recommendations**, which describe the proposed mechanisms for implementing the policy recommendations.

There is also a recommendation for a post-implementation review.

Table 1 below summarises the recommendations of the review and matches policy recommendations with implementation recommendations.

Table 1: Policy and Implementation Recommendations

<p>Policy Recommendation 1: That the Reform Model for adviser remuneration, being 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, be adopted by the life insurance industry with progressive application through a transition period.</p>	<p>Implementation Recommendation 1: That ASIC be asked to endorse Policy Recommendations 1, 2 and 3 relating to adviser remuneration and licensee remuneration and, on the basis of that endorsement, to impose a suitable set of licensing conditions on life insurers that would give effect to these three recommendations.</p>
<p>Policy Recommendation 2: 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 2 years, the industry operates according to the current hybrid commission arrangements with a cap on initial commissions.</p>	
<p>Policy Recommendation 3: That licensees be prohibited from receiving benefits from insurers that might influence recommended product choices or the advice given by the licensees’ advisers</p>	
<p>Policy Recommendation 4: 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 (APL) at least half of the authorised retail life insurance providers.</p>	<p>Implementation Recommendation 2: That the recommendation that all licensees include at least half of the authorised retail life insurance providers on their APL be implemented by all individual licensees as soon as practicable and that ASIC review APL practices in order to provide suitable guidance to licensees in this area.</p>
<p>Policy Recommendation 5: That all licensees, in conjunction with their advisers, re-examine their culture, behaviours and practices regarding the advice process with the aim of raising consumer understanding of life insurance, ensuring informed consent from clients and reducing the administrative burden on advisers.</p>	<p>Implementation Recommendation 3: That a task force representing professional associations, licensees and advisers be established to explore and make recommendations to the advice sector, in conjunction with ASIC, for improving the advice process and associated documentation.</p>
<p>Policy Recommendation 6: 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.</p>	<p>Implementation Recommendation 4: That a Life Insurance Code of Practice as at Policy Recommendation 6 be developed by the life insurance providers in a consultative process that embraces licensees, advisers and consumers.</p>
<p>Review Recommendation 1: That changes made in the life insurance industry as a result of the recommendations in this report be reviewed in 2020 to assess their effectiveness and, if then appropriate, to make further changes for the benefit of the industry and consumers.</p>	

The productivity and innovation aspects of the recommendations

At its most basic level, industry productivity reflects the sum of the activities of all individual agents and firms within the industry and reflects how efficiently they operate as a whole. For the retail life insurance and advice industry the actors are life insurers, advisers and insurers.

How life insurers, licensees and advisers allocate their overall resources will be a function of the incentives they face in the market place and how their actions interact with one another. In that way industry productivity for the life insurance and advice industry is inextricably linked to the way the market works including the incentives within and the level of competition.

The recommendations in this review are squarely aimed at changing the incentives faced by life insurers, licensees and advisers. They will have productivity implications for the retail life insurance and advice industry that will grow over time. Although the productivity impacts cannot be predicted or quantified with confidence, there will be productivity improvements as a result of the recommendations.

Innovation and structural changes that occur in response to these recommendations will drive productivity outcomes. Some of the more obvious productivity impacts of the recommendations are discussed below.

Policy Recommendation 1, 2 and 3: A new remuneration model for advisers; the transition plan for adviser remuneration; and licensee remuneration and conflicts of interest

Changing the remuneration structures will change the competitive dynamics of the life insurance and advice industry.

For insurers, lapse rates will likely reduce and commission costs on replacement policies will reduce. The focus will change to how to service and compete on customer service. Emphasis of the insurer should shift from trying to promote insurance to licensees and advisers through generous payments, to a focus on customer service. In a competitive market, these influences should lead to greater efforts towards cost reduction and efficiency, eliminating some of the friction costs that exist in the advice and sales process today. This focus will have flow-on benefits for advisers via improved underwriting and claims services. For example, potential productivity measures referred to in the Interim Report such as tele-underwriting, online applications, automated administration notification and risk data feeds will become more interesting to insurers due to the different nature of competition in the industry. If so, there will be benefits to the end consumer and advisers.

Insurers will need to adjust their systems to adapt to the Reform Model. CRM software will become more significant IT and associated initiatives should create some efficiencies in the advice process and reduce the amount of time taken by advisers to complete the advice process including the time taken to generate a Statement of Advice.

Over time products and product features will adjust to these new incentives. They will likely benefit advisers and licensees, as increasingly flexible and customer focused products are introduced in response to the five year rule.

New remuneration structures for advisers will also see them adjust their business models and their approach to client engagement. The five year rule will cause them to search for different ways to optimise their businesses. For example, advisers are likely to make greater efforts to meet customers' life insurance needs without going through the SoA process unless absolutely necessary.

Policy Recommendation 4: Choice of insurer via Approved Product Lists

Requiring a minimum number of product providers on Approved Product Lists used by licensees will expose some life insurers to more competition on price, terms and service. Further, this recommendation can be expected to remove impediments currently limiting competition and innovation in product features and service. Broader APLs and regular review will improve informational efficiency available to advisers. This enhanced competition should benefit consumers and the advisers who serve them.

Policy Recommendation 5: The advice process and Statements of Advice

There is a significant cost to advisers of creating and providing documents in a compliant format based on current advice process practices. The contents of the SoAs are considered necessary to meet the adviser's legal obligations as determined by the licensee but in some cases are designed to protect the licensee and the adviser from being the subject of legal action by the client. Advisers commonly prepare SoAs relating to insurance advice that exceed 20 pages in length (for insurance only – any investment advice can add another 20 pages or more). Streamlined interaction between the client and adviser should have flow-on impacts on the SoA.

Policy Recommendation 6: An Industry Code of Practice

An effective Life Insurance Code of Practice will contribute to improving a range of practices in the industry. Some of those practices can be expected to improve decision making and the efficiency of advisers and licensees in due course as they work through improved techniques for operating their businesses.

How the recommendations address the directions in ASIC's Review of Retail Life Insurance Advice

ASIC recommended that life insurers –

- address misaligned incentives in their distribution channels;
- address lapse rates on an industry-wide and insurer by insurer basis;
- review their remuneration arrangements to support good-quality outcomes and better manage conflicts of interest;

and that licensees –

- ensure remuneration arrangements that support good-quality advice and prioritise client needs;
- review business models to provide incentives for strategic life insurance advice;
- review the training and competency of advisers;
- increase the monitoring and supervision of advisers.

Figure 2 compares the recommendations in this report with the recommendations made by ASIC to life insurers and licensees. It illustrates which recommendations in this report deal with each of ASIC's recommendations. Taken as a whole, the package of recommendations in this report covers the main areas for improvement identified by ASIC.

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Table 2: How the recommendations address the recommendations in ASIC’s Review of Retail Life Insurance Advice

Trowbridge Policy Recommendation	Insurer			Licensee			
	Address misaligned incentives in their distribution channels	Address lapse rates on an industry-wide and insurer-by-insurer basis	Review their remuneration arrangements to ensure that they support good-quality outcomes for consumers and better manage the conflicts of interest within those arrangements.	Ensure that remuneration structures support good-quality advice that prioritises the needs of the client	Review their business models to provide incentives for strategic life insurance advice	Review the training and competency of advisers giving life insurance advice	Increase their monitoring and supervision of advisers with a view to building ‘warning signs’ into file reviews and create incentives to reward quality, compliant advice
Policy Recommendation 1: A new structure for adviser remuneration	✓	✓	✓	✓	✓	✓	NDR
Policy Recommendation 2: The transition plan for adviser remuneration	✓	✓	✓	✓	✓	✓	NDR
Policy Recommendation 3: Licensee Remuneration and Conflicts of interest	✓	NDR	✓	✓	NDR	NDR	NDR
Policy Recommendation 4: Choice of Insurer via Approved Product Lists	✓	NDR	NDR	NDR	✓	✓	✓
Policy Recommendation 5: The Advice Process and Statements of Advice	NDR	NDR	NDR	NDR	✓	✓	NDR
Policy Recommendation 6: An Industry Code of Practice	✓	✓	✓	NDR	NDR	NDR	NDR

Key	Address ASIC's Recommendation	Not Directly Relevant to ASIC's Recommendation
	✓	NDR

2. Addressing misaligned incentives

ASIC has recommended that insurers “address misaligned incentives” and “review their remuneration arrangements to ensure that they support good-quality outcomes for consumers and better manage the conflicts of interest within those arrangements.” It also recommends that AFS licensees “ensure that remuneration structures support good quality advice that prioritises the needs of the client” and that they “review their business models to provide incentives for strategic life insurance advice”.

In seeking to address these issues in a way that provides a meaningful change to industry culture and practices, and prevent or mitigate consumer detriment, we need to consider both direct remuneration (commission) arrangements and other adviser incentives.

It is evident that with front-loaded commissions, whether of the “full upfront” or “hybrid” variety, there is a financial incentive for advisers to arrange for clients to be insured (a good thing in general providing the client’s coverage needs and affordability criteria are properly met). There is also a financial incentive to replace a client’s existing policy with a new one (which can be appropriate or not, depending on client circumstances and insurer offerings).

For reference, standard commission arrangements are:

Upfront commissions” or “Full upfront commissions”:

120% of the Year 1 premium and 10% of all subsequent premiums

“Hybrid commissions”

80% of the Year 1 premium and 20% of all subsequent premiums

“Level commissions”:

30% of each year’s premiums.

It has been noted by ASIC that there is a clear ‘first mover’ disadvantage for insurers attempting to unilaterally change or significantly reduce their commission structures. This essentially prevents any individual insurer from “breaking the cycle”, no matter how interested the insurer may be in rationalising its commission arrangements. To interrupt the cycle therefore requires an industry-wide initiative.

The rationale for considering licensee remuneration and incentives is two-fold: (1) because other adviser incentives can create real or perceived conflicts of interest for advisers that may impact on the quality of advice; and (2) to ensure that in the implementation of any future changes to remuneration practices there is a thorough consideration of any broader issues (which may not always be obvious or apparent) or unintended consequences that may impact on the quality of advice or competition within the life insurance industry.

An effective transition is also required. An effective transition will be one that keeps insurers and advisers engaged such that the community’s insurance needs are not prejudiced in any way during the transition phase.

Three policy recommendations and one implementation recommendation are made in response to these concerns:

- **Policy Recommendation 1:** That the Reform Model for adviser remuneration, being 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, be adopted by the life insurance industry with progressive application through a transition period.
- **Policy Recommendation 2:** 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 2 years, the industry operates according to the current hybrid commission arrangements with a cap on initial commissions.
- **Policy Recommendation 3:** That licensees be prohibited from receiving benefits from insurers that might influence recommended product choices or the advice given by the licensees' advisers.
- **Implementation Recommendation 1:** That ASIC be asked to endorse Policy Recommendations 1, 2 and 3 relating to adviser remuneration and licensee remuneration and, on the basis of that endorsement, to impose a suitable set of licensing conditions on life insurers that would give effect to these three recommendations.

A New Structure for Adviser Remuneration

Policy Recommendation 1: That the Reform Model for adviser remuneration, being 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, be adopted by the life insurance industry with progressive application through a transition period.

Policy Recommendation 2: 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 2 years, the industry operates according to the current hybrid commission arrangements with a cap on initial commissions.

Elaboration

The recommendations on adviser remuneration are in two parts in the form of a Reform Model supported by a three year Transition Plan -

1. the Reform Model is intended to be the position after transition, from a date in 2018 which is three years from commencement of the transformation process; and
2. a Transition Plan that is intended to enable adaptation of the industry and particularly the adviser community to introduce elements of the Reform Model progressively over the three years of the transition period.

The Reform Model can be described as level commissions supplemented by an Initial Advice Payment available at a client's first policy inception and then no more often than once every five years, where:

- the level commission is a maximum of 20% of premiums;
- the Initial Advice Payment (IAP) is paid by the insurer to the adviser **on a per client basis** (which would generally mean the insured life);
- the IAP is available to the adviser when a client first takes out a life insurance policy and subsequently no more often than once every five years and then only when a new policy is being taken out (the "five year rule"); and
- the IAP is a maximum of \$1,200 or, for customers with annual premiums below \$2,000, no more than 60% of the first year's premiums.

Further, to support the integrity of the Reform Model, it is recommended that:

- the IAP be available only on advised business (i.e. for personal advice only and not available for general advice, either through direct sales or other agency sales or through group life policies inside superannuation funds);
- existing arrangements for retention periods ('clawbacks') apply to commission on the first year's premium and to the IAP if there is one;

- all commission or other payments from insurer to adviser be fully transparent to the client with the adviser disclosing clearly whether any insurer payments represent full, partial or nil commissions; and
- the adviser and client remain free to agree on fees for service that are additional to the insurance premium.

The single IAP available no more often than once every five years and only then, when a new policy is taken out, is intended to address the problem of an adviser having a financial incentive to replace a client's existing policy with a new one. When done inappropriately, this activity is often referred to as "policy churn".

The single IAP will mean that when new policies are written for existing advised clients, no payments beyond the level commission are made unless at least five years have passed since the last IAP was paid.

As noted, none of these arrangements is intended to limit the freedom of advisers to arrange fees for service with their clients that are additional to or in place of commission payments and any IAP payable to the adviser.

The Transition Plan has two phases –

The first phase is where the five year rule is to apply on a best endeavours basis by insurers and licensees. It is recommended to commence as soon as possible, say 30 June 2015. In all other respects current arrangements would remain in place pending the second phase.

The second phase will require some form of regulation, to begin from a suitable date in 2016 and is where –

- the maximum commissions are to be on the current hybrid basis with a cap, so that the maximum initial commission is 80% of premiums capped at \$8,000 and maximum renewal commission is 20%;
- for the purposes of the five year rule, the initial commission is to be treated as a recurring component of 20% and an IAP of 60% of premiums;
- this arrangement is to continue for two years pending full introduction of the Reform Model.

Further, to support the transition, it is recommended that:

- all renewal commissions in place at the commencement of the second phase be grandfathered as is (i.e. the existing renewal commission, whether above or below or at 20%, continue without change until policy lapse or cancellation);
- the five year rule be applied from the inception date of a client's most recent policy.

Policy Objectives

- Better align the interests of life insurers, advisers and consumers by removing any real or perceived misaligned incentives for advisers that could create a conflict of interest and result in consumer detriment.
- Improve consumer trust and confidence in retail life insurance advice in order to improve life insurance coverage in Australia.

- Maintain a competitive and efficient life insurance industry across the entire value chain comprising life insurers, licensees, advisers and consumers.

Issues the recommendation seeks to address

ASIC Report 413 *Review of retail life insurance advice* found that current commission arrangements of retail life insurance create an incentive for advisers to recommend consumers replace a policy rather than retain it, which can occur irrespective of the consumer’s best interests. Numerous examples of consumer detriment were cited where it was apparent that the adviser was focused on making a product sale as opposed to providing non-product specific advice or strategic advice. Importantly, ASIC found that 96 per cent of advice rated as a ‘fail’ was given by advisers paid under high upfront commission model.

The underlying concern of ASIC’s findings was that upfront commissions whereby the initial commission exceeds the renewal commission, whether at the “full upfront” or “hybrid” level, can create a conflict of interest for advisers to inappropriately place a consumer into a life insurance policy (i.e. a sales incentive) or replace a consumer’s life insurance (i.e. a churn incentive). This can lead to consumer detriment.

A clear ‘first mover’ disadvantage for insurers attempting to unilaterally change commission structures has prevented the industry to date from solving misaligned incentives due to commission structures. Policy intervention to improve current market dynamics, engender competition that is aligned with consumer interest and break down the first mover problem can be expected to improve consumer outcomes and restore consumer trust and confidence. It may also improve industry efficiency by shifting the focus of competition and innovation to service provision and product offerings. This should make insurer, licensee and adviser businesses more sustainable.

Ensuring consumers are adequately insured is a key policy objective. While recent growth in direct and group distribution channels has improved life insurance coverage in Australia it is still the case that the majority of consumers purchase life insurance via a financial adviser. It is in the best interests of consumers in the long term to ensure that the life insurance advice distribution channel is effective and sustainable. To do this, any policy intervention in commission arrangements must:

- improve the quality of advice available to consumers;
- create a competitive life insurance advice industry that compensates advisers reasonably for their work; and
- ensure any remuneration arrangements not directly paid by the consumer are transparent and based on a clear rationale either to promote insurance coverage or to compensate advisers for their work.

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.

Finally, a smooth transition that is sustainable for the industry is necessary to ensure that levels of life insurance coverage are maintained or increased over the medium term and that competition and innovation in the life insurance advice market are not impaired.

Discussion of Recommendations

The recommended Reform Model is built on the following foundations –

- Recognition that the continued payment of commissions (vis-a-vis the alternative of a nil commission model) is essential to the continued functioning of the life insurance advice industry along with access by the community to life insurance advice and proper insurance coverage.
- The need to neutralise the two primary sources of conflict of interest for advisers under current remuneration arrangements, which are -
 - initial commissions for new policies that substantially exceed renewal commissions, and
 - commissions for replacement policies that substantially exceed renewal commissions.

In my opinion a Reform Model that balances these objectives will have the following characteristics:

- total initial adviser payments (commissions and any other insurer-funded payments but excluding any fee for service paid by the client) to contribute to adviser cost recovery but to be less on average than the adviser’s initial costs;
- renewal commissions to be high enough to meet adviser costs including regular client reviews and recoupment of any remaining initial costs over time but not to be so high as to encourage advisers to usurp the clients of other advisers (i.e. avoidance of “client churn”);
- commissions available on replacement policies not to be so high as to encourage advisers to replace existing policies with new policies (i.e. avoidance of “policy churn”); and
- the adviser and client to be free to agree on a fee for service additional to the insurance premium subject to full transparency of any payments the adviser is to receive from the insurer.

The Reform Model meets all of these criteria because of the following design features –

- the way the IAP is structured;
- the maximum level commission of 20%, which is expected to fund any shortfall of the IAP against costs and also to fund regular insurance reviews for clients;
- the five year rule;
- the client basis instead of a policy basis for the IAP and the five year rule;
- the absence of any restrictions on fees for service and on commissions that are less than the maximum allowable commissions; and
- the lack of entitlement to an IAP on direct business, being business where a policy is bought without any personal advice being given.

As a result, we can expect to see advisers suitably compensated for their initial costs in introducing new clients to life insurance, giving advisers incentives to service their clientele properly, promoting product and service innovation within the life insurance industry, creating better alignment of interests between adviser and client and, in so doing, improving alignment also with life insurers.

An initial adviser payment at the right level

The IAP serves the important purpose of contributing to the adviser's initial costs when first setting up one or more policies for a client (but usually would not fully reimburse the adviser's costs).

The recommended IAP of a maximum of \$1,200 from insurers represents a material change to the structure of adviser incentives and the overall remuneration advisers receive. Key aspects worth highlighting are that the IAP represents a partial cost recovery payment, is on a per client basis as opposed to current industry practice of a per policy basis, is not indexed and is fully discretionary in that an adviser can always choose instead to charge the client a fee. Each of these features is designed to stimulate meaningful behavioural and cultural change in the industry, while at the same time delivering strong consumer and business outcomes.

Setting the IAP at \$1,200 is intended to make a contribution to cost recovery for advisers while falling short of full cost recovery, which is variously estimated at between about \$1,500 and \$3,500 per client. It is aimed at delivering a balance between acknowledging the initial costs of advisers and eliminating any behavioural doubt as to whether the client's interests are being placed ahead of the adviser's own interests.

The IAP of a maximum of \$1,200 therefore takes away the financial incentive for the adviser to write new business for the sake of the adviser payments: generally the initial payments received will fall short of the adviser's costs (to be recouped from subsequent renewal commissions).

Having the IAP as flat dollar fee (other than for smaller policies) is preferred over other suggestions in submissions of tiered fee arrangements, as it improves transparency of adviser remuneration and standardises cost regardless of premium.

The cap at 60% of one year's premium for clients with smaller premiums is to ensure that the total adviser payments are commensurate with the level of premiums and thereby to minimise for policyholders with smaller premiums the type of incentive that currently exists for all policies.

Having the IAP set at a maximum of \$1,200 and not indexed will support the viability of advice business models in the medium term while over the longer term it will devalue and create an incentive for advisers to use fee for service offerings more often. It is also an incentive for the industry to improve productivity and reduce costs of delivering advice and placing policies.

The alternative of no initial advice payment

In the light of the FSI report advocating level commissions only, the question will be raised as to whether any form of initial payment such as the IAP should be allowed. In response, it is important to consider the following:

If there were no initial payment to advisers beyond renewal commission, there would be a substantial mismatch between initial advice costs and initial payments to advisers in the absence of a fee for service. Although there is a case for advisers achieving less than full cost recovery when taking on new life insurance clients, in the absence of any such initial payment at all -

1. the funding of advisers' initial costs would be problematic and would likely concentrate the market in the hands of the larger institutions;
2. it is highly likely that large numbers of financial advisers, including representatives of most of the independently owned adviser groups and perhaps as many as half altogether, would cease to offer life insurance advice such that the diminished supply of this advice would likely exacerbate greatly the underinsurance problem in Australia;

3. the withdrawal of so many advisers from the market would most likely have the greatest effect on supply of advice to lower and middle income families and businesses rather than to higher income earners; and
4. the mismatch between adviser costs and revenues would likely create a “client churn” problem where advisers would find it financially attractive to persuade clients of other advisers to change allegiance instead of pursuing the goal of introducing new consumers to the benefits of life insurance protection, thereby having the effect of reducing competitive advice services to the community and further exacerbating the advice supply problem.

Retail or advised insurance vis-a-vis “no advice” insurance

The five year rule has implications for the sale of insurance products under *general advice* as well as for advised policyholders who have received *personal advice*.

The subject matter of this report is retail life insurance and associated advice. It is generally the case that when we refer to retail life insurance we are contemplating a financial adviser giving personal advice to a client who is a policyholder or potential policyholder. There are, however, various arrangements within the insurance industry and the advice industry where personal advice is not given (‘general advice’ only is given instead) and commissions are payable. The most common such arrangements are where insurance is sold to the public by an insurer directly, by an intermediary acting as an agent for the insurer or by a broker supported by one or more insurers.

It is recommended that all such arrangements be subject to the same maximum commissions and maximum payment regime as is recommended for retail insurance transacted through an adviser. A consequence of this proposal is that, in all cases where general advice only is given, not personal advice accompanied by a full SoA, there would be no eligibility for an IAP. Therefore the maximum commission would be a level annual commission of 20% of premiums.

Renewal commissions

It is important to the viability of advisers and the integrity of their role as continuing insurance advisers to their clients that they be compensated for their client servicing role in regularly reviewing the insurance needs and protection of their clients including encouraging them or assisting them to continue with their insurances. Also, because the IAP is not expected to cover all of their initial costs with new clients, there is a need for advisers to have an opportunity to recoup that shortfall in costs over time. There is therefore a need for advisers to receive renewal commissions at a level that meets these costs.

On the other hand, one of the potential sources of conflict around remuneration by commission besides the initial payment relates to the rate of renewal commission. It is important to avoid having level commission on renewal at a rate that is so high as to cause advisers to take steps to usurp clients from other advisers for the purpose of improving their own income, without having written the business for the client in the first place (the “client churn” problem).

The Reform Model responds to these adviser revenue requirements simultaneously with this potential source of conflict by limiting renewal commissions to a maximum 20% of premiums.

It is notable that this maximum recommended rate of renewal commission is the same as the standard ‘hybrid’ version of renewal commissions that insurers currently pay.

Commissions on replacement policies

The third and final potential source of conflict around remuneration by commission, besides the initial payment and the rate of renewal commission, relates to the well-known replacement policy problem. In the current market, initial payments in the form of high initial commissions (from 80% to 120% or more of premiums) represent an incentive or a temptation for a client's adviser to replace existing policies with new ones and also for advisers to attract clients from other advisers and then replace their existing policies. This problem is tempered by the Best Interest Duty but the financial incentive remains.

The replacement policy problem

It is self-evident that high adviser payments on policy replacement create incentive or a temptation for advisers to replace policies. Equally, however, there are many circumstances where a policy is replaced because it is in the best interests of the client that there be a different policy or different insurance arrangements that are not consistent with one or more existing policies.

The problem is often described, as in the ASIC report, in terms of lapse rates that seem to be either too high or rising. Yet if there were no financial advantage to an adviser to issue a replacement policy, one could ask why any particular level of lapse rate, high or low, would be of concern to the community or to ASIC. It is clear that insurers do not like high lapse rates because they incur additional costs when policies lapse and they also incur high costs, separately from commissions, when a new policy is issued.

The goal then is to eliminate unnecessary or inappropriate policy replacement and the first step in achieving that goal is to eliminate the financial incentives that advisers currently have. Indeed if the incentive were to work the other way round, where advisers were reluctant to replace policies unless it was very clear that it is to the benefit of the client to have a new policy, we would undoubtedly see a shift downwards in lapse rates. We would also see greater competitive efforts by both advisers and insurers to modify existing products and advice processes. We may also see some price reductions from insurers.

None of this argument is aimed at preserving a consumer's existing policy that is inappropriate. The best interests duty applies irrespective of financial incentives but we can see from various behavioural studies that, if the financial incentives are better aligned, there will be better outcomes all round (for clients, advisers, licensees and insurers).

The most common solution advocated for the replacement policy problem is "clawback" arrangements whereby, if a policy lapses during the "responsibility period" agreed between insurer and adviser, the adviser is obliged to repay to the insurer part or all of the commission received.

Responsibility periods at present are mostly just one year. In submissions received, many advocated more extensive responsibility periods as a proposed solution to the replacement policy problem. These extended responsibility periods and clawback arrangements do not, however, work very effectively. There is the difficulty of discriminating adequately between genuine changes in client circumstances that call for a replacement policy within say two or three years of policy issue and other situations where it is less clear that new policies are needed and the adviser's integrity is then questioned.

It should be further noted that the clawback idea essentially places full responsibility for the lapse in the hands of the adviser and none in the hands of the client or the insurer.

The Reform Model responds to this potential source of conflict through the move to a per client basis instead of per policy basis and the five year rule (no additional IAP for at least five years since the previous one).

The per client approach

The move to a per client basis in place of per policy is a material change. The incentive will be for advisers to concentrate more closely on client needs, irrespective of how many policies might be needed. That should be an incentive for insurers, licensees and advisers to manage their portfolios with a more effective client orientation and a less transaction focused approach. Shifting to a customer basis also limits the ability of advisers to manipulate the IAP as would be likely if it were set on a per policy basis.

The shift to a per client basis would also be expected to induce life insurers to design more customer-centric products. This may alleviate some concerns raised in submissions regarding some insurer product practices. We would also expect to see more innovation around underwriting and claims practices by insurers as well as the advice process. A number of subsequent recommendations are aimed at ensuring this occurs (recommendations on APLs, SoAs and Code of Practice).

Implementing the per client approach will create a class of “advised policyholders” who are consumers who have purchased a life insurance policy through obtaining personal advice from a financial adviser.

Who is an advised policyholder?

A person is first classified as an *advised policyholder* at the time that the person (or another legal entity such as the person’s superannuation fund or the person’s own business) first takes out a life insurance policy on the life of that person through an adviser.

A more complete definition will be needed in practice and a workable definition might be one where a person retains the status of advised policyholder until 13 months after the expiration, cancellation or lapse of all life policies held by that person.

The five year rule

Under the Reform Model, the absence of any initial payment to advisers more frequently than five yearly should significantly reduce inappropriate adviser-led policy replacement. There would be reduced financial incentive on the adviser to go to the trouble of switching from an existing policy or insurer to another. At the same time the renewal commissions available, and the prospect of losing them by client lapse or through competition (by change of adviser), should be sufficient incentive to review the client’s needs and coverage on a regular basis, say at least every 2 or 3 years.

The likely outcome is policy replacement only when it is clearly in the client’s best interest. It may well also engender a stronger and more genuine interest by advisers in their client’s life and health risks.

Some consultations have noted the risk that the five year rule may create an incentive not to recommend replacement of a client’s life insurance policy even when the client has a material change in circumstance that would warrant a change in coverage or provider. The best interest duty still applies, however, and the adviser should be reviewing the client’s cover regularly in any event. Also, as already noted, the prospect of losing the client through competition should be an incentive to review the client’s needs.

In summary, the five year rule is expected to reduce materially the adviser initial commission problem associated with replacement policies and thereby overcome the conflict of interest for advisers on policy replacement, particularly within the first five years.

Ensuring compliance with the IAP as a single payment will need to be introduced by the industry as a joint responsibility of each licensee and each insurer. It will require cooperation to identify reliably whether each new policy was being issued to an existing advised policyholder or a new advised policyholder.

To clarify this five year rule, we might consider what happens if, within the five year period, an advised policyholder takes out one or more additional or replacement policies, or agrees to pay increased premium, or increases or reduces cover, or arranges endorsements to any policies. The five year rule is expected to operate as follows: for as long as a person is classified as an advised policyholder, none of these changes creates any eligibility for the adviser to receive another IAP within five years of the last such payment. If, however, there are premium increases or additional policies, the adviser may receive commission payments of up to 20% on the additional premiums.

Accordingly, neither the original adviser nor any other adviser is eligible to receive another IAP until at least five years from the initial classification of the client as an advised policyholder and then only in the event that a new SoA is prepared and a new policy issued.

Fee for service

There should be no impediment to an adviser and a client agreeing together that the client will pay a fee for service that is additional to any insurance premium that the client would pay. It is important, however, that in such cases there is adequate transparency of commission arrangements so that the client is fully informed as to whether, in addition to any fee for service, the adviser is receiving full, partial or nil commission payments from the insurer.

Under the Reform Model including the transition period, all consumers and their advisers are free to arrange a fee for service payable directly from the client to the adviser, separately from and additional to any premium payable. It is recommended that in such cases the transparency requirement noted above is observed.

It is also worth noting that, given that it is unlikely to be feasible in the foreseeable future to operate the life insurance advice business exclusively on a fee-for-service basis, this Reform Model, with its reduced initial payments for large policies and the “anti-churn” single IAP, should give ample encouragement for more advisers to introduce fees for service for their clients, especially those with larger policies.

The transition

With all but approximately 20% of business currently being written on upfront commissions of the order of 120% of premiums, it will be a major adjustment for many advisers to move into this second phase of the transition with maximum initial commissions of 80% of premiums.

Nevertheless, with limited administrative disruption to existing arrangements during the transition period, a total of 3 years to prepare for the Reform Model should allow enough time for insurers, licensees and advisers to modify their systems, procedures and practices to accommodate the Reform Model.

At the end of the transition period, all business written in the preceding 2 years will have a 20% renewal commission and will therefore already be well adapted for the Reform Model.

Prices, costs and margins

Some preliminary actuarial work undertaken on the Reform Model indicates that the combined effect of the IAP and the five year rule is likely to be a reduction in overall insurer costs of between 5% and 10% of premiums.

The IAP should contribute to reduced costs because of the lower average initial payments compared with a hybrid model. The five year rule should contribute to lower costs because of expected improvements in lapse rates.

It is possible that there would be further cost improvements from the five year rule as a result of the IAP being paid less frequently than initial commissions are in today's environment and for the move from a per policy basis to a per customer basis.

Questions will arise on all cost estimates and will need to take account of –

- the transition period during which some financial benefits of the five year rule may be realised;
- the need for reorientation of business models and associated costs at insurer, licensee and adviser level; for insurers, these costs will be material because of the need to rework systems; and
- the unknown consequences of the various behavioural changes that can be expected; they can be speculated upon and their effects estimated but it will be some time before they occur and some further time before they can be measured with any confidence.

If cost reductions do emerge, it is highly desirable of course that they manifest themselves in price reductions by insurers to the benefit of consumers. The best outcome would be that insurer competition is stronger for the transformation process that will take place in the next few years, and that insurers will therefore find themselves competing more on price than they do today, causing cost reductions to flow readily to price reductions.

The Reform Model: Benefits in summary

The imposition of the maximum commission terms for advisers under the Reform Model can be expected to sustain a competitive life insurance industry and a competitive financial advice industry. It would oblige the insurers to compete on products, prices and services to customers through advisers and licensees instead of, as at present, by competing for the favours of licensees and advisers.

This regime, including the five year rule and the per client basis, will also assist advisers to continue to compete for customers through the quality of their own services and the support they can receive from their licensees and from insurers, without the terms of their own remuneration interfering with either the competitive offerings of life insurers to customers or the quality of advice and services they offer to their clients.

Finally, customer value should be increased not only by better products and services from insurers, licensees and advisers but also by some premium reductions in due course.

Analysis of other options

The following remuneration models were considered:

- level commissions only;
- a hybrid or modified hybrid model;
- extended clawbacks (as a model component);
- a level funded commission model; and
- a fee for service model.

A level commission model

An explanation has been given earlier under the heading *“The alternative of no initial advice payment”* of some of the likely consequences of a level commission model. The points made there on the necessity of initial adviser payments could arguably be overcome to some extent from the adviser’s viewpoint by increasing the rate of level commission of 20% to a rather higher number, such as the current norm for level commissions of 30%.

Such a high rate of renewal commission, however, does not meet the requirement that renewal commissions be high enough to meet adviser costs including regular client reviews and recoupment of any remaining initial costs over time but not to be so high as to encourage advisers to usurp the clients of other advisers. At such a high rate, the phenomenon of “client churn” may become very pronounced. It would give a strong incentive to advisers to persuade clients of other advisers to change adviser. The likely result is extensive activity within the adviser fraternity to “churn” clients and much reduced effort to locate and advise new clients, to the detriment of the community and the industry.

Of course a high rate of level commission also translates directly into higher premiums and therefore reduced value for the consumer to the benefit of the adviser.

There are two conclusions therefore regarding level commissions –

1. at a level commission rate of 20% of premiums, there would be significant adverse consequences for the industry and hence for the supply of life insurance advice and life insurance products, as explained earlier, and
2. if the rate of level commission were increased to a level attractive enough for advisers to arrange funding of the initial costs, there would be a range of different adverse consequences including the likelihood that extensive efforts would be made by advisers to “churn” clients from other advisers at the expense of seeking out new clients, thereby failing to contribute towards overcoming the underinsurance problem in the community.

In summary, the level commission model does not meet all of the characteristics identified earlier, notwithstanding its potential as a solution to the replacement policy problem. Further, these two conclusions are, in my opinion, strong and sufficient reasons to reject level commissions as a suitable response to the problems raised by the ASIC Review.

Submissions also noted that the higher the rate of level commissions the more that “client churn” would be accentuated, whereby other advisers or other parties holding AFS licences seek to sign up existing policyholders in order to capture the entire renewal commission stream, perhaps without

providing any level of advice or service. Level commissions of 20 per cent would limit the incentive for this type of behaviour.⁴

A hybrid or modified hybrid model

The hybrid model as understood by the industry today usually comprises an initial commission of 80% and renewal commission of 20% of premiums.

As an ultimate position for the industry, this model does not adequately address the primary problem of misaligned incentives, at least for clients with premiums exceeding say \$2,000 to \$3,000.

At 80% initial commission on a per policy basis, it presents essentially the same conflicts of interest as the “full upfront” model in respect of both initial commissions and replacement policies. It therefore does not meet the criteria set out earlier in this chapter.

A hybrid model fails to adequately address consumer trust issues by retaining the perception and the reality of significant conflicts of interest, due to relatively high remuneration upon the sale of a policy. Without consumer trust in the financial advice industry, a significant portion of the community will continue to refrain from seeking advice regarding insurance needs and remain underinsured. They also fail to encourage behavioural and cultural change in the industry and would not suitably manage conflicts of interest created by commissions or support quality advice outcomes.

Simply shifting to hybrid arrangements on an industry wide basis would therefore fail to improve consumer trust and confidence in financial advice. In any event the incentives inherent in the 80% initial commission for both new business and replacement business would not be overcome.

Extended clawbacks

An extended commission clawback period (e.g. 3 or 4 years) is often cited as a potential design feature to respond to the replacement policy problem. The idea is that the threat of loss by an adviser of commissions already received creates an “anti churn” incentive for the adviser. It is an ill targeted incentive, however, because there are many valid reasons for policyholders and their advisers to cease a policy. There is no workable method for distinguishing between genuine policyholder-initiated policy replacement and policy replacement initiated or encouraged by the adviser. The fundamental problem of high initial commissions on replacement policies remains and, when clawback is enforced by an insurer, the adviser is in the position of having taken all the risk while the insurer and the client essentially have no risk.

Consequently the extended clawback idea does not meet the requirement to resolve the conflict of interest that occurs on policy replacement. It is also difficult to administer and so its effectiveness in practice is likely to be even lower than its theoretical potential. Accordingly it is not seen as a useful technique for the future.

A level funded model

A level funded model is actually a level commission model with a particular feature that enables or assures advisers that their initial costs can be funded through loans.

⁴ In consultations it became clear that this issue is beginning to be actively managed within the industry, specifically by insurers introducing more robust systems for policyholders to authorise change of adviser.

If a loan is supplied by a bank or some other third-party lender, the adviser is at risk of being unable to repay the loan as repayment relies on the continuing business success of the adviser. And these same risks will limit the ability of advisers to borrow on reasonable terms from third-party lenders. If on the other hand the loan is from an insurer, there are likely to be many complications with the loans. Unless they are on a policy by policy basis, individual advisers may become beholden to insurers with whom they may have low amounts of business or the advisers may become compromised by believing they need to place business with a particular insurer in order to sustain the loan arrangement.

Arrangements of this kind came to prominence in the late 1980s in the form of “agency development loans”. Ultimately many of these loans were forgiven as insurers had been generous and the agents and insurers had both been over-optimistic about the sales that would follow.

In summary, this kind of model would not meet the criteria for a suitable response to the conflicts of interest in adviser remuneration.

A fee for service model

The fee for service model is actually a nil commission model. The limitations of nil commissions are explained earlier in this chapter.

While every encouragement ought to be given for insurance advisers to be paid for their services through fees that are additional to insurance premiums, there are many reasons why elimination of all commissions would be inappropriate. These include:

- differing consumer attitudes and circumstances when considering life insurance relative to other types of insurance and investment products;
- adverse impacts on adviser business models; and
- impacts on underinsurance and access to quality advice in a competitive marketplace with different distribution channels.

Some submissions, including consumer groups, suggested that a fee for service model would be the best way to remove misaligned incentives for financial advisers, and had been successful in the context of its application in Australia to investments. They also argue that underinsurance is the Australian consumers’ biggest problem and the existence of commissions has not assisted in solving the underinsurance problem which still exists today.

As noted in the Interim Report, historically, fees paid for insurance advice are uncommon both in Australia and in other jurisdictions. One of the major reasons is that any fee will be an add-on or an extra cost to the policyholder over and above the premiums payable. Unlike investments, where fees can simply be drawn from the investor’s corpus of funds, there is usually no pool of money which a consumer can draw on to fund the advice. This would present a barrier to purchasing insurance and increase underinsurance.

There is extensive evidence to indicate that many prospective policyholders will never purchase life insurance products if they are obliged to pay not only the insurance premium itself but a fee for service as well (and a fee which in the first year could well be of similar magnitude to the premium itself). The attitudes and behaviours of consumers are key in understanding this phenomenon:

- the risks consumers face are often multi-faceted;

- the risks that consumers need to protect against do not materialise at a predictable point in time so there is no immediate or daily trigger to act; and
- the risks to be protected against stem from a “human problem” (we live too long, die too soon or become disabled in between) and consumers tend to treat these as “deferrable” problems and often consider themselves to be better risks than the average risk or simply not at risk in the short term.

The consequence is that the consumer can perceive that the deferral of the purchase of life insurance is both not a large risk and has a high opportunity cost in the short term.

Importantly, where fee for service is utilised for life insurance in other jurisdictions there are unique market circumstances and regulatory requirements that make that system viable (see Box 1)

Box 1: Commission arrangements in other countries

Submissions varied in their consideration of life insurance commissions in an international context. Some suggested that bans on the practice overseas justified the same approach being employed locally. Others pointed to the continued operation of commission models subsequent to recent policy consideration by international regulators, arguing that these precedents are more relevant to the Australian context. Below we briefly examine the recent experience in international jurisdictions:

Netherlands – In 2013 a ban was placed on commissions for financial services products including life insurance. The Dutch insurance market is fundamentally different to other jurisdictions as approximately 90% of life insurance sales are tied to mortgages which can only be accessed by those with a life insurance policy. Figures suggest that discretionary (non-mortgage) insurance sales, which make up only 10% of the Dutch market, were down around 30% in 2013. Mortgage related sales did not slump in line with a slowly recovering housing market⁵. This suggests that overall impacts of the commission ban on insurance coverage in the Netherlands will be buffered as obligatory sales continue to derive as a result of the mortgage linkage. The drop in discretionary insurance sales is an early indicator that a commission ban may be undermining discretionary insurance coverage.

UK – Although the Retail Distribution Review (RDR) considered a ban on life insurance commissions in 2013, a parallel to the FoFA reforms, the decision was made not to apply its financial product commission ban to protection-only life insurance for similar reasons to the exemption granted under FoFA. The doubt around RDR settings preceding the final outcome had impacts on the UK advice market that continue to play out today, including the withdrawal of large numbers of advisers from the industry and retail banks withdrawing financial advice offerings or re-positioning them to be accessible for wealthy customers.

South Africa – Amongst other things, the Financial Services Board’s 2014 Retail Distribution Review noted problems with churn “In the long-term insurance sector, levels of churn are high, with corresponding risks in terms of mis-selling.”⁶ The FSB accepted that there are strong arguments for and against banning commissions. Their “hybrid” proposal is to place a cap on upfront commissions with clawback provisions and have them operate in conjunction with a fee for service model. In addition, to deal with churn, they propose a complete ban on commissions for replacement policies.

USA – Commissions on the distribution of financial products continue to be a legitimate form of remuneration. In recent times, political constraints have limited the ability to address conflicts of

⁵ RGA Quarterly Europe August 2014 – Rijn van der Linden “Banning Protection Commissions – the Netherlands Experience”

⁶ FSB Retail Distribution Review 2014

interest in the financial sector. However, in early 2015 President Barack Obama announced a new policy that would place fiduciary obligations upon US advisers and deal with conflicts of interest in relation to retirement advice, potentially restricting the use of commissions for these products. Consideration of commissions on life insurance advice was not contemplated by the announcement.

In summary, international regulatory settings relating to life insurance commissions are highly variable. The settings have been established with reference to local insurance market dynamics and political constraints. There is seemingly no 'silver bullet' in addressing the issue but it is clear that local considerations play a significant role in the development of remuneration frameworks.

Arguments are also put forward that commissions of themselves create a disincentive to provide quality advice. They are not very transparent, preventing true price signalling of the cost of services provided by the adviser, leading to a lack of consumer understanding and a reduction in effective competition in the cost of providing advice.

Importantly, submissions advocating fee for service arrangements failed to adequately consider the impacts these arrangements would have on advisers and flow on effects to consumers. Advice is not free and Australians are underinsured. A fee for service remuneration model would risk exacerbating underinsurance through the unavailability of quality advice due to the financial impact such a change would entail. Existing levels of life insurance coverage are a function of the ability of advisers to cover their initial costs of providing insurance advice via commissions.

Regarding both group and direct life insurance, on current market pricing the consumers are usually paying a similar price for life insurance without receiving the benefit of any advice or tailoring of a life insurance offering to their particular needs and circumstances.

- Direct life insurance is characterised by simple products, short form underwriting and very limited guidance around product selection and insurance needs. Short form underwriting typically translates underwriting at the time that claims are lodged, a highly undesirable situation. Direct solutions can be more expensive, have less features and are less likely to be tailored to the individual circumstances of the customer.
- Group insurance in recent history has been characterised by automatic acceptance limits (i.e. no underwriting) and generous policy terms. The emerging deterioration in claims experience over recent years has driven significant increases in premiums. Also, as with direct insurance, group coverage is not a tailored solution for customer needs.

Implementation

Regulation can take several forms. The Government can legislate or introduce regulations; or ASIC can impose conditions or requirements on insurers, licensees or advisers; or the ACCC can authorise activities or arrangements that might otherwise be deemed anti-competitive; or the industry can impose its own self-regulatory mechanisms.

It is essential for the integrity of the recommendations on adviser remuneration that there be some kind of externally imposed regulation on the industry. An effective form of this regulation, given the nature of the regulations required and the ability of ASIC to maintain an associated compliance regime, is likely to be the imposition by ASIC of licensing conditions on life insurers. These conditions would oblige all life insurers, and through them all licensed adviser groups (generally referred to as licensees in this report) by means of the contractual relationships between insurers and licensees, to conform to the Reform Model and the Transition Plan.

If an ACCC authorisation were sought and obtained instead of an ASIC intervention, there would be some practical difficulties of application and enforcement. An authorisation would apply only to

members of the industry association (the FSC) so that any insurer determined to avoid the terms of the authorisation would have the right to cease membership of the FSC. Also once the ACCC has given its authorisation, compliance monitoring and sanctions would be in the hands of the industry body, the FSC, The ability to impose sanctions or enforcement by the FSC would be problematic, especially compared with the ASIC compliance regime that would accompany modifications of licence conditions.

Implementation Recommendation 1: That ASIC be asked to endorse Recommendations 1, 2 and 3 relating to adviser remuneration and licensee remuneration and, on the basis of that endorsement, to impose a suitable set of licensing conditions on life insurers that would give effect to these three recommendations.

Licensee Remuneration and Conflicts of Interest

Policy Recommendation 3: That licensees be prohibited from receiving benefits from insurers that might influence recommended product choices or the advice given by the licensees' advisers.

Elaboration

It is important that non-commission remuneration and other benefits granted by insurers to licensees do not contain any incentives that might compromise the effectiveness of the Reform Model proposed in Recommendation 1 and the Transition Plan proposed in Recommendation 2.

Conflicts of interest within licensee remuneration arrangements need to be minimised in relation to licensee benefits that could influence adviser product recommendations.

Minimising such conflicts of interest for licensees can be achieved by prohibiting non-commission benefits to dealer group licensees that could influence product choices or the advice given by the licensees' advisers. The recommended mechanism for doing so is to extend to life insurance products the current 'substance over form' provisions of the FoFA arrangements that apply to licensees in respect of investment products. An explanation of FoFA's so called 'conflicted remuneration' arrangements and how they are applied to investments is provided later in this section in Box 2.

This recommendation is aimed at capturing a range of non-commission remuneration and other benefits that are currently offered by insurers to licensees but which can be seen as misaligned incentives that can impair advice quality. Examples include, but are not limited to, certain volume based payments, free or subsidised business equipment or services, hospitality related benefits, shares or other interests in a product issuer or dealer group, marketing assistance and some 'buyer of last resort' arrangements.

This recommendation is not intended to capture all payments to licensees. Licensees provide a range of essential services to advisers which are integral to the delivery of advice including research, business support, professional development and education, compliance and risk management, and technical services. By exception and to promote continued investment in these services, it is recommended that a maximum Licensee Support Payment (LSP) be specified as a percentage of premiums in force and payable from life insurers to licensees. The LSP will be prohibited from being passed on to advisers as this would defeat its intended purpose. The LSP is also expected to promote competition in the life insurance advice market by contributing to the viability of licensees that are independent of life insurers or other larger financial institutions.

The LSP is proposed to be a maximum of 2% of premiums in force.

Policy Objectives

- Ensure that licensee remuneration promotes the delivery of life insurance advice in clients' best interests, thereby improving consumer outcomes.
- Promote fair and honest treatment of consumers buying products at all stages of the life insurance value chain.

- Improve consumer trust and confidence in life insurance products and distribution practices by addressing conflicts of interest of licensees.
- Minimise conflicts of interest for licensees and their advisers without threatening the viability of licensees.

Issues the recommendation seeks to address

To date, the advice industry has been on a five year journey due to FoFA to improve the quality of advice, modify a sales culture by prioritising customers' best interests over product sales and introduce a consumer focus in the provision of financial advice.

Advisers are required to act in accordance with a statutory best interests duty⁷ prescribed by FoFA and must place the client's interests ahead of their own in a situation of conflict. However, the life insurance exemption from the FoFA requirements has diminished the effectiveness of these reforms by perpetuating conflicts of interest for licensees and allowing incentivising conduct that does not always align with consumers' best interests.

At the time that the FoFA exemption was provided for retail life insurance in 2012 the then Government noted that any conflicts of interest within the life insurance and advice industry that could lead to consumer detriment would be actively monitored and if necessary corrected.

Despite this announcement and the example now set by licensees in respect of investment products where the FoFA requirements have led to improving culture and practices, many of these practices appear to have continued in relation to life insurance advice. As noted earlier in the report (see Recommendation 1) there are genuine reasons why commissions in insurance are made available that are on the whole in the best interest of consumers, but these arguments do not apply to other monetary and non-monetary benefits received by licensees from insurers.

Allowing a broad array of non-commission remuneration and other benefits that could reasonably be expected to influence advice or product recommendations to flow across the value chain is in conflict with the prioritisation of consumers' best interests in the advice process. It also fails to support a sustainable commission model by providing an avenue for avoidance of the commission regulations. Addressing these payments is therefore crucial to minimising conflicts of interest.

Further, the solution being recommended, which is to align the life insurance requirements for licensees with their investment product requirements under FoFA, avoids the problem that any other solution would have whereby licensees would have to suffer different regimes for life insurance and investment products. The application of dual arrangements for non-commission remuneration and other benefits would then introduce an unnecessary level of complexity and limited transparency that risks continuing to undermine consumer trust and confidence.

Discussion of Recommendation

Prohibiting benefits to licensees that have the potential to create conflicts of interest for advisers is an essential step to ensure the integrity of life insurance advice into the future. A number of non-commission remuneration payments or other benefits that create conflicts of interest, outlined in Table 3 below, are prohibited for investments but still allowed in relation to life insurance products. Box 2 outlines how FoFA bans payments or other benefits that can create conflicts of interest for advisers.

⁷ Corporations Act section 961B

Table 3: Examples of non – commission licensee benefits and why they are potentially conflicted

Benefit/Incentive	Potential conflict of interest
Volume bonuses and rebates, marketing and sponsorship payments	Encourage licensees to write more of a particular product to achieve sales volumes or portfolio outcomes. Create the potential to influence the choice of life insurance product or advice provided.
Low lapse rate or persistency bonuses	Incentivise client insurance arrangements not to be reviewed even when it may be in a client’s best interests to replace an existing policy. Issue will be exacerbated as Recommendation 1 of this report will reduce replacement business incentives operating to offset this effect.
Shelf space fees (particularly volume based)	Can incentivise narrow market consideration by licensees, limit APLs and reduce competition for insurance products. Can inappropriately influence product recommendations.
Certain buyer of last resort arrangements with reduced licensee fees	Advisers are incentivised to write group product to reduce dealer fees or increase practice values and future payments upon sale of practice. Can inappropriately influence product recommendations.

Source: Adapted from ASIC (2013) RG 246 Conflicted remuneration

Box 2: How FoFA deals with non-commission remuneration and other benefits

In determining what forms of remuneration are prohibited FoFA does not discriminate between commissions and other benefits flowing between product providers and licensees. Instead it applies a principles based test which outlaws monetary or non-monetary benefits given to a licensee or representative that could reasonably be expected to influence the product recommendation or advice provided⁸. Specifically, Conflicted Remuneration in FoFA is defined as:

Any benefit, whether monetary or non-monetary, given to a financial services licensee, or a representative of a financial services licensee, 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:

- a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or*
- b) could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.⁹*

Commissions naturally fall within the scope of this application given their inherent ability to influence conduct, as do a range of other payments or non-monetary benefits. Common examples of non-commission benefits that generally meet the relevant principles and are therefore prohibited are reported in table 1. These include certain types of volume bonuses and rebates, marketing and sponsorship payments and buyer of last resort arrangements. There is a presumption that all volume-based benefits are conflicted and therefore prohibited, unless proved otherwise¹⁰. This places the onus on a party who disputes the presumption to prove the benefit is not conflicted and could not reasonably be expected to influence conduct.

⁸ Corporations Act section 963A

⁹ Corporations Act section 963A

¹⁰ Corporations Act section 963L

FoFA applies to product providers and licensees/advisers explicitly prohibiting both the payment and receipt of conflicted benefits by relevant parties. There is sound industry understanding of how these provisions apply and the types of benefits captured. Regulatory guidance has been issued by ASIC and there has been extensive consultation amongst impacted stakeholders to reach this point.

It is important to note that in addition to aforementioned principles based test, there are prescriptive bans and exceptions contained within FoFA that enable its effective operation in specific circumstances that cannot be managed through the application of section 963A alone. FoFA categorically bans volume-based shelf space fees and asset-based fees on borrowed amounts¹¹. It also prescribes particular benefits that are not prohibited despite the fact that they pass the principles based test and would otherwise be outlawed. Such benefits include those paid in relation to general insurance, life risk insurance and basic banking products and those with a genuine educational or training purpose.

The treatment of Consumer Credit Insurance (CCI) demonstrates the modification of FoFA's application through a separate regulatory regime, in this case the National Credit Code (NCC). ASIC guidance states:

The conflicted remuneration provisions do not apply if a monetary benefit is given in relation to consumer credit insurance. This is because such benefits are covered by the exclusions for general insurance products (reg 7.7A.12G) and life insurance products (reg 7.7A.12A).¹²

So CCI, regulated as an insurance product under the Corporations Act, escapes scrutiny under FoFA by virtue of the express exemption contained in the regulations as contemplated by ASIC. However despite FOFA allowing for unrestricted commission payments on sales of CCI, the NCC precludes payment of commissions greater than 20% of the premium, effectively constraining the operation of the FoFA exemption.

This example provides a clear precedent demonstrating the application of more prescriptive remuneration constraints (than those contained in FoFA) to a subset of regulated products, via a disassociated process, in order to achieve desired policy intent. In a similar vein prohibiting conflicted remuneration on life insurance and adopting a modified commission payments regime could be implemented through a regulatory construct independent of FoFA to serve the policy objectives.

Submissions generally supported the elimination of benefits which may contravene clients' best interests. Some submissions proposed varying models to determine which particular payments and benefits should be banned and discretion for licensees to manage conflicts and determine their own arrangements. Such discretion would not guarantee appropriate behaviour or drive industry-wide outcomes in line with the policy objectives. The application of FoFA's Conflicted Remuneration provisions to life insurance product providers and licensees can, however, achieve these objectives.

By way of example, under the current framework licensees or insurers who act unilaterally to decline to receive or pay volume bonuses and shelf space fees do so at risk of commercial loss where such practices persist elsewhere in the industry. This problem serves as a disincentive to eliminate these payments as it may result in competitive disadvantage for both the licensee and insurer. On the other hand the recommended solution will alleviate the potential for commercial detriment to be suffered by insurers and licensees who "do the right thing" in declining these benefits.

¹¹ Corporations Act section 964

¹² ASIC Regulatory Guide 246: Conflicted Remuneration

As new commission obligations are introduced (as per Recommendation 1 of this report) there is some risk that insurers and licensees circumvent their intent by increasing payments of other benefits that conflict with clients best interests. Such payments would contravene the policy objectives and fail to support a sustainable commission model by providing an avenue for avoidance. This recommended solution is designed to eliminate this risk, protect the integrity of life insurance advice and create a level playing field where no insurance product is favoured over another through incentives.

It is envisaged that all forms of benefit permitted under FoFA should continue to be allowed in relation to life insurance arrangements. The legislation and regulations¹³ expressly exclude certain benefits from FoFA's Conflicted Remuneration provisions and there is no need to narrow these provisions in relation to life insurance. For example, non-monetary benefits under \$300 and prescribed education and training support could continue to be provided in line with these regulations.

In addition, the recommended Licensee Support Payment (LSP) is a measure designed to contribute to the viability of licensees for the provision of essential services to advisers. It can only be paid under the proviso that it is not passed on to advisers as the intention is that it is used to offset advice licensees' operating costs in delivering services that support adviser services. It does not create a conflict as it is calculated exactly the same way as renewal commissions.

The proposed maximum LSP of 2% of premiums in force may be an appropriate level. The rate should, however, be conclusively determined by industry in consultation with ASIC.

The purpose of the payment is to support licensees on an economic basis, not to create unnecessary margins that of themselves interfere with industry structure, at 2%, which equals 10% of the maximum commissions payable, it is believed that it is not high enough to create a changed market for the sale and purchase of advice businesses. That is an important test of the suitability of its level. At the same time, given the FoFA restrictions on many other forms of remuneration, it is believed to be high enough to make a material contribution to the viability of independent licensees.

A further benefit associated with the LSP is the promotion of competition in the life insurance advice market. This will be achieved as licensees who are not integrated with life insurance product providers and do not otherwise have access to parent funding will be able to deliver a service offering and compete in the market. If the remuneration measures contained in this recommendation and Recommendations 1 and 2 were implemented without the LSP, it is likely that the viability of independent licensees would come under pressure, leading to market concentration and reduced competition.

Analysis of other options

Other options considered include:

- extending FoFA's conflicted remuneration provision to life insurance, including commissions; and
- do nothing.

¹³ Corporations Act Part 7.7A, Division 4, Subdivision B; Corporations Regulations, Volume 3, Chapter 7

Application of FoFA’s Conflicted Remuneration provision to life insurance, including commissions

As noted in the Interim Report, the case for commissions generally on life insurance products has been made in numerous places, most recently in the FSI report. Hence the case has been widely accepted outside the insurance and advice industries in order to encourage the giving of advice and the provision of life insurance cover. It is supported by the general belief across the community that insurance against premature death, disablement, illness and other vicissitudes is an important service to the individual, families and businesses.

Submissions to the Interim Report proposed various modified commission models as being appropriate to achieving these broader objectives. It is clear, however, that the abolition of commissions altogether would result in significant unintended consequences that do not align with the policy objectives. For example, whilst insurance advice would theoretically be “pure” through fee for service and devoid of conflict, under the current industry structure it would also become widely unaffordable with the likely consequence of a substantial decrease in levels of insurance across the community.

Do nothing

To do nothing would perpetuate conflicts of interest for licensees and increase the potential for licensee conduct that is not aligned to the best interests of consumers. Numerous submissions from the insurance and advice industries themselves suggested limiting or prohibiting benefits granted by insurers to licensees that have the potential to compromise the quality of life insurance advice to consumers.

Implementation

Three possible techniques for implementing the recommendation have been identified. They are –

- to rely on the proposed new Life Insurance Code of Practice;
- for ASIC to impose licence conditions on insurers, or
- for the FoFA legislation to be amended.

It is essential for the integrity of the recommendations on licensee remuneration that there be some kind of externally imposed regulation on the industry. An effective form of this regulation, as for adviser remuneration given the nature of the regulations required and the ability of ASIC to maintain an associated compliance regime, is likely to be the imposition by ASIC of licensing conditions.

Implementation may be achieved through the imposition by ASIC of equivalent licence conditions on all insurers, thereby restricting payment flows at source.

Current arrangements with licensees are not able to be rescinded due to contract law. Existing arrangements will need grandfathering under the licensing condition but such arrangements should be allowed to persist only for the least time possible.

Implementation Recommendation 1: That ASIC be asked to endorse Recommendations 1, 2 and 3 relating to adviser remuneration and licensee remuneration and, on the basis of that endorsement, to impose a suitable set of licensing conditions on life insurers that would give effect to these three recommendations.

3. Quality of Advice

Chapter 2, *Addressing misaligned incentives*, made recommendations that, if implemented, would alter the incentives with respect to adviser and licensee remuneration in a way that would reinforce good quality retail life insurance. This chapter provides stand alone recommendations that relate more directly to influencing and improving the overall quality of retail life insurance advice.

In order to support good quality advice ASIC recommended that AFS licensees review their business models to provide incentives for strategic life insurance advice and review the training and competency of advisers giving life insurance advice.

From submissions responding to the Interim Report, three subject areas relating to quality of advice have emerged as matters deserving of attention in lifting the standards of life insurance advice and the performance of advisers. They are –

- Approved Product Lists;
- the advice process and Statements of Advice; and
- education and training of advisers and other personnel.

Approved Product Lists

A prominent issue raised in the Interim Report regarding constraints on advisers that can impact the quality of advice related to Approved Product Lists (“APLs”). Each AFS licensee makes its own determinations as to which life insurers are on its Approved Product List. Its financial advisers are then largely limited to using only those insurers that are on the list. If too restrictive, APLs could compromise the adviser’s ability to act in the consumers’ best interest. Further, a limited APL may exclude an adviser from ready access to the products and services of more innovative insurers that may have more efficient or competitive offerings.

The Advice Process and Statements of Advice

To ensure that clients receiving life insurance advice are making informed decisions, the advice process should ensure effective levels of client engagement, understanding and decision-making resulting from the advice process. While some parts of the adviser community already operate this way, others are hampered by administrative processes from their licensees that add cost and limit the level of genuine client engagement. In some cases, the client service culture that should dominate the activities of advisers is impeded by the culture surrounding the emphasis placed on compliance by their licensees.

The Interim Report also raised the topic of Statements of Advice (SoAs) as a major aspect of both the obligations on advisers and, in view of all the regulatory constraints on advisers, how they affect the quality of advice. Inherent in the receipt of good client advice is effective client engagement, including clear and succinct transmission of information and advice from adviser to client. The interpretation of regulatory requirements around SoAs and the current practices of licensees and advisers in preparing them can be seen as an impediment to effective communication and delivery of advice to consumers.

Education and training of advisers and other personnel

Some topics canvassed in the Interim Report relating to adviser standards and education are being dealt with via a separate process. The PJC issued a report in December 2014 which made a number of recommendations on increasing education standards and incorporating professional standards. The industry is reviewing the recommendations which are aimed at increasing professional, ethical and education standards. It is likely the government will also review the recommendations of the PJC to determine a suitable course of action.

Changes to life insurance education standards are best addressed with other educational requirements for financial advice provision more broadly. Education standards are best raised on a holistic basis and should be addressed through an industry wide response to the PJC recommendations.

ASIC's emphasis on strategic life insurance advice suggest some initiatives that could usefully supplement the PJC recommendations. For example, in addition to or as part of other initiatives, especially as may flow from the PJC recommendations, it may be valuable for the professional adviser associations to take initiatives such as the following:

- prepare and deliver Quality Strategic Life Insurance Advice training programmes;
- develop and deliver a comprehensive CPD-accredited training module on strategic life insurance advice; and
- work with training providers including tertiary institutions to incorporate greater focus on strategic life insurance advice into course curriculums.

Such training initiatives should not be limited to advisers but should include staff of licensees and insurers, including business development managers and others, who have a vested interest in the business success of their employers.

Recommendations

Two policy recommendations and two implementation recommendation are made in response to the first two topics above, APLs and the advice process including SoA.:

- **Policy Recommendation 4:** 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 (APL) at least half of the authorised retail life insurance providers.
- **Policy Recommendation 5:** That all licensees, in conjunction with their advisers, re-examine their culture, behaviours and practices regarding the advice process with the aim of raising consumer understanding of life insurance, ensuring informed consent from clients and reducing the administrative burden on advisers.
- **Implementation Recommendation 2:** That the recommendation that all licensees include at least half of the authorised retail life insurance providers on their APL be implemented by all individual licensees as soon as practicable and that ASIC review APL practices in order to provide suitable guidance to licensees in this area.
- **Implementation Recommendation 3:** That a task force representing professional associations, licensees and advisers be established to explore and make recommendations to the advice sector, in conjunction with ASIC, for improving the advice process and associated documentation.

Choice of Insurer via Approved Product Lists

Policy Recommendation 4: 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 (APL) at least half of the authorised retail life insurance providers.

Elaboration

All licensees operate an Approved Product List (APL) that contains a selection of life insurers from among the current list of 13 providers that service the retail life insurance market. Some licensees use as few as one insurer while some licensees have an “open architecture” approach that lists all 13 insurers.

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 have adequate choice to meet the obligations to their clients.

For licensees who choose not to include all insurers on their APLs, it is recommended that they include at least half of the retail life insurers on their APLs.

It is further recommended, as part of the APL review process, licensees satisfy themselves regularly, for example annually, that any providers not included are justifiably excluded such that their exclusion is not an impediment to giving their clients adequate choice of insurer and meeting their Best Interest Duty to their clients.

Considering that the Best Interest Duty¹⁴ (BID) has been introduced relatively recently, it is also recommended that ASIC be asked to review the interaction of the BID and insurance Approved Product Lists with a view to reassessing its regulatory guidance in this area.

This recommendation is aimed at improving access to life insurance products for all advisers whose licensees currently have a narrow APL and to encourage licensees to review their insurance APLs regularly. An APL which provides good market coverage across life insurance providers will increase the level of product choice, market competition and consumer access to life insurance products and services including pricing, underwriting, administration and claims management.

Policy objectives

- Promoting quality advice through greater choice and enhanced awareness by advisers of insurers’ products and their service capabilities and performance.
- Improving competition among life insurers and genuine choice for advisers and their clients.
- Supporting adherence by advisers to their Best Interest Duty towards their clients in relation to life insurance.
- Maintaining cost effectiveness via APL construction so that individual advisers do not need to undertake resource intensive product investigations.

¹⁴ s961B *Corporations Act 2001*.

Issues that the recommendation seeks to address

The current management of life insurance APLs, whereby some licensees have very few insurers on their list unnecessarily restricts competition and can prevent advisers from offering their clients access to a broad range of life insurance products and services. Although advisers can make a request of their licensees to go outside the APL, to do so, can be time consuming and difficult, so that it is common practice for advisers to stay within the APL for most or all of their product recommendations.

Limited APLs also create incentives for advisers to favour products that can lead to consumer detriment. The courts have already begun to note 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. An APL which provides good market coverage across life insurance providers should support adherence to the BID and amplify the benefits of product choice, enhancing consumer outcomes and promoting competition in the life insurance industry.

From an adviser's perspective, APLs which provide good market coverage across life insurance providers will also enable consideration of a broader, more diversified range of providers and products containing different features and benefits. This enhanced market coverage will better facilitate the adviser's ability to discharge their BID and reduce the risk of consumers being placed in products that do not meet their individual needs.

Discussion of recommendation

Some submissions expressed doubt as to whether the presence or absence of each insurer on a licensee's APL was a function of relevant factors such as overall product design and pricing along with insurer support and performance for advisers and customers on administrative, underwriting and claims matters. These submissions suggested that APLs are being used by some licensees to restrict competition.

Unlike investment product providers, all life insurance providers are prudentially regulated by APRA. Prudential regulation is focused on the financial viability of the life insurance provider through APRA's prudential standards and supervision. It would be unusual for an insurer to be validly excluded from an APL on grounds of its financial security and ability to pay claims. Furthermore, the market for retail life insurance is relatively limited, with only 13 active participants compared with some hundreds for investment products.

This number of 13 insurance providers is large enough to ensure a competitive market provided that all advisers and all customers have ready access to a reasonable cross-section of these insurers. At the same time, it is not so large, by contrast with the investment products market, that individual licensees need to limit for administrative or risk management reasons their advisers' access to a small proportion of the market.

Given these considerations, restricting insurance APLs to a very small number of life insurance providers, i.e. below half the market, unnecessarily restricts competition and consumer access to broader range of products. Less restrictive APL's will promote market competition and consumer access to a range of potential benefits. It also provides advisers and clients with greater choice and flexibility supporting the adviser's ability to act in the client's best interest when making an insurance product recommendation.

Hence a broader life insurance APL, with a recommended benchmark of at least half of the retail life insurance providers on the APL, should not restrict a licensee's or adviser's ability to undertake

appropriate risk management and identify suitable insurance providers for recommendation to clients.

Also of relevance are the recommended changes to licensee remuneration (recommendation 2), outlined in this report, which are designed to ensure conflicted remuneration does not prejudice the objective and independent assessment of provider and product suitability for clients.

Analysis of other options

- open architecture life insurance APLs; or
- do nothing.

Open architecture life insurance APLs

An open architecture of life insurance APLs, whereby every insurer is on each licensee's APL, would result in similar benefits to those which can be achieved by having wide market coverage across insurance providers.

Conversely, however, a mandated open architecture would restrict a licensee's ability to exclude an insurer from its APL would militate against risk management of the APL and may result in undesirable consumer outcomes. For example, it could lead to an adviser recommending a product provider with a track record of poor claims management, underwriting or client service.

It is appropriate that licensees retain substantial discretion over which insurance providers are included on their APLs rather than mandating that all insurers are included.

Not making any changes to the APL

To do nothing with respect to APLs is likely to entrench the practices of those licensees who have narrow APLs. It would risk limiting the level of product choice, market competition and consumer access to appropriate insurance arrangements and could therefore compromise adherence to the BID by the licensee's insurance advisers.

Whilst there was support for broadening APLs, submissions also supported existing APL practices for a variety of valid reasons. APLs are used as a risk management tool to identify which products are suitable for recommendation to clients. Submissions noted that there may be products which do not meet a licensee's research criteria, that there are risks involved with advisers not having adequate understanding of products outside the APL or of all products where there is a broad APL. These risks could themselves lead to detrimental consumer outcomes.

These arguments are accepted in the context of any proposal to mandate open architecture APLs but, for the reasons noted above, they do not constitute grounds for allowing the continuation of existing practice of some licensees of having a very narrow insurance APLs. A licensee's reasonable risk management efforts should not be at the cost of competition or facilitating product or provider choice to enhance consumer outcomes.

Implementation

It is worth noting that many licensees already have sufficiently broad insurance APLs and will be unaffected by the recommendation that the insurance APL contain at least half of the retail insurance providers. Others, however, may need to undertake a review of the composition of their insurance APLs to increase the breadth of coverage of retail life insurance providers.

Implementing a minimum APL of half retail insurance providers and undertaking regular reviews of the list, perhaps annually, could be undertaken voluntarily by all licensees.

In the absence of a clear regulatory option, enforcement of this recommendation across all licensees may be difficult. ASIC could, however, review the approach of licensees to their APL construction in the context of the Best Interests Duty of advisers.

Further, ASIC may want to review adviser compliance with APL practices, and in particular consider whether processes around products outside the APL are being adhered to and whether they adequately meet the requirements of the Best Interest Duty.

The virtue of this kind of implementation is that most of the cases of narrow APLs are to be found in licensees that have life insurer or related party ownership, in part or in full. Accordingly, imposing this condition on life insurers would go a long way to seeing this recommendation adopted widely across the licensee community

Implementation Recommendation 2: That the recommendation that all licensees include at least half of the authorised retail life insurance providers on their APL be implemented by all individual licensees as soon as practicable and that ASIC review APL practices in order to provide suitable guidance to licensees in this area.

The Advice Process and Statements of Advice

Policy Recommendation 5: That all licensees, in conjunction with their advisers, re-examine their culture, behaviours and practices regarding the advice process with the aim of raising consumer understanding of life insurance, ensuring informed consent from clients and reducing the administrative burden on advisers.

Elaboration

To ensure that clients receiving life insurance advice are making informed decisions, the advice process should ensure effective levels of client engagement, understanding and decision-making resulting from the advice process. While some parts of the adviser community already operate this way, others are hampered by administrative processes from their licensees that add cost and limit the level of genuine client engagement. In some cases, the client service culture that should dominate the activities of advisers is impeded by the emphasis placed on compliance. In others, a narrow focus on product advice and sales may detract from consumer engagement and outcomes.

The required changes in these cases are largely cultural and behavioural. In terms of advice processes, however, they have implications for the formal parts of the advice process because the culture cannot readily be adapted better to the needs of clients without also adapting business processes. Accordingly, there are two topics that are embraced by this recommendation. They are -

- the interactive part of the advice process that is led by the adviser regarding client engagement, client understanding and client service; and
- the documented part of the advice process incorporating among other things a formal Statement of Advice and, if the client proceeds, the client signing a completed application form for the insurance products decided upon.

The cultural and behavioural changes being referred to here are generally changes that need to be initiated by licensees. Individual advisers are normally beholden to the compliance and other formal processes dictated by their licensees. The cultural changes being advocated will only result in behavioural changes by advisers if their licensees are active in promoting the changes.

This report recommends that the life insurance advice industry, in consultation with ASIC and relevant stakeholders, develop a best practice advice process supported by proven or well researched approaches to client engagement, education and advice delivery. It also recommends, as part of the advice process, that initiatives be taken that support improved client engagement and education prior to and during the delivery of a recommendation to the client. Such improvements would aim to ensure that, in every life insurance advice interaction, clients are making informed decisions with a real understanding of the transactions they are considering entering into. The improvements are also likely to result in shorter, more client friendly Statements of Advice (SoAs).

This recommendation is intended to be complementary to other related initiatives on advice standards. In particular in December 2014 the Financial System Inquiry (FSI) and Parliamentary Joint Committee on Corporations and Financial Services (PJC) released reports that recommend improving professional, ethical and educational standards in the advice sector. The implementation of these recommendations will undoubtedly increase standards and drive the sector towards professionalism. This report seeks to build upon those initiatives in contemplating a heightened focus on client engagement, client education and informed client decision-making.

Policy objectives

- Support the provision of quality advice in clients' best interests.
- Promote client engagement and understanding of life insurance benefits and costs through the process of preparing strategic and product advice.
- Promote informed decision making by clients.
- Promote productivity in the advice delivery process.
- Enable advisers and licensees to meet regulatory requirements efficiently and effectively.

Issues the recommendation is trying to address

An important role of the adviser is to provide some level of education and insight into the options available to the client. In these discussions clients may reaffirm their original objectives or they may realise the need to reframe their objectives. Either way, it is important that the adviser appropriately addresses the relevant needs of the client. Further, the adviser's records and the Statement of Advice need to encapsulate the clients objectives and the reasons for any changes from the objectives. Ensuring these processes run optimally has obvious benefits for all parties.

Adviser and client interaction

As highlighted in the Interim Report, clients seeking life insurance advice are often considering this aspect of their life for the first time with limited knowledge about life insurance. They seek advice to understand the benefits and costs of obtaining insurance which may include assistance with identifying the types of life insurance they may need, the levels of cover required and which products may support their needs.

Integral to this process is the role of the adviser in providing client education and understanding of the options available. Bringing clients to the point where they understand the advice provided and can make informed decisions regarding their life insurance cover can be a complex and difficult process. This recommendation proposes measures intended to support the industry in achieving higher levels of client engagement and understanding.

Statements of Advice (SoAs)

Submissions highlighted issues such as the level of detail contained in SoAs, their complexity and their length. Whilst the complexity and type of advice can influence the content of an SOA, lengthy SoAs are commonly viewed as a clear impediment to consumer understanding and are also contrary to regulatory requirements of clear, concise and effective disclosure.¹⁵ Their length often seems to be aimed at giving legal protection to licensees and advisers ahead of the interests of clients.

Underlying the length of SoAs is that they are usually templates provided by the adviser's licensee that contain lengthy sections of standardised disclosures and disclaimers. The tailored, client specific advice section is actually relatively brief. The contents of these SoAs are considered necessary by the licensees to meet the adviser's legal obligations as determined by the licensee. In many cases, however, they are designed to protect the licensee and the adviser from being the subject of legal action by the client.

¹⁵ s947B(6) *Corporations Act 2001*

These SOA concerns are symptomatic of an emphasis on compliance that can overshadow the need to promote client engagement and achieve informed decision-making. A natural decline in SOA length could be expected if levels of client engagement and understanding were put ahead of zealous licensee and adviser legal protection through a more client oriented approach to risk management.

SOA templates are a possible mechanism to promote improved documentation that benefits client understanding and adviser efficiency. However shorter SoAs will only achieve these benefits when combined with an underlying transition initiated by the licensee towards increased emphasis on client service.

In summary, the topic of statements of advice (SoAs) has been identified as a major aspect of both the obligations on advisers and, in view of all the regulatory constraints on advisers, how they affect the quality of advice.

Discussion of recommendation

A number of submissions made suggestions as to how the life insurance advice process could be improved. The following measures could be considered to improve culture, behaviours and practices in the delivery of life insurance advice. These would support the policy objectives and principles of a 'best practice' life insurance advice process.

Adviser competency and client recommendation

In order to increase levels of client engagement and understanding, advisers must be appropriately trained, skilled and competent to manage client interactions at all stages of the advice delivery process. Education and training modules promoting these skills, in addition to knowledge requirements, could comprise a component of minimum advice qualifications as well as being incorporated into ongoing requirements such as continuous professional development. Currently provision of this type of training varies across licensees and a consistent industry approach would lay a strong foundation for broader improvements in client engagement and understanding of life insurance advice.

An advice process that enhances preliminary client engagement and education is likely to improve the general understanding of life insurance benefits and costs. As part of a 'best practice' process the adviser might seek written confirmation of the client's understanding of the general information provided prior to providing more specific personal advice.

Shorter SoAs

Feedback suggested SoAs can range from 5 to 130 pages (in some rare cases exceeding this range) but are more commonly 30 to 40 pages long. On the face of it, SoAs of 100 pages are simply unnecessary and potentially detrimental to consumer understanding. Arguably, 40 page SoAs are not concise enough to enhance consumer understanding of strategic and product advice and facilitate well-informed decision making. Long SoAs also diminish productive and efficient advice delivery. They take longer to produce which is an undesirable outcome from the perspective of both consumers in terms of their understanding and advisers in terms of their costs.

Reasons provided for the complexity and length of SoAs are licensees' interpretations of the regulatory requirements including concerns with litigation and risk management, as well as an overriding compliance focus. Submissions in defence of long SoAs suggested that their length is understandable given the risks involved for licensees and advisers and potential claims from consumers, financial ombudsman service and law firms.

Such a view is clearly, however, contrary to the spirit of the regulations and the requirement for “clear, concise and effective” SoAs. Whilst risk management is an important and appropriate consideration for licensees, it should not compromise consumer understanding and the provision of quality advice in clients’ best interests.

ASIC has provided an example of a 13 page SoA in Regulatory Guide 90 (released in August 2013) to illustrate what a short and concise SoA may look like. The example SoA was limited to a scenario that did not require a full financial plan and instead related to the provision of scaled advice. The objective of the sample SoA was to demonstrate good disclosure practice, not best disclosure practice, that satisfied a ‘basic level of disclosure and complies with the law.’¹⁶

Despite regulatory guidance on what a shorter SoA may look like and a requirement that the SoA be clear, concise and effective, the industry continues to produce lengthy SoAs.¹⁷

Hence a lack of regulatory clarity is diminishing the achievement of the policy objectives. It remains unclear to some in the advice sector what scope for flexibility of format and content advisers have for SoAs. It is also unclear what lengths licensees and advisers must go to in order to scale advice, which is important for reducing the length of SoAs and assisting consumer understanding. It is appropriate for the advice sector to initiate further consultations with ASIC on this subject.

It is notable here that some licensees and advisers have received endorsement from ASIC for rather shorter SoAs. Accordingly, there is clearly scope for further rationalisation and evolution of SoAs beyond ASIC’s published SoA example.

Given the extensive obligations imposed in relation to SoA requirements, as well as the severity of implications arising from failure to provide a compliant SoA (amounting to an offence under the Corporations Act), it is understandable that a thorough approach be taken when preparing an SoA.

However when one considers the findings of research undertaken by ASIC in Report 224, that advice documents are often long and complex and that 62% of consumers have a preference for written advice that is no more than 3 pages in length¹⁸, then it is worth exploring this issue further. This may have profound implications for the cost of preparing the SoA.

In order to address the problem, SoAs need to be treated as an integral tool to enhance consumer understanding as part of an effective advice process. They should not be viewed as a mere disclosure document completed solely to satisfy regulatory obligations. A better informed consumer will generally be a better protected consumer who is more likely to be satisfied with the advice received and policy placement made, which in turn protects the licensee and the adviser.

The documents do not need to be prescriptive but should be shorter, expressed in plain English and less legalistic than SoAs that are currently common practice across the industry. Non-essential elements or generic content could be moved to supplementary attachments or supporting documentation.

¹⁶ ASIC *Regulatory Guide 90* at page 4.

¹⁷ In 2005 ASIC produced its first shorter SoA at 13 pages which drew some industry criticism. In 2009 ASIC *Regulatory Guide 200* provided three further examples of two-to-three page sample SoAs. In July 2011 ASIC released five SoA examples of two-to-three pages. In August 2012 it released ASIC Consultation Paper 183 with a further 10 examples of two-to-four page SoAs. ASIC’s latest example in August 2013 under *Regulatory Guide 90* provided another 13-page SoA document’ source Keenan (2014) *Why it’s time to standardise statements of advice*.

¹⁸ ASIC *Report 224* (2010) *Access to financial advice in Australia*, pages 63 -64.

Such a “best practice” approach would also reposition the SOA as a more useful consumer information tool that enhances informed client consent rather than just a compliance document that needs to be completed and presented to the client.

Analysis of other options

It would be useful for the industry to explore the following matters which may give further assistance to the improvement of standards of advice, client engagement and administrative effectiveness for licensees and advisers. These matters are all noted, but not explored in depth in this report.

- Review and consultation of Records of Advice
- Incorporating the ASIC checklist within an Adviser Code
- Standardising core terms
- A life insurance “key facts statement”
- Improving adviser education and competency standards

Review and consultation of Records of Advice

Record of Advice (ROA) documentation is typically much shorter than an SOA which can be provided where further advice is provided and the client has previously received an SOA. Given the reduced size of an ROA, usage of an ROA could increase productivity and reduce the overall cost of advice.

However, there are specific regulatory requirements determining when an ROA can be used which restricts their overall usage. Submissions have noted these regulatory impediments, including a conservative approach to interpretation of the circumstances in which an ROA may be used.

To facilitate greater ROA usage, further ASIC guidance on what constitutes ‘significantly different’ change in client circumstances as required by the Corporations Act. In the first instance, considering that SoAs form one of the key disclosure documents which must be provided to clients prior to ROAs being used, developing a best practice advice process which facilitates the production of shorter Risk SoAs will be the most effective mechanism for widely enhancing consumer understanding. Nevertheless, further exploration and development of ROAs and the requirements and opportunities surrounding their preparation and use would be a valuable initiative.

Incorporating the ASIC checklist within an Adviser Code

Some submissions noted that the ASIC checklist was useful information which assists in confirming the requirements of providing appropriate advice. Conversely, some other submissions indicated that the checklist reflects what is already expected of an adviser when providing life insurance advice to clients and that prudent licensees already have, or are likely to have, similar checklists or processes to enable their advisers to satisfy the best interest duty in relation to life insurance advice.

This feedback suggests that incorporating the ASIC checklist into an Adviser Code may not provide a great deal of further benefit to advisers and consumers in relation to the provision of quality advice. However it is suggested that adviser and licensees who have not yet done so incorporate the checklist into their advice process.

Standardising core terms

The prospect of standardising core insurance terms to enhance adviser productivity and consumer understanding was considered. Whilst there was support for standardising core terms, concerns were raised regarding reductions in product competitiveness as well as removing insurer flexibility in offering consumers the most relevant terms and conditions.

Consumer education and understanding will be enhanced through the best practice advice process, supported by streamlined and easier to understand disclosure documents such as the Risk SoA. It is also envisaged that client education on the terms and associated coverage achieved through the recommended policy will be encapsulated as part of the advice process.

Whilst a recommendation has not been made to standardise core terms and conditions, it is an idea that may be worth further consideration or consultation.

A life insurance “key facts statement”

The practicality of preparing very concise statements or summaries of the terms of financial products as a means of giving consumers a simple picture of the key terms of those financial products has been widely discussed. It is difficult to implement one or two page “key facts statements” because they necessarily omit many details that product issuers usually regard as important and that may cause misunderstanding that puts the product issuer or the consumer at risk. Nevertheless, following the Brisbane floods 2011 there was extensive confusion and disillusionment over water damage and flood insurance, the government and the general insurance industry have now formulated a Key Facts Statement for householders insurance. These statements have only been in force less than a year, so their effectiveness for consumers has not yet been evaluated.

It may well be worthwhile for the life insurance industry to give consideration to a “Key Facts Statement for life insurance products along the lines of the corresponding statements now in place for householders insurance.

Improving adviser education and competency standards

To facilitate the provision of quality advice which is designed to assist consumer understanding, increasing adviser education and competency standards were also considered. Submissions noted a range of ways in which minimum education and competency requirements could be raised.

Raising minimum education and competency requirements has also been noted in the Financial System Inquiry report, with support for increasing minimum standards, and has separately been the subject of a specific inquiry and report by the Parliamentary Joint Committee on Corporations and Financial Services (PJC). The PJC made 14 recommendations into proposals to lift the professional ethical and education standards in the financial services industry. These recommendations are currently the subject of further public consultation and so are not specifically addressed in this report.

Implementation

This report recommends that the life insurance advice industry, in conjunction with ASIC and relevant stakeholders, develop a best practice advice process supported by proven or well researched approaches to client engagement, education and advice delivery. This process should enhance the delivery of strategic and product advice.

Implementation Recommendation: That a task force representing professional associations, licensees and advisers be established to explore and make recommendations to the advice sector, in conjunction with ASIC, for improving the advice process and associated documentation.

Implementation Recommendation 3: That a task force representing professional associations, licensees and advisers be established to explore and make recommendations to the advice sector, in conjunction with ASIC, for improving the advice process and associated documentation.

4. Insurer Practices

The activities and the business practices of both licensees and advisers are heavily dependent on the way that life insurers choose to operate their businesses and the range of products that they offer.

This chapter covers how the life insurance industry interacts with advisers and customers.

The Interim Report also raised questions relating to product offerings of insurers, in particular stepped versus level premiums, replacement policy product features, take-over terms, product upgrades and how rating agencies impact product features. Submission views were mixed but a prevailing view was that a number of these features and practices were part of a free market and appropriate for certain customers. Quality advice was promoted as the best way to deal with specific risks that these features or practices pose.

In view of the many issues identified in the ASIC review and considered above in this report on adviser quality, other adviser incentives and issues covered, it is timely to consider whether the life insurance industry should introduce its own code of practice. Codes have been developed in the past to respond to various consumer and regulatory pressures that have been brought to bear following perceived adverse behaviour by institutions or adverse outcomes for consumers.

A policy recommendation and an implementation recommendation are made:

- **Policy Recommendation 6:** 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 consumersImplementation.
- **Implementation Recommendation 4:** That a Life Insurance Code of Practice as at Recommendation 6 be developed by the life insurance providers in a consultative process that embraces licensees, advisers and consumers.

An Industry Code of Practice

Policy Recommendation 6: 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.

Elaboration

An industry code of practice, if embraced by life insurers and consumers, can lead to improved standards of practice and service to consumers and thereby to improved trust and confidence in the industry. If realised, these benefits can be expected to flow on to a greater interest by consumers in seeking life insurance advice and improved life insurance coverage across the community. The life insurance industry, in conjunction with consumer and industry representatives, relevant regulators and other stakeholders should develop and introduce principles based, voluntary, Life Insurance Code of Practice.

The code should be a customer focused document which promotes adequate life insurance coverage for all Australians. The code will be self regulatory, industry funded and should cover direct, retail advised and group life insurance products.

The general insurance industry and the banking industry, among others, have had codes of practice in force for some years. The existence of these codes and experience in developing and applying them can therefore be drawn upon by the life insurance industry.

The content of the General Insurance Code of Practice is based upon achieving the following objectives that could reasonably be adapted to the life insurance industry:

- promote better, more informed relations between insurers and their customers;
- improve consumer confidence in the industry;
- provide complaint and dispute resolution mechanisms; and
- commit insurers and other insurance professions to high standards of customer service, including in relation to claims practices.

In addition, submissions raised a number of areas that could be considered in the development of a Life Insurance Code of Practice, they include:

- **Standards of practice during the life cycle of the life insurance process**
 - Appropriate behaviours for insurer Business Development Managers and other employees associated with providing their products to licensees and advisers;
 - Standards of behaviour for distributors, employees, and authorised representatives, for example conducting an efficient honest and fair and transparent process.
 - Sales and distributions practices to be conducted honestly, fairly and efficiently;
 - Product disclosure to be succinct, transparent and in plain English;

- Suggested standardised practices for insurers and advisers dealing with non-disclosure, pre-existing conditions and other matters.
- **Education requirements**
 - A commitment to consumer education especially in relation to life insurance concepts.
 - Requirements in respect of education and expertise for life insurance employees that have direct or more specialised interaction with advisers and clients, including Business Development Managers.
- **Customer access to information**
 - Insurers to hold fund trustees to similar levels of customer service standards such as supply insurance coverage details on their members in response to a request in a timely fashion.
 - Upgrade management information flowing between insurers, licensees and advisers to support remuneration reforms, client orientation, improved capabilities and improved economics of licensees and advisers
 - Timeframes for life insurers to respond to requests for information from customers either individually or through their adviser
- **Best practice guidelines for underwriting**
 - Standards for underwriting practice, for example clearly communicating why insurance coverage is not provided in certain circumstances.
 - Standards of practice for policy increases, such as a fair and reasonable, and efficient approach to handling requests to “increase” or “alter” an existing insurance policy online, including ensure an efficient underwriting process on par with new business.
- **Best practice guidelines for claims handling**
 - Standards for claims handling, such as: (i) fast tracking assessment and decision process when an urgent financial need of benefit is necessary; (ii) best practice timeframes for claims assessment; (iii) best practice communication requirements during the claims process
 - Financial Hardship practices.
- **Complaint and dispute processes, including internal and external processes**
- **How monitoring, enforcement and sanction under the Code will work** (see some discussion in implementation).
- **Other**
 - Best practice guidelines for replacement policy advice.
 - Practices relating to quarantining a new product line to existing customers, as well as closing policy series and not offering product updates to clients.

- Principles around providing a legitimate upgrade path for clients to current policy series or backdating of definitions for conditions a client is already covered for.

A review of any life insurance code of practice should take place after an appropriate period of time has elapsed post implementation to ensure that the desired objectives have been met.

Policy Objectives

- Promote fair and honest treatment of consumers buying products at all stages of the life insurance value chain.
- Promote efficiency and limit or avoid the future need for more prescriptive regulation.
- Improve consumer trust and confidence in life insurance products and distribution practices.
- Respond to identified and emerging consumer issues and deliver substantial benefits to consumers.

Issues the recommendation seeks to address

It is notable that both the general insurance industry and the banking industry have Codes of Practice, both developed in the 1990s, but that the life insurance industry does not currently have anything comparable.

There was a Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry, also created in the 1990s, but it was superseded with the coming into force of the *Financial Services Reform Act 2001*. A copy of this guide is reproduced in Appendix 5.¹⁹

This ‘code of practice’ was not a self-regulatory mechanism; instead it was imposed on the industry, albeit with appropriate consultation and support, by the Insurance and Superannuation Commission. Due to a vastly different regulatory regime for financial advice that pre-dated the formation of ASIC and APRA, and more recently FoFA, the majority of the code covered areas in relation to the provision of financial advice, such as, advising and selling practices, and training and competency requirements. Using the life insurer to regulate adviser behaviour made sense because the tied-agent business model was still in existence for life insurance.

Box 3 summarises areas the previous code covered and discusses aspects of the code that have been subsumed into legislation. What is clear from its discussion is that there is no effective system of regulation of a number of areas of the consumer and life insurer relationship. This has on occasion led to poor consumer outcomes in terms of poor customer service in relation areas such as enquiries (either by the adviser or customer) and claims practices.

Box 3 Earlier Code of Practice for Life Insurance and other regulatory developments

In August 1995 APRA’s predecessor, the Insurance and Superannuation Commission (ISC), issued a Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry (Code) that applied to all life companies and life brokers, and their life insurance advisers. It dealt with:

- Acceptable practices when advising or selling life insurance policies;
- Basic competencies and training that life advisers must have; and

¹⁹Insurance and Superannuation Commission (1995) Consumer Issues No G.II.1 ‘Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry’

- Internal complaints handling and membership of external dispute resolution scheme requirements.

Life companies and life brokers were required to provide regular reports to the ISC about compliance with the Code. Breaches of the Code were required to be referred to the life company's Board or Code Compliance Committee, or to the life brokers' directors or principals.

This Code was issued as an interim measure implementing consumer protection initiatives subsequent to the establishment of the *Life Insurance Act 1995* but prior to the development of a statutory framework for consumer protection provisions. At the time of its inception, the Code was a key element in achieving a better balance in the relationship between insurers and consumers, and an increased level of protection for policyholders.

Over the two decades since the Code was issued, alternative regulations have been developed and industry standards adopted with the aim of addressing consumer issues in the Life Insurance sector. These include but are by no means limited to:

- Financial Services Reform Act 2001 – Included heightened conduct and disclosure requirements for insurance product providers and licensees/advisers.
- Future of Financial Advice (FoFA) and associated reforms – Requires Life Insurance advice to be in clients' best interests and increases the education, training and competency requirements for the provision of such advice.
- National Insurance Brokers Code of Practice – Sets out the minimum standards for National Insurance Brokers Association (NIBA) members including in relation to customer service, complaints and compliance review processes.
- Financial Services Council Code of Ethics and Conduct - Compliance with the FSC Code is compulsory for all FSC members including insurers and licensees. It contains specific rules as well as broader ethical principles to guide decision-making.
- Internal and External Dispute Resolution schemes – Insurers are required to resolve complaints received within the regulated timeframe or and consumers have access to the Financial Ombudsman Service (FOS) when unhappy with the insurers resolution.

There is also no self-regulation within the life insurance industry to assist, on an industry wide basis, standards of best practice or industry benchmarks to improve customer experience. The development and introduction of an industry code of practice is desirable and timely.

In addition, a number of recent high-profile media reports of advice failure²⁰ have damaged consumer confidence in life insurance products, especially those sold via financial advisers. These incidents also demonstrate some licensees had serious compliance issues in providing personal risk advice and internal controls. A Life Insurance Code of Practice that considers standards of behaviour for those who distribute their products and how this behaviour impacts the consumer will alleviate community concerns about the quality of financial advice and reduce the risk of inappropriate sales incentives manifesting as consumer detriment.

²⁰ For example, ASIC 2015, ASIC imposes conditions on Guardian Advice licence 7 January.

Discussion of recommendation

Industry codes of practice can play an important part in how financial products and services are self-regulated in Australia. When an industry is committed to developing and enforcing a code of practice, it can deliver valuable benefits to both consumers and those who are bound by the provisions of the code to which they subscribe. An industry code can set standards of best practice that contribute to the delivery of effective outcomes for consumers.

Importantly, such a code could promote fair and honest treatment on customers and set standards for distribution across retail, direct and group channels. This would reduce the risk of consumers being placed in products that do not suit their needs.

Increasing the accountability of life insurers and their standards relating to distribution by introducing principles for conduct and behaviour would improve consumer confidence and trust in the system. This view is supported in submissions by consumer groups, financial advisers and insurers.

A key aspect of this recommendation is that the focus is on life insurers and their relationship with customers. Some submissions suggested a code should consider also covering the adviser relationship with the customer, and the insurer relationship with the adviser or dealer group. There are a number of reasons, however, why the focus should be life insurer and customer rather than adviser and customer, including:

- **Precedent** – existing industry codes in banking and general insurance define the customer relationship between product manufacturer and customer. These arrangements have been found to be effective in improving consumer outcomes and trust and confidence.
- **Limiting duplication** – customer relationships with advisers are already managed through a number of mechanisms including professional standards, and legislation such as FoFA. Further existing processes are currently underway aimed at improving adviser standards and customer outcomes, including the PJC Inquiry into educational and professional standards for financial advisers. As identified earlier in the case of life insurer interactions with clients there is a clear gap to be filled.
- **Appropriate focus** – a focus on how insurers interact with licensees or advisers would lack a consumer focus. This relationship could still be covered in a Life Insurance Code of Practice but with a view to how these interactions impact on consumer outcomes. Commercial dealings between life insurers, licensees and advisers are generally a matter for the marketplace to determine but inserting behavioural or conduct principles around these practices would assist.
- **Effective coverage** – for a code of conduct to be effective it will require broad industry support and membership. Aiming this at life insurers would effectively mean capturing a smaller group than licensees and advisers. However, lifting life insurer standards will have flow on effects on licensees and advisers and seems the quickest and most effective way for change to be implemented through the industry. This approach has been successful in banking and general insurance.

Some submissions from licensees raised areas of insurer practice that they believe promotes churn, such as takeover terms and the role and education of life insurer Business Development Manager (BDM) as an area that should be covered in a code of practice. Such a code could cover the appropriate behaviours and education requirements for life insurer BDMs. However, underwriting practices and how they interact with takeover terms are: (1) an area of competition amongst

insurers that can deliver value to consumers; and (2) an issue for the insurer to determine the appropriate level of risk they wish to engage in their business. Further, the recommendations on adviser remuneration, in particular the IAP, will limit the commission available to an adviser accepting these terms to level commission only.

In addition, a number of prescriptive measures were also highlighted in submissions, such as mandating product upgrade, specific forms disclosures, APL practices, and remuneration practices. In some cases it would be inappropriate to deal with these issues due to the restrictive nature they could have on competition and end consumer outcomes. In other cases, specifically remuneration and APL practices, there are separate recommendations aimed at addressing these issues so their inclusion in a code of conduct is not necessary.

Some submissions noted that this Code of Practice would need to be part of a package of more fundamental reforms to conflicted remuneration in the retail life insurance distribution. In conjunction with other recommendations in the report, a life insurance code of practice could improve consumer outcomes by making insurers more accountable regarding underwriting, claims, and remuneration arrangements with those who distribute their product.

This option would also deliver benefits to industry, including strengthening internal risk management for claims and underwriting practices, which may mitigate future problems, as well as signalling a higher level of customer focus. This approach could also avoid new, more complex and interventionist regulating in the future.

Analysis of other options

- A regulator approved code of conduct, either ACCC if prescriptive or ASIC under s110A of the *Corporations Act 2001* if principles based.
- An individual appropriateness test at point of sale.

A regulator approved code of conduct

ASIC has published a Regulatory Guide (RG 183) that sets out its expectations for financial services sector codes of conduct. Although it is not mandatory for the life insurance industry to seek approval of its Code of Practice, the criteria set out in RG 183 serve as a very useful set of criteria in developing a code. For example, ASIC expects an effective code to do at least one of the following:

- a) address specific industry issues and consumer problems not covered by legislation;
- b) elaborate on legislation to deliver additional benefits to consumers; and/or
- c) clarify what needs to be done from the perspective of a particular industry, practice or product to comply with legislation.

This option would still be available to industry if they chose to seek approval. However, a properly designed principles based self regulatory code should achieve the objectives for the industry and consumers without necessarily obtaining ASIC's approval.

An individual appropriateness test at point of sale

In consultations, consumer groups raised the idea of an individual appropriateness test at the point of sale. In retail life insurance, this is not relevant as the adviser is bound by the best interest duty. However, in other distribution channels this may be a concern. The Financial System Inquiry noted that:

An individual appropriateness test, where no personal advice is provided, would introduce significant costs for issuers and distributors due to necessary changes to the sales process. Appropriateness tests are also open to manipulation.

A principles-based life insurance code of conduct that covers direct, group and retail products would be a less prescriptive solution to these concerns.

Implementation

The code will represent a self-regulatory arrangement that defines the relationship between the consumer and life insurance industry.

In many respects such a code would mirror the General Insurance Code of Practice. However, part of the code will need to be augmented by a range of practices that are specific to the life insurance industry in view of such factors as the long-term nature of life insurance, the nature of the involvement of licensees and financial advisers, and the tripartite nature of the industry through the existence of direct life insurance, retail life insurance and group life insurance

Existing industry code of practice structures should be adopted to facilitate the effectiveness of the code. These typically entail a contractual relationship between signatories to a code and its governing body. The following governance mechanisms would facilitate the effectiveness of the code:

- an independent body with responsibility for monitoring and enforcing compliance with the code;
- an industry body, such as the FSC, with responsibility for policy development of the code, in consultation with relevant stakeholders, on a continuing basis; and
- linking the code to external dispute resolution processes such as the Financial Ombudsman Service (FOS), the Superannuation Complaints Tribunal (SCT) and the courts which may choose to report possible code breaches to the monitoring body.

The creation of an industry code of practice needs to be a well constructed consultative process that involves the primary interested parties, namely the life insurers, life insurance advisers and consumers. The code of practice should not limit competition and innovation amongst insurers, licensees and advisers and should be principles based.

Implementation Recommendation 4: That a Life Insurance Code of Practice as at Policy Recommendation 6 be developed by the life insurance providers in a consultative process that embraces licensees, advisers and consumers.

Appendix 1 – Terms of Reference

Life Insurance and Advice Working Group (LIAWG) Terms of Reference

1 Objectives

The LIAWG will review ASIC's report and make recommendations on how the industry can respond to the issues identified to ensure that Australians are adequately insured and receive world class financial advice.

2 Scope

The LIAWG will consider all options in its response including those which will be industry led and those which will require regulatory assistance.

The LIAWG will:

- Provide a unified response to the identified issues;
- Address the three key issues arising from the report:
 1. remuneration structures;
 2. product design issues; and
 3. quality of advice.

2.1 The LIAWG will provide specific analysis on the options and recommendations for industry change, including transitional paths.

3 Timing

3.1 The Working Group will provide an Interim Report by mid December 2014 and will report in early 2015.

4 Consultation

4.1 The Working Group will consult with key industry stakeholders, consumer groups, regulators and the Parliament.

5 Support

5.1 The Working Group will be supported by a Secretariat within the associations.

5.2 The LIAWG will have an independent chair, and will include a mix of advice, practitioner, and insurance representatives drawn from the founding industry organisations, the AFA and the FSC.

Appendix 2 – Biographies of LIAWG Members

Chairman – Mr John Trowbridge

Mr John Trowbridge has a background as a consultant, executive, company director and regulator in a career spent predominantly in the financial services sector, with an emphasis on insurance-related businesses. He started Trowbridge Consulting in the 1980s, which became a leading actuarial and management consulting firm in Australia and Asia, and has participated in a wide range of life insurance consulting assignments. From 2006 to 2010 Mr Trowbridge was one of three APRA Members where he had carriage of life and general insurance.

Mr John de Zwart, CEO Centerpoint Alliance

Mr John de Zwart is currently the Chief Executive Officer of Centrepoint Alliance, the largest non-institutionally controlled advice business in Australia. Mr de Zwart has over 25 years of senior executive experience in the Australian, UK and NZ financial services industry including roles at TAL and AMP.

Mr Brad Fox, CEO AFA

Mr Brad Fox is currently the Chief Executive Officer of the Association of Financial Advisers. Previous to this role Mr Fox was a financial advice practice owner and adviser for 8 years and spent 5 years as an AFA Board Member including 2 years as the AFA President.

Mr Andrew Hagger , Group Executive NAB Wealth

Mr Andrew Hagger is currently Group Executive, NAB Wealth. Mr Hagger is also a director of the FSC and co-chair of the FSC's Advice Board Committee. Prior to joining NAB, Mr Hagger spent 21 years with PricewaterhouseCoopers (PwC) in a number of capacities, including Melbourne Managing Partner and as a member of PwC's Firmwide Leadership Team.

Ms Sally Loane, CEO Financial Services Council

Ms Sally Loane is currently Chief Executive Officer of the Financial Services Council. Previous to this role Ms Loane was a director of media and public affairs for top 50 ASX Listed company, Coca-Cola Amatil. Ms Loane was a broadcaster and journalist before entering the corporate sector.

Mr Geoff Summerhayes, CEO Suncorp Life

Mr Geoff Summerhayes is currently Chief Executive Officer Suncorp Life. Mr Summerhayes is also a director of the FSC and co-chair of the FSC's Life Board Committee. Mr Summerhayes has more than 20 years experience across property and financial services with previous roles at Lend Lease, MLC and NAB.

Mr Jeff Thurecht, Director and Financial Adviser at Evaluesco Financial Services

Mr Jeff Thurecht is currently a Director and Financial Adviser at Evaluesco Financial Services. Mr Thurecht is also a NSW State Director of the Association of Financial Advisers (AFA). Mr Thurecht has over 17 years in the industry, and has held previous roles within life insurance, management, paraplanning and financial advice.

Appendix 3 – Submissions and Consultations

Submissions

In total 137 submissions were received from a wide range of interested parties. Submissions were received from:

- Life insurers;
- Life reinsurers;
- Licensees;
- Advisers;
- Consumer groups;
- Insurance brokers including aggregator website businesses;
- Industry associations;
- Professional associations; and
- Individuals and consulting firms.

The bulk of submissions received were from licensees and advisers. The majority of life insurers active in the retail life insurance industry made submissions.

Submissions varied in length with some submissions only comprising one page, while others were detailed responses over 50 pages long. In total over 1,000 pages of content were received in submissions.

The submissions were rich in content, which ranged across explanations of business practices and models, expressions of opinion, anecdotal experiences, commercial information, financial analysis, examples of documentation, ideas or proposals for reform, advocacy of preferred positions, etc.

Some submissions were very comprehensive and covered detailed analysis and commentary on some or all of the issues and questions raised in the Interim Report.

Additional information

Some organisations provided data and other material on request to assist the review. Included were five insurers and three adviser groups who supplied data on portfolio composition and premiums.

Consultations

Consultations were conducted through the course of the review with many individuals variously representing life insurers, advisers, licensees, consumer groups and government agencies (Treasury, ASIC and APRA).

Most authors of submissions included an invitation for meetings or opportunities to discuss their submissions. With limited resources and time, these invitations were accepted on a limited basis in order to gain additional information, test ideas and submission content etc where it was thought that such interaction would assist the review and development of recommendations.

There were more than 50 meetings with relevant parties. In addition the Life Insurance and Advice Working Group met nine times from its inception in October 2014.

Appendix 4 – Registered Life Insurance Companies

The Life Insurance companies listed below are currently registered under section 21 of the Life Insurance Act 1995.

This list was sourced from the APRA Quarterly Life Insurance Statistics (June 2014).

Registered Retail Life Insurers:

- AIA Australia Limited
- Allianz Australia Life Insurance Limited
- AMP Life Limited
- ClearView Life Assurance Limited
- Colonial Mutual Life Assurance Society Limited and St Andrew's Life Insurance Pty Ltd
- Macquarie Life Limited
- MLC Limited
- OnePath Life Limited
- QBE Life (Australia) Limited
- Suncorp Life & Superannuation Limited
- TAL Life Limited
- Westpac Life Insurance Services Limited
- Zurich Australia Limited

Other Registered Life Insurers/ Reinsurers

- Challenger Life Company Limited
- Combined Life Insurance Company of Australia Ltd
- GLOBAL Life Reinsurance Company of Australia Pty. Limited
- General Reinsurance Life Australia Ltd
- H C F Life Insurance Company Pty Ltd
- Hallmark Life Insurance Company Ltd.
- Hannover Life Re of Australasia Ltd
- Munich Reinsurance Company of Australasia Limited
- RGA Reinsurance Company of Australia Limited
- SCOR Global Life Australia Pty Limited
- St. George Life Limited
- Swiss Re Life & Health Australia Limited
- The National Mutual Life Association of Australasia Limited

Appendix 5 – ISC Code of Practice for Advising, Selling and Complaints Handling



CIRCULAR

INSURANCE AND SUPERANNUATION COMMISSION

LIFE INSURANCE ACT 1995

**CIRCULAR TO LIFE INSURANCE COMPANIES
AND LIFE BROKERS**

CONSUMER ISSUES No G.II.1

**CODE OF PRACTICE
FOR
ADVISING, SELLING AND COMPLAINTS HANDLING IN THE
LIFE INSURANCE INDUSTRY**

AUGUST 1995

CODE OF PRACTICE FOR ADVISING, SELLING AND COMPLAINTS HANDLING IN THE LIFE INSURANCE INDUSTRY**1. Introduction**

On 1 July 1995 the *Life Insurance Act 1995* (the Act) came into effect establishing a new regime for the regulation of the life insurance industry. A stated object of the Act is:

‘to protect the interests of the owners and prospective owners of life insurance policies in a manner consistent with the continued development of a viable, competitive and innovative life insurance industry.’

Specific consumer protection measures have always been an intended component of the new regulatory regime. The Consumer Protection Provisions are expected to be passed as an amendment to the Act in the early part of 1996. These provisions will provide the statutory framework for development of legislative instruments (Commissioner’s rules) in respect of:

- requirements for product information disclosure (Disclosure rules)
- requirements for advising selling and complaints handling (Code of Practice)

In the interim, these initiatives will be implemented by way of Circular.

2. Background to the Development of the Code of Practice

It has long been a recognised concern of the government of the day that, in respect of the dealings between large corporations and individual consumers, there may not be equality of bargaining power. In respect of the life insurance industry in particular, this view was supported, and raised to the public agenda, by three major reports published during the period 1992 - 1993. These were:

- The Trade Practices Commission Report on “Life Insurance and Superannuation”, December 1992
- The Senate Select Committee on Superannuation Report No 6 “Super Fees, Charges and Commissions”, June 1993
- The Australian Law Reform Commission Report No 65 “Collective Investments, Other People’s Money”, June 1993

These reports were consistent in their criticism of selling practices in the life insurance industry - highlighting as potential problem areas commission levels, pressure sales and low early termination values.

The Consumer Protection Provisions represent the Government's response to perceived, and evidenced, poor practice in the life insurance industry. These provisions, in concert with the other elements of the new regulatory regime, will facilitate a more equitable relationship between the life insurance company as provider and its customers.

The Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry (the Code of Practice) is a key element in achieving a better balance in the relationship between insurance providers and consumers, and an increased level of protection for policyowners.

The early development of the Code of Practice was driven by a Government Taskforce chaired by the Insurance and Superannuation Commission and including representatives from the Federal Bureau of Consumer Affairs and the Trade Practices Commission.

A draft Code of Practice was released for public comment in August 1994 and over 70 submissions were received. These submissions highlighted the diversity of opinion amongst the various stakeholders and interest groups affected by the proposals.

Accordingly, in the final stages of the development of the Code of Practice, a Working Group was established, chaired by LIFA, with a membership representative of the major stakeholder groups including government, consumer groups, product providers and intermediaries. The Working Group was instrumental in facilitating discussion and achieving a consensus position across the stakeholder groups on a number of the issues. The final version of the Code of Practice reflects those consensus positions, but required final decisions on some remaining contentious issues to be taken by the Government.

While the Code of Practice, as issued, is clearly aimed at improving selling practices and ensuring policyowner protection immediately, it is anticipated that many companies will impose higher standards and that, in time, the Code itself will reflect an overall lifting of minimum standards.

Proposed Registration Board

During the development of the Code of Practice the original intention to include basic competency requirements and recruitment standards for life insurance advisers was set aside, pending the development of an industry based Registration Scheme. Such a scheme was strongly advocated by the agents' association, supported by the insurance companies and accepted in concept by the Government. The development phase of the scheme is well advanced and is expected to be completed during 1996.

3. The Role of the ISC in Consumer Issues

The draft Consumer Protection Provisions under the Act require the establishment within each life company of a Compliance Committee. The principal purpose of this Committee being to assist in dealing with consumer-related issues that arise in the

course of the life company's operations, and to ensure that the life company at all times has a proper system of management controls that will enable it to comply with the Disclosure Rules and the Code of Practice.

The motivation for establishing the Compliance Committee was to reinforce with life companies the importance of the Consumer Protection Provisions and to ensure that directors recognised that the responsibility in respect of these matters was theirs.

In keeping with this motivation it must be stressed, at this early stage of implementation of the Code of Practice, that enforcement of these provisions of the Code of Practice is the responsibility of the life company or life broker as appropriate. Within the ambit of this responsibility it is the life company or life broker that must make the operational and commercial judgements necessary in determining acceptable standards of practice to achieve compliance with the Code of Practice.

The ISC accepts responsibility for, and intends to play an active role during, the introduction of the concepts and intentions underlying the Code of Practice. Further the ISC will be taking an active role in monitoring the industry and the procedures life companies and life brokers have in place to enforce the requirements of the Code of Practice. The ISC cannot, and will not, accept responsibility for the interpretation of the specific requirements which the Code of Practice imposes or the judgmental decisions on how they should be complied with.

The ISC will be seeking to establish a relationship with representative industry groups and facilitate a communication process that works largely through these industry channels. The ISC encourages individual life companies and life brokers to similarly establish networks within the industry for communication of, and discussion on, the operational aspects of the Code of Practice. The function of the Compliance Committee and/or the nomination of a compliance officer is seen as integral to the development of appropriate communication lines between the ISC and the individual life companies or life brokers.

4. Commencement Date of the Code of Practice

Individual parts of the Code of Practice will take effect on the following dates:

1 September 1995	Part I	Introduction
	Part IV	Inquiries, Complaints and Disputes
1 January 1996	Part II	Advising and Selling Practices
	Part III	Training and Competency
	Part V	Monitoring and Reporting

While life companies and life brokers do not have to formally comply with Parts II, III and V until 1 January 1996 it is expected that they strive for full compliance as early as possible.

5. Implementation of the Code of Practice

The implementation phase for the Code of Practice is the period from launch of the Code of Practice (3 August 1995) to the date on which the full requirements of the Code of Practice have commenced (1 January 1996). During the implementation phase, the ISC will be acting to ensure that industry is responding to the requirements of the Code of Practice and that life companies and life brokers will be in a position to comply with the full requirements by 1 January 1996.

To assist the ISC in this process, life companies and life brokers are required to provide the following information:

(a) *Code of Practice implementation plan*

The implementation plan will assist the ISC in monitoring industry implementation of the Code of Practice.

Life companies and life brokers are required to complete the attached implementation plan (Attachment 2) and forward it to the ISC by 30 September 1995.

(b) *Pre-Code statistical survey*

The purpose of the statistical survey is to gather pre-code statistics on life company and life broker practices. This information will be used as benchmark data against which changes in practices and procedures can be measured.

Life companies and life brokers are required to complete the attached statistical survey (Attachment 3) and forward it to the ISC by 30 September 1995.

(c) *Interim compliance report*

The purpose of this report is to monitor life company and life broker progress in putting in place procedures and mechanisms in anticipation of the implementation of the Code of Practice. This report will target the matters set out in paragraph 41.

The ISC will distribute an interim compliance report in November 1995 for completion and return by December 1995.

6. Monitoring of the Enforcement of the Code of Practice

The ISC's role in monitoring the enforcement of the Code of Practice will commence, in respect of the particular requirements of the Code of Practice, on the respective dates of commencement of those requirements. In this capacity, the ISC will be acting to ensure that, on an ongoing basis, life companies and life brokers remain in a position to comply with the requirements of the Code of Practice (i.e. maintain and develop the systems and management controls in place to enable compliance).

This monitoring will be primarily achieved through:

- (i) statistical reports from life companies and life brokers; and

(ii) an audit program implemented by the ISC involving routine and special-site inspection of the companies and brokerages.

Statistical report

Life companies and life brokers will be required to report to the ISC by completing a regular statistical report (paragraph 45 of the Code of Practice). The Pre-Code Statistical Survey included in this package should not be taken as indicative of the type, or level of detail, of information which will be sought on a regular basis.

Development of the format and content of the statistical returns to be required of life companies and life brokers will be progressed over the next three to six months. The development will occur in close consultation with industry representative bodies, and as a part of the total review of the financial and statistical returns required under the Act. This will ensure consistency and avoid duplication of the information sought under the Code of Practice and provided through other statistical returns under the Act.

As an indication of the matters on which it is expected information will be requested, the following list highlights some of the areas identified to date. (This should not be taken as an exhaustive list).

- use of Fact Finders
- business written and terminated by reason of replacement business
- same day sales
- experience under the cooling off provisions
- discontinuances by duration in force

The ISC will publicly report the findings of its data-gathering. In addition a comprehensive report will be presented to Parliament by inclusion in the ISC Annual Report.

7. Administration of the Code of Practice

(a) Customer Advice Record

There is no requirement under the Code of Practice for the Customer Advice Record (CAR) to be signed by the customer (refer to paragraphs 18-26).

The Commissioner is of the view that industry best practice would require the signing of this record by the customer. Life companies and life brokers are encouraged to adopt industry best practice in respect of the CAR.

LIFA has undertaken to monitor this by way of periodic survey, the results of which will be made available to the ISC. Further the ISC, in its own monitoring program, will have regard to this issue.

(b) External Dispute Resolution Mechanisms

Under the Code of Practice paragraphs 37-39, the Commissioner has power to grant and revoke approval for external dispute resolution mechanisms.

At the time of releasing this Circular the Commissioner has granted approval to the following:

- Life Insurance Complaints Service Limited
- Superannuation Complaints Tribunal

8. Attachments

1. Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry
2. Implementation Plan
3. Pre-Code Statistical Survey

R G Glading
Deputy Commissioner
Life Insurance

3 August 1995

Contact for Enquiries:

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INSURANCE AND SUPERANNUATION COMMISSION

**CODE OF PRACTICE
FOR
ADVISING, SELLING AND COMPLAINTS HANDLING
IN THE
LIFE INSURANCE INDUSTRY**

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PART I INTRODUCTION

OBJECTIVES

1. This Code is intended to:
 - (a) promote the provision of high quality advice in relation to life policies, so that where policies are issued they are appropriate to the needs of the persons to whom they are issued;
 - (b) ensure that life companies, life brokers and life insurance advisers maintain a minimum standard of service when dealing with customers in relation to life policies;
 - (c) ensure life companies and life brokers play an active role in overseeing the conduct and competence of their life insurance advisers;
 - (d) ensure that life insurance advisers are competent in arranging the issue of life policies;
 - (e) ensure that life companies and life brokers have adequate procedures for dealing with inquiries and complaints by owners and prospective owners of life policies and by any persons who have an interest in a life policy; and
 - (f) ensure that, in the case of disputes that are not able to be resolved under procedures referred to in paragraph (e), owners and prospective owners of life policies and any persons who have an interest in a life policy have access to an adequate external dispute resolution mechanism.

2. The function of this Code is to require:
 - (a) the observance of standards to ensure that customers are placed in a position to make an informed choice;
 - (b) the establishment of arrangements to ensure that life insurance advisers meet relevant competency standards and follow principles of fair dealing; and
 - (c) the establishment of inquiries and complaint-handling mechanisms which ensure that customers are provided with timely and acceptable standards of assistance.

3. Compliance with the requirements of this Code shall be assessed having regard to the principle of utmost good faith that applies to contracts of insurance, as set out in the *Insurance Contracts Act 1984*.

APPLICATION

4. This Code applies to:
 - (a) all life companies registered under the *Life Insurance Act 1995*; and
 - (b) all life brokers registered under the *Insurance (Agents and Brokers) Act 1984*;in respect of their conduct and the conduct of their life insurance advisers.
5. Parts I and IV of this Code commence with effect from 1 September 1995, with the remainder of the Code to commence with effect from 1 January 1996. The provisions of the Code apply in respect of conduct engaged in by life companies, life brokers and life insurance advisers, and policies issued, on or after the date of commencement of the relevant Part. Notwithstanding the above, the complaint-handling and dispute resolution arrangements referred to in Part IV of this Code apply to complaints in respect of events which occurred before the date of commencement of this Code.
6. Where a group life or group superannuation policy is effected and any individual whose life is insured under the scheme, while not the policyowner, is making the effective purchasing decision, all the provisions of the Code will apply as if that individual were the customer. In all other cases where a group life or group superannuation policy is effected, Part II of the Code will not apply.

INTERPRETATION

7. References to the singular include references to the plural and vice versa.
8. For the purposes of this Code:

"advice" means any recommendation, express or implied, made to a customer with respect to the purchase, variation or termination of a life policy, but does not include:

 - (a) answers to routine administrative queries;
 - (b) factual information about a particular life policy;
 - (c) collection of premiums and issue of receipts without other contact;
 - (d) placing promotional statements on display, or merely handing them out or posting them;
 - (e) merely acting as a facilitator, such as arranging for medical examinations;
 - (f) non-personalised advice which merely analyses and reports on life policies and does not involve any needs analysis of a particular customer; or
 - (g) merely incidental advice.

"agent", in relation to a life company, means a person in relation to whom an agency agreement is in force with the life company.

"association" for the purposes of this Code has the same meaning as "association with" has in respect of life brokers under section 38 of the *Insurance (Agents and Brokers) Act*

1984, except that it also extends to all employers or contractors of life insurance advisers.

"**authorised product**" means a product which a life insurance adviser is authorised by a life company or life broker to give advice on.

"**Commissioner**" means the Insurance and Superannuation Commissioner.

"**complaint**" means an expression of dissatisfaction conveyed to a life company or life broker about a product, advice or service offered or provided coupled with a request to remedy it.

"**customer**" means a person who deals with a life insurance adviser for the purpose of either:

- (a) purchasing, varying or terminating a life policy; or
- (b) seeking advice regarding a life policy;

and includes a policyowner, a life insured, a prospective policyowner and a person with an interest, or a prospective interest, including under a superannuation policy.

"**dispute**" means an unresolved complaint.

"**life company**" means a company registered under the *Life Insurance Act 1995*.

"**life insurance adviser**" is a natural person who, for reward, provides advice in respect of, or arranges, life policies.

"**life broker**" means a person who is for the time being registered under Part III of the *Insurance (Agents and Brokers) Act 1984* in respect of life insurance business.

"**life policy**" for the purposes of this Code has the same meaning as in the *Life Insurance Act 1995*.

"**merely incidental advice**" is advice provided by a solicitor, accountant or other adviser in circumstances where that solicitor, accountant or adviser:

- (a) does not provide a discrete advisory service in respect of life policies;
- (b) does not receive a fee, commission or other benefit for providing such advice; and
- (c) attaches to their advice a written recommendation that the customer seeks the advice of a life insurance adviser.

"**multi-agent**" is an agent who is authorised to act as a life insurance adviser by more than one life company.

"**product**" means a particular kind of life policy.

"**risk policy**" means a policy which provides no surrender value and no benefit payable on a specified date or dates.

"**sale**" means a customer's request, expressed in writing, for the issue of a new life policy, or for the variation of an existing life policy where that variation results in increased expenditure by the customer.

"**sell**" means obtain a sale, and sold and selling have corresponding meanings.

"**superannuation policy**" for the purposes of this Code has the same meaning as in the *Life Insurance Act 1995*.

"**termination**" means the giving by a customer of an instruction to terminate a life policy.

"**unsolicited contact**" means contact between a life company, life broker or life insurance adviser and a customer made where there has been no previous contact between the parties, but excludes a meeting which has been initiated by the customer.

PART II ADVISING AND SELLING PRACTICES

This Part specifies standards of practice that life companies and life brokers are to observe and to require their life insurance advisers to observe.

EXEMPTIONS

9. The requirements of this Part do not apply to risk policies where the annual premium payment under such policies is less than \$500 in total per life insured.

DISCLOSURE OF CAPACITY

10. At the earliest reasonable opportunity during advising or selling, a life insurance adviser must provide written advice to a customer of:
 - (a) the name and address of the life insurance adviser;
 - (b) the means of remuneration of the life insurance adviser, who is responsible for the life insurance adviser's conduct and whether the life insurance adviser's primary duty is to the customer or the life company; and
 - (c) if the life insurance adviser is only authorised to sell or advise on a restricted range of products - a statement to that effect.

SAME-DAY SALES

11. A life insurance adviser must not sell a policy (other than a risk policy) to a customer where that life insurance adviser has already sold another policy (other than a risk policy) on the same site (eg. work place, flats) or to someone of the same community group (eg. sporting club, ethnic group), within the previous 24 hours. Such sales will be permitted where the sale does not result from an unsolicited contact. Where a same-day sale occurs, this must be clearly indicated on the application/proposal form.

FACT FIND AND NEEDS ANALYSIS

12. In all cases where advice is given by a life insurance adviser, he or she must:
 - (a) analyse the needs, circumstances and objectives of the customer to ensure that advice is given on a reasonable basis and is not inappropriate; and
 - (b) take reasonable steps to ensure that the customer can sufficiently comprehend the advice and the basis for the advice to place the customer in a position to make an informed choice.

13. Unless the customer chooses (in terms of paragraph 17 of this Code) not to provide information, a life insurance adviser must undertake a fact find, that is, he or she must obtain sufficient information from the customer, subject to paragraph 16 of this Code, to satisfy the requirements of paragraph 12. This information would generally include, where relevant:
- (a) the customer's financial and family circumstances;
 - (b) details of the customer's needs and objectives for income, capital growth, security, liquidity, and the time period the customer is planning for;
 - (c) individual investment preferences and aversion or tolerance to risk;
 - (d) the level and type of retirement benefit which the customer (and domestic partner) can currently expect to receive;
 - (e) other customer details such as employment security, age, partner's age, expected retirement age and partner's expected retirement age.

Where the customer has indicated prior to the fact find or in its early stages that his or her interest extends only to risk policies, the fact find may not need to proceed through (b) to (e) above.

14. The information obtained during a fact find must be recorded in writing, the resultant document being referred to in this Code as a Fact Finder. The Fact Finder must be signed by the life insurance adviser as a record for the purposes of paragraph 40.
15. In satisfying the requirement in paragraph 13, a life insurance adviser may utilise information previously collected from the customer, provided that the customer agrees that the information remains relevant and up to date.
16. Where the customer and the life insurance adviser agree that only certain types of products or identified objectives are to be considered, the life insurance adviser need only obtain, and the Fact Finder need only contain, information that is relevant to the types of products or objectives under consideration. A reference to this agreement must be included in the Customer Advice Record referred to in paragraph 18.

INCOMPLETE FACT FIND

17. Where the customer chooses not to provide all information requested by the life insurance adviser for an effective fact find, the customer must be advised of the implications of not allowing an effective fact find and needs analysis to be conducted. The Customer Advice Record (referred to in paragraph 18) must contain:
- (a) a specific warning that appropriate advice may not be able to be given without complete information; and
 - (b) a statement that, by not providing sufficient information, the customer risks making a financial commitment to a life policy that may not be appropriate to his or her needs.

CUSTOMER ADVICE RECORD

18. The customer must be provided with a copy of a written Customer Advice Record containing the information prescribed in paragraphs 16, 17 and 19 to 25 of this Code, no later than at the commencement of the cooling-off period.

Requirements where advice is given

19. Where advice is given, the Customer Advice Record must contain an explanation of the life insurance adviser's status and obligations that includes:
- (a) the name and business address of the life insurance adviser;
 - (b) the types of products which the life insurance adviser is authorised to give advice on, arrange or sell and the authorising life company(ies) or life broker which he or she represents;
 - (c) a description of any association the employer or contractor of a life insurance adviser has with the life company(ies) whose product(s) is/are recommended; and
 - (d) the means of remuneration of the life insurance adviser, who is responsible for the life insurance adviser's conduct and whether the life insurance adviser's primary duty is to the customer or the life company(ies).
20. Where advice is given, the Customer Advice Record must also contain the basis for advice including:
- (a) a brief summary of the information and material on which the advice is based;
 - (b) the type(s) of product(s) that was/were identified as suitable and an explanation of why that/those type(s) of product(s) is/are likely to satisfy the customer's identified needs and objectives;
 - (c) the name(s) of the particular product(s) that is/are recommended;
 - (d) an explanation of the reasoning that led to the recommendation and how the particular product(s) is/are likely to satisfy the identified needs and objectives of the customer;
 - (e) a statement in the Customer Advice Record that a copy of the Fact Finder is available on request; and
 - (f) any additional information required by paragraphs 21, 22 and 24.
21. If advice is given that does not, either wholly or in part, address the customer's identified needs and objectives, this must be documented in the Customer Advice Record.

22. If the customer elects to purchase a life policy that differs from the life insurance adviser's recommendation, or elects only to receive advice about a more limited range of products than the life insurance adviser offers (other than in terms of paragraph 16), the Customer Advice Record must contain:
- (a) information about this election; and
 - (b) a statement that, by making this election, the customer risks making a financial commitment to a life policy that may not be appropriate to his or her needs and objectives.

Requirements where advice is not given or fact find is not undertaken

23. Where no advice is given to the customer, or no fact find is undertaken, the customer must be advised of any implications, and the Customer Advice Record must contain:
- (a) a specific warning that a life policy sold without the completion of a fact find may not be appropriate to the customer's needs; and
 - (b) a statement that, by not receiving advice, the customer risks making a financial commitment to a life policy that may not be appropriate to his or her needs and objectives.

Requirements where an existing life policy is replaced

24. Where termination of an existing life policy and sale of a new life policy is advised by a life insurance adviser, the advice must be appropriate and have a reasonable basis and all reasonably foreseeable and relevant consequences of the change must be listed in the Customer Advice Record, including:
- (a) termination charges for the existing life policy;
 - (b) entry/establishment charges for the proposed replacement life policy;
 - (c) any duplication of initial costs; and
 - (d) any loss of benefits, temporarily or otherwise, that may arise when replacing the existing life policy.

Upon request and with the consent of the policyowner, a life company must provide to the life insurance adviser the necessary information to enable compliance with subparagraphs (a) and (d) within 20 working days.

Completion and retention of the Customer Advice Record

25. The Customer Advice Record must begin with a clear boxed statement that this is an important document that the customer should read. It must also invite the customer to contact the life insurance adviser or life company or life broker if he/she disagrees with, or does not understand, the Customer Advice Record. The opening statement should also remind the customer of the 14 day cooling-off period.
26. The Customer Advice Record must be dated and signed by the life insurance adviser and forwarded to the life company(ies) of the recommended product(s), or the life broker.

The life company(ies)/life broker must retain the Customer Advice Record signed by the life insurance adviser. The Customer Advice Record must be made available by the life company or life broker to the Commissioner or the relevant external dispute resolution mechanism promptly following request.

APPLICATION FORMS

27. Life companies must ensure that their application/proposal forms make appropriate provision for a signed acknowledgement by the customer that either:
- (a) the customer provided information requested by the life insurance adviser to form the basis of a complete fact find and needs analysis, and elected to purchase the life policy(ies) recommended by the life insurance adviser; or
 - (b) the customer chose not to provide all information requested by the life insurance adviser, and understands that by not providing sufficient information, the customer risks making a financial commitment to a life policy that may not be appropriate to his or her needs; or
 - (c) the customer elected to purchase a life policy that differs from the life insurance adviser's recommendation, or elected only to receive advice about a limited range of products, and understands that by making this election, the customer risks making a financial commitment to a life policy that may not be appropriate to his or her needs and objectives; or
 - (d) the customer was not given any advice, or no fact find was undertaken, and the customer understands that by not receiving advice, the customer risks making a financial commitment to a life policy that may not be appropriate to his or her needs and objectives.

PART III TRAINING AND COMPETENCY

This part specifies requirements of life companies and life brokers regarding the training and competency of life insurance advisers.

BASIC COMPETENCIES

28. Prior to the commencement of life insurance adviser registration, a life company or life broker must ensure that a life insurance adviser authorised on its behalf has adequate knowledge to enable him or her to demonstrate the following competencies:
- (a) the requirements of this Code, including complaint handling mechanisms;
 - (b) how to conduct a fact find and needs analysis and complete a Customer Advice Record; and
 - (c) legal requirements under all relevant legislation, together with the requirements of Insurance and Superannuation Commission circulars.

The necessary basic competencies applicable from the commencement of life insurance adviser registration will be determined by the then established Registration Board.

PRODUCT-SPECIFIC COMPETENCIES

29. A life company or life broker must ensure that a life insurance adviser receives sufficient information and/or training to enable him or her to satisfy the following competencies for each specific company product that the life insurance adviser has been authorised to sell on its behalf:
- (a) an adequate knowledge of the relevant product, including (where the product is investment linked) knowledge of the risk and return profiles of relevant securities;
 - (b) the ability to clearly explain the product and product-related material;
 - (c) an adequate knowledge of any specific laws which affect the product; and
 - (d) an adequate knowledge of the life company's systems, forms and procedures for that product, including procedures in the case of a claim or termination.

Multi-Agents

30. Each life company must provide sufficient information and/or training to ensure that multi-agents are competent to sell those company-specific products which the multi-agent is authorised to sell.

CONTINUING EDUCATION REQUIREMENTS

31. A life company or life broker must ensure that its life insurance advisers receive adequate continuing education, to enable them to continue to meet competency requirements.

PART IV INQUIRIES, COMPLAINTS AND DISPUTES

All life companies and life brokers must handle inquiries in a timely manner, must have internal complaint-handling mechanisms which meet minimum standards and must ensure that complainants have access to effective and independent external and free dispute resolution mechanisms.

INTERNAL INQUIRY AND COMPLAINT ARRANGEMENTS

32. A Customer of a life company or life broker is entitled to a response to written requests for:
- (a) information about existing policies, including requests about the surrender value;
 - (b) variation of life policies; or
 - (c) termination of life policies;
- within 20 working days of receipt of the inquiry.
33. Where a life company or life broker is unable, on reasonable grounds, to respond to a customer's written inquiry or request within 20 working days the customer is entitled to be advised of that fact as soon as is practicable within 20 working days and to be given an indication of when a response will be made.
34. Each life company and life broker must establish an internal complaint-handling mechanism. The mechanism must:
- (a) be free of charge to the complainant;
 - (b) be open to all persons who have an interest in a life policy;
 - (c) be capable of addressing all possible complaints against the life company or life broker;
 - (d) have documented procedures including time lines for making a decision and informing the complainant of those procedures in relation to a complaint;
 - (e) have a complaint dealt with by an officer of the life company or life broker who has authority to resolve most complaints without further referrals within the life company or life broker;
 - (f) provide written advice to the complainant of a decision and, unless the decision has been resolved to the satisfaction of the complainant, of the reasons for the decision;
 - (g) record decisions, reasons for decisions and maintain appropriate statistics; and

- (h) provide information to the complainant at the outset on the availability of the external complaint-handling mechanism and have arrangements for referral of relevant complaints to an external mechanism if the complaint is not resolved internally. The complainant must be reminded in writing of the availability of the external complaint-handling mechanism in the event that the claim is rejected in whole or in part.
35. All complaints should be resolved by the internal complaint-handling mechanism within 45 days of lodgement. However, where there are special circumstances relating to the complaint such that it is not reasonable for it to have been resolved in that period, the life company or life broker must inform the complainant of the reasons for the delay and that the complainant may, if the complaint has not been resolved within 90 days of lodgement, then take it to the relevant external dispute resolution mechanism in terms of paragraph 37 of this Code.
36. If the internal complaint-handling mechanism has not resolved a specific complaint within 90 days, the life company or life broker must inform the complainant of the reasons for the further delay and that the complainant may take the complaint to the relevant external dispute resolution mechanism referred to in paragraph 37 of this Code.

EXTERNAL DISPUTE RESOLUTION MECHANISMS

37. Each life company and each life broker that offers insurance directly to the public must be party to an external dispute resolution mechanism which:
- a) has the unrevoked approval of the Commissioner;
 - b) does not consider a complaint or dispute unless it has first been lodged with the relevant life company or life broker and:
 - i) has been resolved by the life company or life broker, but not to the satisfaction of the complainant; or
 - ii) has not been resolved by the life company or life broker and 90 days have elapsed since lodgement with the life company or life broker;
 - c) provides annual reports to the Commissioner and the Minister for Consumer Affairs (the Commissioner may require a specific format and content for annual reports); and
 - d) reports any systemic, persistent or deliberate conduct (including that of life insurance advisers) that infringes the requirements of this Code to the Commissioner and to the relevant life company(ies) or life broker(s) as soon as they are identified.

38. Before granting an approval under paragraph 37, the Commissioner must be satisfied that the mechanism will:
- (a) operate free of charge to the complainant;
 - (b) cover a sufficiently broad range of complaints;
 - (c) be independent of the parties to the complaint;
 - (d) be overseen by a body which includes consumer representation (appointed or approved by the Minister for Consumer Affairs) and a delegate of the Commissioner;
 - (e) have procedures which accord with the principles of natural justice (including written reasons for decisions);
 - (f) make decisions by reference to what is fair in all the circumstances, observes applicable law, relevant judicial authority and this Code, and has regard to good life insurance practice;
 - (g) have appropriate published procedures, including suitable standards of timeliness;
 - (h) be effectively promoted;
 - (i) have adequate resources;
 - (j) obtain observance by life companies and life brokers of its decisions;
 - (k) have adequate remedies available to it;
 - (l) maintain and publish appropriate statistics on its operations; and
 - (m) provide to the Commissioner, and to relevant industry associations, details of the decisions made in respect of all complaints, or a representative selection of complaints, including the reasons for the decisions but excluding information that would identify any of the parties to the complaint.
39. The Commissioner may revoke an approval granted under paragraph 37 if he/she is satisfied that a dispute resolution mechanism does not meet the conditions referred to in paragraph 38.

PART V MONITORING AND REPORTING

40. Responsibility for compliance with this Code rests with individual life companies and life brokers. Each life company and life broker must have appropriate documented procedures in place to monitor the performance of its life insurance advisers in relation to all aspects of this Code.
41. The monitoring procedures required by paragraph 40 must achieve a standard acceptable to the Commissioner. Without limiting the matters that the Commissioner may consider in determining whether a life company or life broker meets the requirements of paragraph 40, the Commissioner must be satisfied that procedures are in place to:
 - (a) ensure that fact finds are undertaken in line with the requirements of this Code;
 - (b) monitor the appropriateness of advice provided by its life insurance advisers to customers;
 - (c) closely monitor complaints about the conduct of life insurance advisers;
 - (d) ensure that there are appropriate pre-recruitment screening procedures;
 - (e) verify that life insurance advisers are trained to the necessary level of competence; and
 - (f) ensure adequate documentation is maintained.
42. Each life company and life broker must maintain adequate records including:
 - (a) internal complaint-handling mechanism statistics;
 - (b) all conduct (including that of life insurance advisers) known to the life company or life broker that infringes this Code including a record of systemic or repetitive infringements;
 - (c) a record of remedial action and its effect; and
 - (d) a record detailing training of life insurance advisers.
43. All serious or persistent conduct infringing this Code must be referred to the life company's Compliance Committee (or to the Board of the life company), or to the Directors or Principals of the life broker, so that systemic problems or problems with particular life insurance advisers can be identified and rectified.
44. Where a life company or a life broker becomes aware of a material breach of this Code, it must check the appropriateness of the procedures applicable, and of relevant policies previously issued through that life insurance adviser during the three year period preceding the date on which it became aware of the breach (as noted in paragraph 5, this obligation only applies to policies issued on or after the date of commencement of the Code) and take remedial action where appropriate.
45. A life company or life broker must provide regular reports to the Commissioner on its compliance with this Code.

