



NOVEMBER 2022

CONFLICTED REMUNERATION

Submission to The Quality of Advice Review

ABOUT US

CCLSWA

CCLSWA champions the financial rights of Western Australians on credit, debt and consumer law issues.

- We ensure people in Western Australia are treated fairly in the financial marketplace by providing free, confidential legal advice through our Telephone Advice Line.
- We provide legal representation to people experiencing vulnerability and disadvantage so that they can access justice.
- Our community legal education programs empower West Australians experiencing vulnerability and disadvantage to understand their rights and avoid financial pitfalls.
- We help other service providers, including financial counsellors and community support workers, to understand and support their clients' financial rights.
- We are a voice for change so that financial systems and consumer laws are improved for all.

CHOICE

CHOICE is the leading consumer advocacy group in Australia. CHOICE is independent, not-for-profit and member-funded. Our mission is simple: we work for fair, just and safe markets that meet the needs of Australian consumers. We do that through our independent testing, advocacy and journalism.

Consumer Action Law Centre

Consumer Action is an independent, not-for-profit consumer organisation with deep expertise in consumer and consumer credit laws, policy and direct knowledge of people's experience of modern markets. We work for a just marketplace, where people have power and business plays fair. We make life easier for people experiencing vulnerability and disadvantage in Australia, through financial counselling, legal advice, legal representation, policy work and campaigns. Based in Melbourne, our direct services assist Victorians and our advocacy supports a just marketplace for all Australians

Financial Counselling Australia

Financial Counselling Australia (FCA) is the peak body for financial counsellors in Australia. Financial counsellors work in community organisations and provide advice and support to people experiencing financial hardship.

Super Consumers Australia

Super Consumers Australia is the people's advocate in the superannuation sector. Super Consumers Australia advances and protects the interests of people on low and middle incomes in Australia's superannuation system. It was founded in 2013 and received funding for the first time in 2018.

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Introduction

People who seek financial advice deserve to have confidence that it will be high-quality and free from conflict of interest. Despite this, conflicts of interest continue to contribute to widespread consumer harm in Australia.

The Quality of Advice Review (**'the Review'**) is presented with an opportunity to finish the work of the Future of Financial Advice (**'FOFA'**) reforms and the Banking Royal Commission by recommending removal of the remaining harmful conflicts of interests in the industry. The intent of the FOFA reforms was to prohibit conflicted remuneration. While grandfathered commissions were phased out in the aftermath of the Banking Royal Commission, the conflicts arising from other carve-outs like life insurance commissions continue to contribute to harm. These conflicts contribute to a sales-driven culture where product manufacturers compete for the business of advisers.

Consumer groups are extremely disappointed with many of the proposals suggested by the Review. The Review has been presented with clear evidence that conflicts of interest contribute to poor-quality advice. Every major inquiry into the life insurance industry over the past decade has shown that the industry is plagued with conflicts of interest that contribute to poor quality advice to consumers. In evidence cited in this consultation paper, ASIC found that over 40% of people received life insurance advice that breached the law, with 1 in 14 people receiving advice where there was significant consumer harm.¹

The Review's solution to this evidence of harm is to recommend advisers disclose conflicts of interest. This ill-conceived approach flies in the face of decades of empirical evidence from regulators and academics that disclosing a conflict of interest is ineffective and often harmful to consumers. Increased disclosure is not the solution to solving the problem of conflicted remuneration.

The Review needs to address the driving factors of poor-quality advice and recommend a ban on all remaining conflicts of interest in the advice industry. Conflicted remuneration creates incentives for advisers to recommend a product where one is not needed, or to recommend a product that attracts the biggest commission, not what's best for their client. Consumer groups support a prohibition on life insurance, general insurance, timeshare and consumer credit insurance commissions. People should be able to receive unconflicted and high-quality advice that is not influenced by the financial rewards for an adviser.

The Review has an opportunity to improve the quality of financial advice in Australia. Failing to clean up the remaining conflicts of interest will perpetuate a harmful, sales-driven advice culture in the sectors of the advice industry where conflicted remuneration remains key to the advice business model.

¹ Quality of Advice Review, 2022, Conflicted Remuneration Paper, p.3

Recommendations

The Quality of Advice Review's Final Report should recommend:

1. the removal of the exemption to the ban on conflicted remuneration for life insurance commissions.
2. the removal of the exemption to the ban on conflicted remuneration for general insurance and consumer credit commissions.
3. the removal of the exemption to the ban on conflicted remuneration for timeshare commissions.
4. a broad review of regulation of the timeshare industry.
5. the prohibition on charging asset-based fees in financial advice.
6. the removal of the exemption to the ban on conflicted remuneration given to agents or employees of Authorised-Deposit Taking Institutions (ADIs) for recommendations on basic banking products, general insurance products or consumer credit insurance.
7. the removal of the exemption to the ban on conflicted remuneration for financial product advice that has not been given to a client in the 12 months immediately before the benefit is given.

Conflicted remuneration continues to drive poor outcomes for consumers

The Review should recommend the prohibition of life insurance commissions

Consumer groups support removing the exemption to the ban on conflicted remuneration for life insurance commissions. Life insurance commissions distort the quality of advice that consumers receive and create a perverse incentive for advisers to sell inappropriate insurance that is not suitable to people's needs.

Life insurance is a complex financial product that often has confusing exclusions and definitions. The implications of receiving poor advice about insurance can be devastating. People may not be covered for events they thought they had or may have been paying too much for inappropriate coverage. It is imperative that advisers are recommending life insurance that is in the best interests of their clients, not their own.

The recent ASIC Life Insurance Review ('LIF') showed that people are continuing to receive poor quality life insurance advice. Over 40% of people received life insurance advice that breached the law, with 1 in 14 people receiving advice where there was significant consumer harm.² This is clear evidence that the industry is still contributing to poor outcomes for consumers.

Life insurance commissions remain a leading contributor of this misconduct. In 2014, ASIC's targeted review of life insurance sold through the advice channel concluded that how an adviser was paid, "had a statistically significant bearing on the likelihood of their client receiving advice that did not comply with the law."³ ASIC found that advisers who were remunerated with an upfront commission were in breach of the law 45% of the time.⁴ Whereas, advisers remunerated under a different method, including a fee-for-service or hybrid model, were in breach of the law 7% of the time.⁵ Outside the advised sector, ASIC has also found that commissions and risky remuneration structures for direct insurance have encouraged insurance sales staff to engage in pressure selling or other poor conduct to close a sale and are likely to contribute to poor outcomes.⁶

Commissioner Hayne recommended ASIC conduct a review of life insurance commissions and said, "unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero."⁷ In particular, Commissioner Hayne recommended that:

²Quality of Advice Review, 2022, Conflicted Remuneration Paper, p.3

³Australian Securities & Investments Commission, 2014, REP413, Review of retail life insurance advice, p.42

⁴ASIC, REP413, p.43

⁵ASIC, REP413, p.43

⁶ASIC, 2018, REP587, The sale of direct insurance.

⁷Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2018, Final Report, Recommendation 2.5

“Unless the reduction in life insurance commissions can be shown to contribute significantly to underinsurance, I can see no justification for allowing this form of conflicted remuneration to continue to be paid.”⁸

The Quality of Advice Review and ASIC’s Life Insurance Data Collection (LIDC) have failed to produce any evidence that life insurance commissions should be retained. As was the case when Commissioner Hayne considered the evidence before the Royal Commission, there is no evidence that banning life insurance commissions would result in underinsurance. Consumer groups note that the life insurance industry regularly makes poor attempts to substantiate claims about underinsurance to justify adviser’s receiving billions of dollars in commissions to sell life insurance. These claims about underinsurance need to be assessed in a context that considers demand side drivers, such as people’s willingness or ability to pay for cover. As well as the adequacy of protections such as public safety nets (e.g. disability support pension, NDIS), workers compensation and compulsory third party insurance. They also tend to ignore the fact that over 70% of Australians have life insurance through group life policies in their superannuation fund.⁹ While consumer groups recognise that there are opportunities for improving group life insurance in superannuation, the existing system provides a safety net for the overwhelming majority of the Australian working population. Under a fee-for-service model, people who had a genuine need for life insurance outside the group insurance system would still be able to purchase life insurance and would likely receive higher-quality advice.

Recommendation 1

The Quality of Advice Review’s Final Report should recommend the removal of the exemption to the ban on conflicted remuneration for life insurance commissions.

The Review should recommend the prohibition of general insurance and consumer credit commissions

Consumer groups recommend the removal of the exemption for monetary and non-monetary benefits for general insurance and consumer credit insurance. The Banking Royal Commission revealed that these carve-outs lead to poor consumer outcomes, with consumers being sold into general insurance products inappropriate to their needs.

Financial advisers, insurance brokers and other intermediaries are incentivised to recommend general insurance products that maximise their commission, rather than the products that best match the best interests of their clients. ASIC’s 2019 review of consumer credit insurance

⁸Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry 2018, Final Report, p.188

⁹Rice Warner, 2016, Insurance through Superannuation, <https://www.ricewarner.com/insurance-through-superannuation>

(‘CCI’) found that sales practices and product design were still delivering poor outcomes for consumers. Between 2011 and 2018, ASIC found that for CCI sold with credit cards, consumers received only 11 cents in paid claims for every dollar paid in premiums.¹⁰ In 2016, ASIC found that car dealerships were selling add-on insurance that it considered were:

“expensive, poor value products that provided very little or no benefit, and a sales environment with pressure selling, very high commissions and conflicts of interest.”¹¹

Concerningly, the latest data from APRA shows consumer credit insurance has a claims paid ratio of 31%.¹² This indicates that there has not been an improvement in the claims paid ratio for consumer credit insurance, despite significant reforms being implemented regarding the sale of these products following the Financial Services Royal Commission.

The northern Australian insurance market is another prominent example that highlights the consumer harm caused by a conflicted remuneration model. The ACCC’s Northern Australia Insurance Inquiry recommended a ban on conflicted remuneration for general insurance retail products sold through insurance brokers. The ACCC found that,

“Commissions and other benefits given to insurance brokers can give rise to an unacceptable conflict of interest... Disclosure alone is insufficient to address these conflicts.”¹³

The ACCC concluded that commissions charged on home and contents insurance have a “significant effect on the final premium that consumers are charged.”¹⁴ As with other forms of conflicted remuneration, as long as advisers and brokers are incentivised to sell insurance to maximise commissions, consumers will continue to experience poor outcomes.

Consumer groups recommend that the Review recommend that general insurance commissions be prohibited. This will protect people from poor-quality insurance advice. Under a fee-for-service model, people will still be able to purchase general insurance through an intermediary. However, banning commissions will reduce conflicts that drive poor consumer outcomes across the industry.

Recommendation 2

The Quality of Advice Review’s Final Report should recommend the removal of the exemption to the ban on conflicted remuneration for general insurance and consumer credit commissions.

¹⁰ ASIC, 2019, REP 622 Consumer credit insurance: Poor value products and harmful sales practices, p3

¹¹ ASIC, 2019, REP 622 Consumer credit insurance: Poor value products and harmful sales practices, p5

¹² APRA, 2022, Life insurance claims and disputes statistics, <https://www.apra.gov.au/life-insurance-claims-and-disputes-statistics>

¹³ Australian Competition and Consumer Commission, 2020, Northern Australia Insurance Inquiry - Final Report, Recommendation 19.1

¹⁴ Australian Competition and Consumer Commission, 2020, Northern Australia Insurance Inquiry - Final Report, p. xiv

The timeshare industry is causing widespread harm and needs reform

Consumer groups recommend that timeshare commissions be banned. Commissions in the timeshare industry encourage high-pressure sales tactics that trap consumers in poor-value and lengthy financial products. Timeshare salespeople have an obligation under Section 961B of the *Corporations Act 2001 (Cth)* to act in the best interests of customers. Despite this, some salespeople who are financial advisers sell people into complex timeshare contracts that can last over 60 years and can cost over \$450,000.¹⁵ Consumer groups are concerned that the advice provided to people attending timeshare presentations is of poor-quality and very seldom is in their best interests.

A leading driver of poor-quality advice is the sales-driven, commission-orientated culture in the timeshare industry. A 2021 CHOICE survey of 350 timeshare holders found 18% of survey respondents reported being subject to high-pressure sales tactics or being misled by salespeople about their timeshare membership.¹⁶ Between 2018 and 2019, ASIC shadow shopped a sample of personal advice on timeshare schemes provided to consumers, and found “high levels of non-compliance with the best interests duty and related obligations.”¹⁷ In the same shadow shop, ASIC also found that not a single consumer who attended a timeshare presentation recognised that they were receiving financial advice. No participants could recall receiving any advice as to whether the product aligned with their objectives, financial situation and needs.

Timeshare company Ultiqa was recently found to have breached multiple financial services laws. The Federal Court revealed sections of the sales manual used at Ultiqa's timeshare seminars. It showed a harmful sales culture that was focused on maximising sales commissions using high-pressure tactics. One section read:

"Once your client is on the Sales Deck they come to the grim realisation that this is a sales environment and what is going through their mind is 'How can we get out of here?'; and, if you give them the chance, they will. DO NOT GIVE THEM THE CHANCE! Do everything you can do to amuse, interest, excite, relax, humour, flatter and if necessary cajole your clients into staying." ¹⁸

The Federal Court found that Ultiqa salespeople, who were acting as financial advisers, stood to gain up to \$1,850 in conflicted commissions per client they signed up at sales presentations.¹⁹

¹⁵CHOICE, 2018, “Are holiday timeshare resorts worth it?”, accessed on 20 May 2022, www.choice.com.au/shonky-awards/hall-of-shame/shonkys-2018/marriott

¹⁶CHOICE, 2021, “The Timeshare Trap”, accessed on 20 May 2022, <https://www.choice.com.au/consumer-advocacy/policy-submissions/2021/may/super-complaint-to-asic-about-the-timeshare-industry>

¹⁷ASIC, 2019, REP 642 Timeshare: Consumers' experiences, p6.

¹⁸ASIC, 2022, 22-111MR Federal Court finds timeshare company Ultiqa failed consumers with multiple breaches of financial services laws, accessed 18 May 2022.

¹⁹Australian Securities and Investments Commission v Ultiqa Lifestyle Promotions Limited (in liq) [2022] FCA 561, s88

Consumers will continue to be targeted by these sales tactics as long as timeshare salespeople continue to receive commissions for selling products. A ban on conflicted remuneration is a critical step in reducing consumer harm in this industry.

Consumer groups support the Quality of Advice Review's proposal to review the broader regulatory requirements for timeshare. An independent review of the timeshare industry is long overdue. We have observed so many potential breaches of law that we question whether the timeshare industry should be allowed to operate with existing business practices. The timeshare industry could be reviewed as part of the Federal Government's recently announced inquiry into the regulation of managed investment schemes.²⁰

Recommendation 3 - 4

The Quality of Advice Review's Final Report should recommend:

3. the removal of the exemption to the ban on conflicted remuneration for timeshare commissions.
4. a broad review into regulation of the timeshare industry.

Conflict of interest disclosure is an ineffective consumer protection

Consumer groups oppose the Quality of Advice Review's proposals that attempt to mitigate the harm of conflicted remuneration by requiring advisers to disclose and seek consent for the provision of life and general insurance commissions. These proposals contradict the Review's conclusion that, "disclosure and consent are not always (and perhaps not even often) effective consumer protection tools."²¹ The solution to reduce widespread consumer harm caused by conflicted remuneration is to remove conflicts of interest, not disclose them.

The Review's proposals contradict empirical evidence that disclosure of a conflict of interest is an ineffective and often harmful consumer protection. Disclosing conflicts of interest regularly leads to perverse outcomes, including consumers placing more trust in an adviser, when they should be more sceptical of the advice. In 2019, ASIC and the Dutch Authority for Financial Markets released a joint report titled, "Disclosure: Why it shouldn't be the default."²² The regulators found that disclosure can:

"place an unrealistic and onerous burden on consumers – for example, expecting them to overcome complexity and sophisticated sales strategies."²³

²⁰M Read, 2022, 'Sophisticated investor test to face fresh scrutiny', Australian Financial Review

²¹Quality of Advice Review, 2022, Conflicted Remuneration Paper, p. 5-6

²²Australian Securities and Investments Commission and the Dutch Authority for the Financial Markets, 2019, REP 632 Disclosure: Why it shouldn't be the default

²³REP 632 Disclosure: Why it shouldn't be the default, p.4

The joint report found that conflicts of interest disclosure can increase trust in sales staff, when it is intended to have the opposite effect.²⁴ This disclosure can also backfire by giving advisers a ‘moral license’ to recommend biased choices to clients. It also “creates unintended detrimental outcomes for some consumers ... e.g. by increasing rather than decreasing trust in conflicted advisers.”²⁵

Professor Sunita Sah of Cornell University found “disclosing conflicts of interest can have surprising unintended consequences.”²⁶ Professor Sah found that conflict of interest disclosure, “may fail to adequately protect advisees and could even backfire.” Research by the US Federal Trade Commission found that mortgage broker disclosure of commissions can actually increase trust in a broker, when it should have led customers to be more critical about the advice.²⁷ The Review should heed the warnings of regulators and academics, and recommend that conflict of interest should be banned, rather than disclosed.

Asset-based fees need to be prohibited

Consumer groups support the prohibition of asset-based fees. This is essential to improving the quality of financial advice. Asset-based fees are calculated as a percentage of funds under management. These fees obscure the true cost of the service provided, and share many of the harmful characteristics of commissions or ongoing service arrangements. These fees bear no relationship to the work actually done by the financial adviser or the quality of that work.

Asset-based fees also create conflicts of interests that may encourage the adviser to give poor quality advice. They discourage strategic advice, such as personal debt reduction, like paying down a home loan or credit card, for which the adviser would not earn a fee, towards recommendations of investment in products for which an adviser can receive an asset-based fee. Once established, asset-based fees do not provide an incentive to provide ongoing services to the client, because the financial adviser is paid regardless. They have consistently been a source of poor consumer outcomes for decades, and have driven disastrous business models.

The FOIA reforms prohibited the charging of asset-based fees on borrowed amounts.²⁸ The financial services industry successfully lobbied to carve-out asset-based fees from this prohibition. The Review must consider the harms of asset-based fees and recommend these fees be banned.

²⁴REP 632 Disclosure: Why it shouldn't be the default, p.4

²⁵ EP 632 Disclosure: Why it shouldn't be the default, p.42

²⁶S Sah, 2018, 'Conflicts of Interest and Disclosure',

<https://sunitasah.com/media/pdfs/Sah-2018-Conflicts-of-interest-and-disclosure-Banking-Royal-Commission.pdf>

²⁷J Lacko and J Pappalardo, 2004, 'The effect of mortgage broker compensation disclosures on consumers and competition: a controlled experiment', Federal Trade Commission,

<https://www.ftc.gov/sites/default/files/documents/reports/effect-mortgage-broker-compensation-disclosures-consumers-and-competition-controlled-experiment/030123mortgagetextofrpt.pdf>

²⁸Corporation Act 2001 s964D and 964E

Recommendation 5

The Quality of Advice Review's Final Report should recommend the prohibition on charging asset-based fees in financial advice.

The loophole for bank employees needs to be closed

Consumer groups support the Review's proposal to remove the exemption on conflicted remuneration for agents or employees of Authorised Deposit-Taking Institutions ('ADIs'). This loophole has permitted bank staff to receive conflicted remuneration when they sell basic banking products, general insurance or consumer credit products. The evidence before the Banking Royal Commission highlighted the systemic mis-selling of financial products from bank salespeople.

Consumer groups are concerned that balanced scorecards may be used as a new loophole to reward staff members for sales. Many scorecards purport to have 'customer-focused' outcomes, yet still reward staff for selling products to consumers. The Review concludes that this proposal to remove the exemption for ADIs,

"would not prevent bank employees from being provided with performance-related benefits and incentives under a balanced scorecard approach."²⁹

In 2021, the Finance Sector Union surveyed its members and found 58% of survey respondents indicated that they still have sales campaigns that attract rewards for exceeding or meeting sales targets.³⁰ This intentional obfuscation of balanced scorecards has been highlighted by the UK Financial Conduct Authority, who say that,

"Sales targets might be given less prominence by changing terminology, for example where staff are given objectives for how many 'customer needs' are met, but this might still have the same effect as a sales target."³¹

If this exemption is removed, consumer groups will be calling on ASIC to monitor the use of balanced scorecards by ADIs.

Recommendation 6

²⁹Quality of Advice Review, 2022, Conflicted Remuneration Paper, p. 8

³⁰Finance Sector Union, Submission: Sedgwick Review into remuneration 2021

³¹Financial Conduct Authority, 2015 'Risks to customers from performance management at firms. Thematic review and guidance for firms.' <https://www.fca.org.uk/publication/guidance-consultation/gc15-01.pdf>

The Quality of Advice Review's Final Report should recommend the removal of the exemption to the ban on conflicted remuneration given to agents or employees of Authorised-Deposit Taking Institutions (ADIs) for recommendations on basic banking products, general insurance products or consumer credit insurance.

The 12-month exemption needs to be removed

Consumer groups support the Review's proposal to remove the exemption to the ban on conflicted remuneration for the issue or sale of a financial product where advice about that product (or class of products) has not been given to the retail client by the AFS licensee or a representative in the 12 months before the benefit is given.

There is no justifiable rationale for retaining this exemption. Conflicted advice remains harmful to clients irrespective of when it was provided. Removing this exemption will simplify the law and reduce the number of carve-outs in the legislation.

Recommendation 7

The Quality of Advice Review's Final Report should recommend the removal of the exemption to the ban on conflicted remuneration for financial product advice that has not been given to a client in the 12 months immediately before the benefit is given.