

15 August 2017

Ms Natasha Nguyen
Lawyer, Financial Advisers
Australia Securities and Investments Commission

By email: natasha.nguyen@asic.gov.au

Dear Ms Nguyen,

Comment on ASIC CP 284: Example statement of advice for life insurance—Update to RG 90

Thank you for the opportunity to comment on ASIC's draft *Regulatory Guide 90: Example statement of advice: Scaled advice for new customer (example SOA)* and Consultation Paper 284. We appreciate the complex and extensive work, including consumer testing, which has led to the clear, useful and straightforward draft example SOA.

In our view, the example SOA will be effective if it is used to assist consumers to understand:

- the premiums they must pay for the recommended insurance, and how these can be paid,
- the total commissions the adviser will receive,
- the benefits, conditions and exclusions under the policy, particularly any exclusions relevant to them,
- the meaning of technical terms that are important to understanding the insurance, and
- the major consequences and risks of taking the advice.

Our comments are detailed more fully below.

Disclosure of commissions

The new example SOA comes on the heels of the Government's reforms to life insurance adviser commissions. These reforms are a welcome response to the known systemic problems with commission models in life insurance advice.

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We note that preceding these reforms, ASIC's 2014 report on life insurance advice found significant failings in life insurance advice,¹ including:

- a high prevalence of poor quality advice, with 37% of advice not legally compliant,
- a close relationship between high adviser commissions and poor consumer outcomes—96% of non-compliant advice was given by advisers paid an upfront commission. ASIC deduced that an upfront commission has a 'statistically significant bearing' on the likelihood of an adviser giving poor advice,² and
- high lapse rates due to 'incentives for advisers to write new business or rewrite existing business to increase commission income', and a correlation between high lapse rates and upfront commissions.³

The Financial System Inquiry Final Report of November 2014 reinforced that high upfront commissions were common and could affect the quality of advice. It recommended law reform to establish a sustainable remuneration model which more closely aligned the interests of advisers and consumers. If commission reforms do not work, the FSI has recommended that the Government should revisit banning commissions for life insurance advice.⁴

The industry-commissioned Trowbridge review then recommended, in relation to advice and commissions, that industry work with ASIC to identify ways improve the advice process and associated documentation.⁵

In short, adviser commissions are a significant cause of poor advice and policy 'churn'. For as long as advisers continue to receive commissions for selling life insurance, it will be important for consumers to understand these commissions, and the effect they can have on advice.

In the example SOA, the prominence of the commissions on page 1 is appropriate. However, the commissions are out of context without some information about premiums payable. Including the total premiums payable on page 1 would allow consumers to understand commissions in the context of what they will pay for the recommended insurance.

In addition to this, disclosing commissions does not necessarily alert a customer that they need to proactively assess the advice they get. As we submitted to the Financial System Inquiry, people have limited 'processing power' and time, so use rules of thumb to make decisions. More information, even accurate information, can distract people, lead them to make poor decisions, and discourage them from taking up products. US research has shown that requirements to disclose mortgage broker commissions actually increased trust in brokers, when it should have led customers to be more critical about the advice.⁶

¹ ASIC, *Report 413: Review of retail life insurance*, October 2014.

² ASIC, *Report 413: Review of retail life insurance*, October 2014, para 158.

³ ASIC, *Report 413: Review of retail life insurance*, October 2014, paras 10 and 11.

⁴ *Financial System Inquiry Final Report*, November 2017, p 219.

⁵ Trowbridge, *Review of Retail Life Insurance Advice: Final Report*, 26 March 2015, p 58.

⁶ ANZ and Consumer Action, *Improving Consumer Disclosure: Submission to the Financial System Inquiry*, September 2014, p 5, <http://consumeraction.org.au/wp-content/uploads/2014/09/ANZ-CALC-Improving-disclosure-of-financial-products-draft-FSI-submissi-2.pdf>; citing Lacko and Pappalardo, *The effect of mortgage broker compensation disclosures on consumers and competition: A controlled experiment*, Federal Trade Commission Bureau of Economics Staff Report, February 2004, <https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition->

While prominent commissions disclosure is an important and welcomed feature of the example SOA, the effect of commissions disclosure on consumer decision-making should be carefully considered and monitored. These disclosures should also be used in conjunction with other elements of the example SOA to engage people with the advice they are given.

Definitions of key terms

While plain language is used effectively throughout the example SOA, it nonetheless by necessity includes technical terms. These are well-known to people connected with the insurance industry. They include, for example, ‘total and permanent disability (TPD)’, ‘trauma’, disability definitions (unlikely and unable), occupation definitions (own and any), ‘activities of daily life’ (if applicable), ‘stepped’ and ‘level’ premiums, ‘agreed value’, rollover and underwriting. However, very few people outside the insurance industry understand these terms—including the vast majority of people who get advice on life insurance.

While some of these terms are defined throughout the document,⁷ their meaning could be easier to ascertain. A person who receives advice on life insurance needs to be able to quickly access a plain language explanation which will help them to understand what the recommended insurance covers and does not cover, and what it costs. This could be done in a glossary or similar attachment to the SOA. While this would expand the length of the document, it would also make it much easier for consumers to digest and engage with it.

Improving in response to consumer testing

We appreciate the extensive consumer testing that has gone into the development of the example SOA.⁸ We note that some elements of the example SOA scored more highly than others and that this was addressed in subsequent drafts. The most concerning areas where consumers lacked comprehension, and where further improvement may be made, are:

- Performance requirement 16: Why the adviser recommended these options over others—a clearer comparison of current and recommended insurance and why the adviser has made the recommendation could be made. For example, this could be by way of a table in the section ‘Why my advice is in your best interests and appropriate’ which shows the existing insurance and recommended insurance side-by-side and explains why the recommendation has been made, based on the features of the existing and recommended products.
- Performance requirement 21: Ongoing costs and charges—all premiums and any costs should be obvious on p 1 and/or in the ‘Summary of insurance recommendations’ at p 3. For example, the table of recommended insurance could include estimates of the premium at years two, five, ten and twenty.

This should assist consumers to understand the risks and consequences of taking up the recommended insurance.

[controlled-experiment](#). This report is also cited in Financial Services Authority, *Consumer Research 69: Financial Capability: A Behavioural Economics Perspective*, July 2008.

⁷ For example, ‘underwriting’ at p 15, ‘stepped premium’ pp 20, 22.

⁸ See CP 284 Appendix: Designing and testing a new example SOA for life insurance.

Please contact Susan Quinn on 03 9670 5088 or at susan@consumeraction.org.au if you have any questions about this submission.

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

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

Susan Quinn
Senior Policy Officer