Reform agenda and priorities

Post Royal Commission, the financial services industry must band together to advocate for sensible reforms that fix the industry's problems and lead to stronger consumer protections, without any adverse unintended consequences for participants and consumers.

ClearView broadly supports the Royal Commission's recommendations and we understand that change is important and necessary but there are some elements worth protecting, namely the ability for product manufacturers to fund the provision of life insurance advice through commissions.

Rather than sit back and wait for changes to be dictated to us, we must develop a program and petition regulators and policy makers to secure satisfactory outcomes for all parties.

This document details our advocacy agenda for 2019.

At a high level, we believe that commission rates under Life Insurance Framework (**LIF**) are appropriate and once LIF has been fully implemented, grandfathered rebates are removed and restricted Approved Product Lists (**APLs**) are banned, the vast majority of the industry's conflicts will be addressed. This is the right foundation to build on and at this critical juncture there's no case for changing the commission rates.

Why is ClearView passionate about this?

Life insurance is an important pillar in Australia's social security framework and it makes an enormous difference in people's lives.

As such, it is critical that personal financial advice is easy to access and as affordable as possible.

Reform priorities

1. Stable life insurance commission rates, no additional changes

Current life insurance commission rates do not encourage or lead to poor behaviour and consumer outcomes.

Life insurance commission caps under LIF are appropriate and should remain in place.

It is unnecessary, and way too early, to consider tinkering with commission caps again given the LIF reforms are only partly implemented and won't be fully implemented until 2021.

Any review into the effectiveness of recent regulatory reforms (including LIF) on the quality of advice should take place after 2021, given it will take some time for the positive impact of LIF to be apparent. The review should also assess the impact of regulation on Australia's underinsurance problem.

! Why this is important?

Financial advisers provide invaluable service to their clients on a range of matters including life insurance, investing, superannuation and retirement planning.

The cost of providing this advice has been steadily rising due to mounting regulation and compliance, putting professional advice out of reach for many households.

At the same time, Australia's underinsurance gap is widening. According to Rice Warner's 2015 report; *Underinsurance in Australia*[1], the gap between current levels of insurance and the amount of cover needed in order for Australian families to maintain their quality of life until retirement if affected by death or disability tops $1.8 trillion.

The report also found that:

- Life insurance meets 61 per cent of basic needs (defined as the minimum required to pay all non-mortgage debt and sustain the current living standard until age 65 or until children reach age 21);
- Total and Permanent Disability (**TPD**) insurance meets just 13 per cent of basic needs; and
- Income protection cover meets just 16 per cent of basic needs.

It is critically important that more Australians hold appropriate cover to protect themselves and their loved ones from the dire financial impact of an unexpected accident, injury or illness, or premature death.

Life is a risk

Close to **50,000** Australians were predicted to die from cancer in 2018.[4]

Around **140,000** new cancer cases were expected to be diagnosed in 2018.[4]

The average 5-year cancer survival rate is **69%**.[4]

Half of Australians have a chronic condition which are responsible for most deaths.[4]

Almost **half a million** Australians live with dementia.[3]

The demand for hospital-based palliative care has **risen by almost 30%** since 2012.[2]

There were around **1,150** road fatalities in 2018.[5]

The number of fatal workplace injuries recorded in 2017 was **190**.[6]

Currently, the full or partial cost of advice on life insurance is covered by the product manufacturer in the form of commissions. Without this subsidy, the average Australian household would not be able to seek advice and get adequate cover. In the event of a tragedy, the cost and responsibility would fall on the government.

Even with this subsidy, the nation's underinsurance gap is $1.8 trillion and growing. This demonstrates the importance of making advice assessable and affordable to more people.

The unintended consequences of reducing or banning life insurance commissions and forcing consumers to pay a fee are likely to include:

- Putting professional advice out of reach for the average person, given they don't have the discretionary income to pay for it;
- The closure of hundreds of advice businesses;
- The exacerbation of Australia's underinsurance problem; and
- The burden of caring for the sick and destitute falling on families, society and the government. Life insurance is an important pillar in Australia's social security framework.

While clients pay fees for advice on superannuation and investments, consumers generally will not pay a fee for insurance advice because:

- Charging an upfront and ongoing Adviser Service Fee (**ASF**) linked to a large capital sum, such as an investment portfolio or self-managed superannuation fund (**SMSF**), is feasible because the fee can be deducted from the client's account. The client does not physically need to write a cheque or transfer money.

But for open-ended service contracts, such as a mobile phone plan, utilities and life insurance, consumers do not pay a lump sum upfront. In most cases, they pay monthly or quarterly in arrears with the cost of distribution built-in and amortised into the contract.

- Life insurance is a complex product because there is no immediate, tangible value exchange, making it difficult to charge a fee for advice. The financial benefit of that advice may not be realised for many years, potentially 20-30 years. Although consumers receive comfort and peace of mind, they are effectively buying a promise. Financial intermediation and advice are critical in helping consumers assess the value.

Judging by the Dutch experience, a ban on life insurance commissions would destroy Australia's already underperforming life industry.

The Netherlands banned life insurance commissions in 2013. As a result:

- Fewer people get financial advice;
- Lower income households have been affected the most by the high cost of advice;
- Consumers typically choose the cheapest advice not the best;
- Declining IFA numbers; and
- Pressure on the government to provide a safety net.

Background

The LIF legislation was introduced on 1 January 2018, following a series of reports including the Trowbridge Report and the Financial System Inquiry (**FSI**).

LIF aims to ensure better consumer outcomes and greater consistency and transparency in life insurance.

Under LIF, life insurance commissions will be capped at 60% upfront and 20% trail commission by 1 January 2020, phased in over a two-year period (see table below).

Date effective	Maximum upfront cap	Maximum trail
1 January 2018	80% of first year's premium	20%
1 January 2019	70% of first year's premium	20%
1 January 2020	60% of first year's premium	20%

Volume-based benefits clawback provisions also apply. If a policy cancels in the first 12 months, 100% of upfront commission will be clawed-back.

If a policy cancels within 13-25 months, 60% of upfront commission will be clawed-back.

Future of Financial Advice

LIF followed the Future of Financial Advice (**FoFA**) reforms which were introduced on 1 July 2013, in response to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry.

Key changes under FoFA included a requirement for advisers to act in the best interest of clients and a ban on 'conflicted remuneration' namely investment product commissions.

FoFA featured two substantial carve-outs:

- Life insurance product commissions; and
- Grandfathered platform rebates (for agreements entered into before 1 July 2013).

In the case of life insurance commissions, financial advisers (intermediaries) are paid by the life company but under FoFA, they also have a legal obligation to act in the client's best interest.

2. Tax deductibility of financial advice fees (including life insurance advice)

The rules around the tax deductibility of financial advice fees are too narrow and should be expanded to incentivise more Australians to seek professional advice to grow and protect their wealth and ultimately achieve a self-funded lifestyle and retirement.

The current rules unintentionally encourage people to seek investment advice only not holistic strategic advice that considers their total financial situation, needs and goals. This is dangerous because the most appropriate advice may be to save, pay off their mortgage and take out adequate life insurance.

A tax deduction should be available to those who pay an advice fee directly to their adviser.

It should not be available where a fee is deducted from a member's superannuation fund or paid by a commission.

Why this is important?

A tax deduction allows people to lower their taxable income and is commonly a result of expenses, particularly those incurred to produce additional (taxable) income. This is why businesses can claim a deduction for many of the expenses they incur in running their business.

Similarly, people can claim a tax deduction for investment advice fees, where that advice relates directly to an investment/ product that produces assessable income.

However, holistic strategic advice fees should also be tax deductible given that this type of advice often leads to people making informed decisions, avoiding mistakes, and being significantly better off in the future.

It is critically important that more Australians seek advice because:

- The compulsory nature of Australia's retirement income system effectively forces workers to save and invest;
- Superannuation is the average household's largest asset, after the family home;
- The ageing population needs help converting their superannuation into a stable, steady income stream for the rest of their life;
- Australia is on the brink of the largest intergenerational transfer of wealth as the baby boomers pass on their assets;
- The cost of advice, due to mounting compliance, is increasingly prohibitive; and
- The rules around superannuation, life insurance and investing are complex and constantly changing.

Background

People can only claim a tax deduction on fees for investment advice.

As such, there is no tax deduction on fees related to the following:

- Preparing a financial plan or Statement of Advice (**SoA**);
- Initial client meeting or upfront fees;
- Ongoing holistic personal advice that is not product-related; and
- Non-assessable pension income.

These services either will not or have not (yet) lead to the creation of any assessable income, therefore, they can't be treated as a tax deductible cost that is incurred in the course of producing assessable income.

3. Life insurance choice of provider

Financial advisers and their clients should have access to the ten or so APRA-regulated retail life insurers in the market.

Support from the IFA market should be earned by life insurers, not mandated by institutionally-owned and conflicted AFSLs.

Advisers should be able to choose the most appropriate solution for their clients based on factors such as product features, customer care and a commitment and track record for paying claim entitlements. Ownership ties is not a valid reason for inclusion.

Approved Product Lists (**APLs**) in life insurance should be banned.

Why this is important?

APLs are not recognised by law. They are an artificial construct developed by vertically-integrated institutions to influence advice and channel clients into inhouse product.

The majority of financial advisers can only choose from a narrow menu of products dictated by their Australian Financial Services Licensee (**AFSL**).

Some AFSLs use limited APLs to concentrate clients in a small number of products in order to extract higher volume rebates from manufacturers.

APLs are not designed with the clients' best interest in mind and, as such, don't lead to optimal client outcomes.

There is a strong case for reform on life insurance choice, given the inherent conflicts of interest inside vertically-integrated institutions and their inability to self-regulate and adequately manage conflicts.

The lack of competition that currently exists in life insurance has resulted in:

- Little to no product innovation;
- Poor customer care and service;
- Significant under-investment in infrastructure and technology; and
- Sub-optimal consumer outcomes in terms of costs and claims because there's no pressure on manufacturers to phase out legacy products with outdated definitions and features.

In a highly competitive market, where all insurers have equal access to the market, such practices and outcomes would not be sustainable.

Life insurance choice is also necessary if financial advice is ever going to progress to become a bona fide profession.

There are three features that distinguish a profession from a trade:

1. Public good comes first
2. Fiduciary duty to the client
3. Commitment to ongoing learning both individually and collectively

APLs limit product choice for the benefit of an adviser's parent company and not the client.

In order for advisers to be recognised as professionals, they must have the ability and autonomy to use their skill and judgement to recommend the most appropriate life insurance solutions for their clients.

Background

An APL dictates the financial products that an AFSL's authorised representatives can choose from. It is common for licensees to have very few insurers on their APL, in some cases one.

The use of limited life insurance APLs is confined mainly to institutionally-owned dealer groups, which still see financial advisers as distribution agents not advice professionals.

APLs are not mandated in legislation but a lack of clarity in the law enables institutional AFSLs to dictate the products their aligned advisers can use, based on arbitrary criteria namely ownership and shelf space fees.

Clients are unknowingly paying for limited advice and choice.

The Financial Services Council's (**FSC**) APL standard is grossly inadequate. It merely requires AFSLs to voluntarily include a minimum of three options on their APL. This protects the best interests of the FSC's institutional members but not consumers or advisers who are legally required to act in their clients' best interest.

For further information, please contact your Business Development Manager or Adviser Support on **132 979**.

1. https://www.ricewarner.com/australias-relentless-underinsurance-gap/
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