



8 June 2017

By email: FOFA.PIR@treasury.gov.au

Manager
Financial Services Unit
Financial System Division
Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Future of Financial Advice – Post Implementation Review

The Consumer Action Law Centre (**Consumer Action**) is pleased to provide a submission in response to the Consultation Paper (**the Consultation Paper**) prepared as part of the Post Implementation Review of the Future of Financial Advice (**FoFA**) reforms.

We have limited our submission to the following matters:

- the ban on up-front and trailing commissions and like payments for both individual and group life risk insurance within superannuation; and
- the limited carve-out for basic banking products, consumer credit insurance and general insurance from the ban on certain conflicted remuneration structures.

We believe product sales commissions and product based payments inevitably distort adviser and sales-staff behaviour, elevating the sales imperative above considerations of consumer well-being. This can generate very poor consumer outcomes often occasioning significant financial harm. The frequency and extent of this harm is such that the role of commissions and product based payments, (indeed the whole sales-based culture of banking and insurance), should be fundamentally reconsidered.

We therefore consider that the ban on up-front and trailing commissions and like payments for life insurance should be extended to all life insurance policies whether within or outside superannuation. We also believe that consumer credit insurance and general insurance should not be carved out from the ban on conflicted remuneration.

We have provided further comments below.

About Consumer Action

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Prospective ban on up-front and trailing commissions and like payments for both individual and group risk insurance within superannuation

While we support the ban on up-front and trailing commissions life insurance policies within superannuation, we would have preferred the Government pursued Alternate Option C, which would have banned commissions on all life insurance policies whether within or outside superannuation. We understand this option was not selected due to concerns that consumers would purchase cover directly from an insurer without receiving advice, or may not obtain life insurance cover at all. There were also concerns that this would result in some financial advisers having to exit the market or lose business.

In our view, these concerns do not outweigh the significant risk of harm to consumers who receive conflicted advice about life insurance. We do not believe that commissions are a necessary part of adviser remuneration, and indeed we think that commissions may create more costs than benefits for consumers.

Reports from the Australian Securities and Investments Commission (**ASIC**),¹ the Trowbridge Review of Retail Life Insurance Advice,² the Ripoll Inquiry into financial products and services in Australia,³ the Financial System Inquiry⁴ and other reviews have pointed to significant failures in the conflicted remuneration for advisers in the life insurance market. For example, ASIC identified a 'strong correlation between high upfront commissions and poor consumer outcomes, including where the recommendation was to switch products.'⁵

In our view, the risks to people who buy life insurance under conflicted remuneration models are significant. Poor advice can result in high premiums due to over-insurance, inadequate benefits, unexpected exclusions and denied claims. The impact of poor quality, conflicted advice on people's lives cannot be understated. There have recently been reforms to

¹ Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, available at: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/>

² John Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, 26 March 2015, available at: https://1-afa.cdn.aspedia.net/sites/default/files/uploaded-content/field_f_content_file/trowbridge_final_report.pdf

³ Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into financial products and services in Australia*, November 2009, available at:

http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf.

⁴ Financial System Inquiry, *Final Report*, December 2014, available at: <http://fsi.gov.au/>.

⁵ See Australian Securities and Investments Commission, *Report 413: Review of retail life insurance advice*, October 2014, available at: <http://asic.gov.au/regulatory-resources/find-a-document/reports/rep-413-review-of-retail-life-insurance-advice/>

commission payments for advisers who sell life insurance, but this did not extend to a ban on conflicted remuneration. We await evaluation of the impact of these reforms.⁶

Limited carve-out for basic banking products from the ban on conflicted remuneration and the best interest duty

It is clear that there is a sales culture rather than service culture in our banking industry. We see commissions and targets for product sales, but limited (if any) incentives for after-sales service or complaints handling. We need the culture of Australian banking and insurance to shift away from a hard-sell approach and towards a service focus. Incentivised sales targets are a clear impediment to that goal. Bank staff themselves have provided examples of a 'target-based, sales-driven culture where their perception is that the imperative is not customer service per se but to sell.'⁷

A number of international studies have identified a strong correlation between target-based sales incentives and consumer harm.⁸ In early 2016 two major UK banks – the Royal Bank of Scotland and NatWest – scrapped cash bonuses for branch staff offering credit cards, loans and mortgages, in clear recognition of the harm such incentives can cause.⁹

While the industry argues that the costs of removing conflicted remuneration structures for staff would be 'disproportionate' to the potential consumer benefits, we continue to see widespread damage driven by commission-driven selling of insurance, particularly consumer credit insurance (CCI). Twenty-eight percent of claimants on our DemandARefund.com site indicated that they believed the CCI was mandatory for them to obtain their loan or credit card, and 21% were unaware that they had even purchased the CCI.

We continue to see sales of CCI where the objectives and financial needs of client are not taken into account, as demonstrated by the case study below:

Jodie's story

Jodie (name changed) got a personal loan for approximately \$10,800 in 2013. She was also sold consumer credit insurance for unemployment, disability and life costing \$2,681. The maximum payout if she were to be entitled to an involuntary unemployment benefit was six months of benefits at \$1,932.24. She lost her job on account of her inability to continue her work due to her pregnancy. She was subsequently diagnosed with breast cancer and could not work. She made a claim with the assistance of a financial counsellor and was told she was only entitled to a benefit of \$1,344.

⁶ Under the *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* (Cth).

⁷ Stephen Sedgwick AO, *Retail Remuneration Review – Issues Paper*, 17 January 2017, available at: http://retailbankingremreview.com.au/wp-content/uploads/2017/01/Issues-Paper_Retail-banking-remuneration-review.pdf.

⁸ A summary of this research is available in Consumer Action Law Centre's submission to the *Retail Banking Review - Terms of Reference* at pages 3-5: <http://retailbankingremreview.com.au/wp-content/uploads/2016/10/Consumer-Action-Law-Centre-Submission.pdf>.

⁹ Boyce, Lee. *NatWest/RBS scrap bonus incentives for staff members pushing products in branch to help 'rebuild customer trust'*, This Is Money.Co.Uk, 20 November 2015, available at: <http://www.thisismoney.co.uk/money/saving/article-3326750/NatWest-RBS-scrap-bonus-incentives-staff-members-pushing-products-branch-help-rebuild-customer-trust.html>.

Jodie also bought CCI with her credit card without realising. She has made a claim. The insurer has not yet assessed the claim, but told her on the phone that they will decline the claim.

CCI is a complex product, which needs better safeguards. ASIC's 2011 review CCI sales practices in authorised deposit-taking institutions (**ADIs**) found improvements were needed to reduce the risk of the product being mis-sold.¹⁰ Yet the Khoury Independent Review of the Code of Banking Practice recently found that the banks had not tracked their progress on these important changes to training and other internal practices.¹¹ In the absence of any real action by industry, we believe that banning conflicted remuneration for the sales of this product is needed to protect consumers. We also believe there needs to be a best interests duty on CCI distributors as well as a general suitability requirement.

In our view, it is also inappropriate for general insurance to be carved out from the ban on conflicted remuneration. General insurance, such as home and car insurance, is complex and could be characterised as an essential service (for example, home building insurance that covers natural disasters). The current Senate Economics References Committee inquiry into Australia's general insurance industry has examined the lack of fairness in policies and claims handling, difficulties comparing policies and impediments to effective competition in the general insurance market.¹² The Committee has received evidence that more needs to be done to protect insurance consumers, and is due to report on 22 June 2017.

Conflicted remuneration is an issue across the banking and insurance industry (particularly the add-on insurance market)¹³ and will continue to cause significant consumer detriment. We therefore consider that the regulatory option chosen by Government was inappropriate. We believe general insurance products and CCI should not be carved out from the ban on conflicted remuneration.

We note that consumer credit products, including home loans, are also carved out from the ban on conflicted remuneration. A recent ASIC report into mortgage broker remuneration found that the standard commission structure of up-front and trailing commissions for mortgage brokers created conflicts of interest. ASIC also found that when taking out a home loan, broker customers generally borrowed more, had higher loan-to-valuation ratios, take out more interest only loans and pay down their loan slower.¹⁴ As a result of its findings, ASIC

¹⁰ Australian Securities and Investments Commission, *11-224MR ASIC seeks improvement in CCI sales practices*, October 2011, available at: <http://asic.gov.au/about-asic/media-centre/find-a-media-release/2011-releases/11-224mr-asic-seeks-improvement-in-cci-sales-practices/>

¹¹ Philip Koury, *Code of Banking Practice Independent Review Final Report*, January 2017, available at: <http://cobpreview.crkhoury.com.au/>

¹² Senate Standing Committee on Economics, *Inquiry into Australia's general insurance industry*, June 2017, available at: http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Generalinsurance/Terms_of_Reference.

¹³ For more information, see Consumer Action Law Centre, *Report: Junk Merchants*, December 2015, available at: <http://consumeraction.org.au/junk-merchants-report-how-australians-are-being-sold-rubbish-insurance-and-what-we-can-do-about-it/>

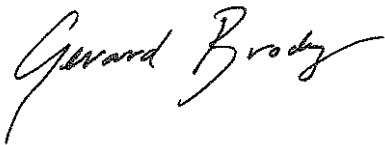
¹⁴ Australian Securities and Investments Commission, *Mortgage Broker Remuneration Review: What We Found*, March 2017, available at: http://download.asic.gov.au/media/4184781/mortgage_broker_review_what_we_found.pdf

recommended that the home loan market change the standard commission model and move away from bonus commissions due to the risk of poor consumer outcomes. We support these proposals, and suggest that conflicted remuneration across the banking, insurance and finance sectors should be fundamentally reconsidered.

Please contact Susan Quinn, Senior Policy Officer, on 03 9670 5088 or at susan@consumeraction.org.au if you have any questions about our comments on the review.

Yours sincerely

CONSUMER ACTION LAW CENTRE

A handwritten signature in black ink that reads "Gerard Brody". The signature is written in a cursive, flowing style.

Gerard Brody
Chief Executive Officer