NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA (NIBA)

SUBMISSION ON CORPORATIONS AMENDMENT (FURTHER FUTURE OF FINANCIAL ADVICE MEASURES) BILL 2011

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 500 member firms and over 2000 individual qualified practising insurance brokers (QPIBS) throughout Australia.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 500 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on risk insurance products.

EXECUTIVE SUMMARY

NIBA's main concerns in relation to The Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011 (ie Tranche 2 of the Future of Financial Advice (FOFA) reforms) (**the Bill**) are summarised below. NIBA's key concern is that the remuneration carve out is not as broad as the Government announced intention for risk insurance, nor consistent with what Federal Treasury advised NIBA would be the position during the FOFA Peak Consultation Group (**PCG)** consultation process.

General insurance issues

Conflicted Remuneration - The conflicted remuneration (monetary and non-monetary) carve outs in relation to general insurance (see proposed sections 963A(a) and 963B(a)) are too limited as they only apply to "general insurers" as defined.

The definition of general insurers does not:

- cover Lloyd's underwriters and unauthorised foreign insurers that are permitted to carry on business in Australia – this creates an inappropriate and uneven playing field (**insurer definition issue**); and
- extend the carve out to other entities that receive payment from general insurers and then themselves directly make monetary conflicted remuneration payments to their advisors selling the general insurance (except to the limited extent of the employer write back in proposed section 963C) (**Non-insurer remuneration arrangements issue**).

The above draft would disadvantage a class of insurers not included in the current "carve out" and would also require all third parties with arrangements of the above type to be restructured at great cost to industry and for no practical benefit. As previously discussed and agreed with Federal Treasury in the consultation process, if the intention is that direct payments by insurers to advisors are not caught, it makes little sense to also ban payments by third parties to the advisors.

The above was not the intent of the general insurance carve out proposed publically by Government and confirmed by Federal Treasury with NIBA during the PCG meetings. The objective, as stated in paragraph 1.8 of the Explanatory Memorandum (**EM**), that the ban on conflicted remuneration "is not intended to apply to: …• General insurance", has not been achieved.

NIBA confirms its recent discussions with Federal Treasury in which it again advised that such a limited carve out was not intended and that the matter will be resolved by either redrafting the Bill or in regulations.

Benefits from product issuers - In addition, proposed section 964 prohibits certain benefits from financial product issuers and there is a similar carve out for "general insurer's" as that noted above. NIBA respectfully submits the problem with the insurer limited definition issue above also needs to be fixed for this provision.

Volume-based shelf space fees - Given the broad definition of volume based shelf space fees this prohibition in section 964C could catch an insurance broker or other entity in the general insurance and life risk insurance space that operates a facility through which financial services licensees and their representatives (e.g insurance brokers) can obtain information about financial products.

This ban was not intended to operate in relation to general insurance and stand alone life risk insurance and this provision needs to carve out such insurance in the same way as proposed by NIBA for the conflicted remuneration provisions above. If not, a significant number of licensees in the general and life risk insurance space could be adversely affected, contrary to Government's and Federal Treasury's representations in the PCG consultation that this ban would not apply in relation to those products.

NIBA has proposed appropriate amendments to address the above issues.

Life risk insurance issues

For monetary conflicted remuneration, the same concerns arise for the limited life risk insurance carve out which only applies to life insurers as defined and not to other entities. The problem that arises is the same as that in the Non-insurer remuneration arrangements issue noted in the general insurance section above and NIBA proposes a change to address this.

For non-monetary conflicted remuneration NIBA notes there was no consultation with it in relation to this change from the original proposed exclusion of stand-alone life risk insurance.

In relation to the proposed restrictions on non-monetary conflicted remuneration, NIBA believes that the proposal regarding:

- "identical or similar benefits are not provided on a frequent or regular basis" will cause argument and confusion.
- professional development being conducted in Australia or New Zealand is inappropriate as many valuable professional development courses are provided in overseas locations.

CONFLICTED REMUNERATION ISSUES

The Australian Government's "The Future of Financial Advice" Information Pack (Monday 26 April 2010) specifically stated that

> *"The reforms will reduce conflicted remuneration structures in relation to advice and distribution of retail financial products. This includes a ban on:*
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> • *All commission payments from any financial services business, relating to the distribution and provision of advice for retail financial products...*
>
> *The ban applies to all financial products, including managed investment schemes, superannuation and margin loans, but does not initially apply to risk insurance."*

The Australian Government's "Future of Financial Advice 2011" Information Pack (28 April 2011) also specifically stated that:

> *"The April 2010 FOFA announcement stated that there would be consultation on whether to extend the ban on conflicted remuneration to risk insurance... After careful consideration and extensive consultation, the Government has decided to ban up-front and trailing commissions and like payments for both individual and group risk within superannuation from 1 July 2013. However,* ***the Government has decided not to extend the ban on conflicted remuneration to risk insurance outside of superannuation****."*
>
> *"...there will be a broad comprehensive ban, involving a prohibition of any form of payment relating to volume or sales targets from any financial services business to dealer groups, authorised representatives or advisers... It should be noted that* ***this ban will not apply in relation to pure risk insurance****..."*

The Explanatory memorandum (**EM**) in paragraph 1.8 is consistent with the above and notes that the ban on conflicted remuneration monetary amounts is not intended to apply to:

- General insurance
- Life insurance which is not bundled with a superannuation product;
- Individual life policies which are not connected with a default superannuation fund.

The carve out for soft dollar conflicted remuneration is also expressed in paragraph 1.9 of the EM to not apply to general insurance.

However, the statements in the EM are misleading as the Bill does not technically result in such a carve out. This is contrary to the Government stated intent and what Federal Treasury advised NIBA during the PCG meetings would be the result.

Subject to the carve outs in sections 963A-C, proposed sub section 963(1) defines conflicted remuneration 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) might influence the choice of financial product recommended by the licensee or representative to retail clients; or
>
> (b) might otherwise influence the financial product advice given to retail clients by the licensee or representative".

Without limiting the above definition, each of the following is included as conflicted remuneration in sub section 963(2):

(a) a benefit access to which, or the value of which, is dependent on the total value of financial products of a particular kind, or particular kinds, recommended by the licensee or representative to retail clients, or a class of retail clients;

(b) a benefit access to which, or the value of which, is dependent on the number of financial products of a particular kind, or particular kinds, recommended by the licensee or representative to retail clients, or a class of retail clients;

(c) a benefit access to which, or the value of which, is dependent on the total value of investments of a particular kind, or particular kinds, made by retail clients, or a class of retail clients, to whom the licensee or representative provides financial product advice. [NA risk insurance]

According to the Explanatory memorandum at paragraph 1.15, "While the above examples provided all relate to volume, a benefit need not be volume-based in order to be conflicted remuneration. For example, any flat payment received by a licensee for product distribution would on its face be conflicted remuneration."

The above is extremely broad, especially as it is not limited to the provision of personal advice and would catch not only persons providing personal advice such as insurance brokers, but employees and other representatives of insurers selling an insurer's products where general advice is given.

There are a number of carve outs in proposed section:

- 963A which sets out when a *monetary benefit* given in certain circumstances is not conflicted remuneration
- 963B which sets out when a non-monetary benefit given in certain circumstances is not conflicted remuneration
- 963C which sets out when certain benefits given by an employer to an employee are not conflicted remuneration.

General insurance issues relevant to conflicted remuneration carve outs

In relation to general insurance, the carves out in proposed sub sections 963A(a) and 963B(a) both read:

(a) the benefit is given to the financial service licensee or representative by a general insurer (within the meaning of the *Insurance Act 1973*) and is given in relation to a general insurance product.

The EM notes in paragraph 1.20 that the general insurer exclusion in sub section 963A(a) "ensures that the Bill does not prohibit the payment of monetary commissions *in the general insurance industry*."

NIBA notes that this statement and the statements in paragraphs 1.8 and 1.9 are misleading as the carve out only applies to payments by "general insurers" and not payments by others to advisors that may not be insurers.

For example, an insurer may have an arrangement where it pays an entity such as an Australian Financial Services Licence (**AFSL**) holder a commission per policy and also possibly a volume commission for policies arranged by the AFSL holder's employees or other representatives but have no obligation to pay the AFSL holder's advisor representatives. This is often done for administrative convenience (**Non-insurer remuneration arrangements**).

The advisors' rights to payment are between them and the AFSL holder. The failure of the carve out to apply to any conflicted remuneration payments made in relation to general insurance products generally will prohibit conflicted remuneration payments by the AFSL holder and others in similar situations (e.g non AFSL aggregators etc) to their advisor representatives which defeats the purpose of the proposed carve out.

The above would require all third parties with arrangements of the above type to be restructured at great cost to industry and for no practical benefit. As previously discussed and agreed with Federal Treasury in the consultation process, if direct payments by insurers to advisors are not caught it makes little sense to also ban payments by third parties to the advisors.

The proposals would in effect simply cause such arrangements to be renegotiated so that payments are made directly by the insurer to the advisors. This would clearly be an unnecessary compliance cost.

NIBA also notes that a "general insurer" is defined as "a body corporate that is authorised under section 12 of the Insurance Act 1973 (Cth) to carry on insurance business in Australia."

This definition won't catch Lloyd's underwriters or unauthorised foreign insurers which can legally carry on business in Australia, which would create an inappropriate uneven playing field and is clearly not the intent.

In the carve out in proposed section 963C, a monetary or non-monetary benefit given to a licensee or representative of one by the employer of the licensee or representative is not conflicted remuneration if:

(a) the benefit:

(i) is remuneration for work carried out, or to be carried out, by the licensee or representative as an employee of that employer; and

(ii) is not of a kind mentioned in subsection 963(2) (ie volume based benefits); or

(b) the benefit is remuneration for work carried out, or to be carried out, by the licensee or representative as an employee of that employer and:

(i) the employer is an Australian ADI; and

(ii) access to the benefit, or the amount of the benefit, is dependent on the licensee or representative recommending a basic banking product; and

(iii) the licensee or representative does not, in the course of recommending that basic banking product, give other financial product advice that does not relate to a basic banking product.

NIBA notes that it obtained confirmation from Federal Treasury during the PCG consultation process on this specific proposal, that it would not be relevant to risk insurance because the conflicted remuneration carve out would be applied to all conflicted payments in relation to risk insurance products whether made by insurers or others.

To apply the conflicted remuneration ban in the way proposed having regard to this limited carve out in relation to general insurance products is inappropriate. It would require a significant restructuring of remuneration arrangements where payments are made to advisers by their employers and others to the extent this carve out and the general insurer carve out do not apply, for no practical benefit.

To address the above concerns (ie the limited scope of the carve out and the general insurer definition issue) proposed sub sections 963A(a) and 963B(a) could be replaced with:

"the benefit is given in relation to a general insurance product"

If the Bill cannot be amended, a regulation using the same words pursuant to sub sections 963A(e) and 963B(e) would achieve the same result and would also solve the "general insurer" definitional problem as payments by Lloyd's Underwriters and unauthorised foreign insurer would be covered by the above words even though the words in the Bill are too limited.

Life risk insurance issues relevant to conflicted remuneration carve outs

In relation to the life risk insurance carve outs in proposed sub section 963A(b) relating to monetary benefits, proposed sub section 963A(b) currently carves out conflicted remuneration where:

(b) the benefit is given to the licensee or representative by a company registered under section 21 of the Life Insurance Act 1995 and is given in relation to a life risk insurance product, other than:

(i) a group life policy for members of a superannuation entity as defined in proposed sub section 963A(2); or

(ii) a life policy for a member of a default superannuation fund as defined in proposed sub section 963A(3).

The EM in paragraph 1.21 provides that "The life insurer carve out will ensure that commissions will still be permissible on life risk (non-investment-linked) policies sold outside superannuation. Commissions will still be permissible on individual life risk (non-investment-linked) policies within superannuation for non-default ('choice') funds."

The same problem relating to Non-insurer remuneration arrangements noted in relation to general insurance above arises for life risk insurance too.

As the carve out does not apply to conflicted remuneration paid by entities other than the defined life insurers and to the extent of the limited employer write back in proposed section 963C, arrangements where the life insurer pays an entity and leaves that entity to pay the advisers separately would all need to be restructured.

NIBA proposes that proposed sub section 963A(b) could be replaced with:

> *"the benefit is given in relation to a life risk insurance product"*

If the Bill cannot be amended a regulation pursuant to sub section 963A(e) to this effect would achieve the same result.

The complete carve out of general insurance in relation to certain non-monetary benefits is not proposed to apply to life risk insurance which is a change from what was originally proposed. NIBA notes that it was not consulted on this change by Federal Treasury in the PCG process or by Government.

NIBA makes the following comments in relation to the carve outs proposed, as relevant to life risk insurance:

- NIBA expects that the concept of "identical or similar benefits are not provided on a frequent or regular basis" will give rise to much argument and confusion. Has the concept off an annual aggregate amount for types of identical or similar benefits been considered?

- In relation to the criteria to be specified in the regulations for the professional development exemption NIBA believes that the proposed requirement that the professional development must be conducted in Australia or New Zealand is inappropriate as many valuable professional development courses are provided in overseas locations.

BENEFITS FROM FINANCIAL PRODUCT ISSUERS ISSUES

Under proposed section 964 an issuer or seller of a financial product must not give any monetary or non-monetary benefit to a financial services licensee, or a representative of a financial services licensee, who provides financial product advice to retail clients.

There are proposed carve outs for general insurers and life insurers akin to those for monetary conflicted remuneration.

As noted before, the "general insurer" definition won't catch Lloyd's underwriters or unauthorised foreign insurers which can legally carry on business in Australia, which is clearly not the intent.

The same changes as proposed for the conflicted remuneration would solve the issue.

VOLUME-BASED SHELF SPACE FEES ISSUES

Proposed section 964C prohibits a financial services licensee from accepting a "volume based shelf space fee" in circumstances where:

> *(a) a monetary or non-monetary benefit is given by a financial services licensee or an RSE licensee (the **funds manager**) to a financial services licensee or an RSE licensee (the **platform operator**); and*
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> *(b) the platform operator offers:*
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> *(i) a facility through which financial services licensees and their representatives can obtain information about financial products; or*
>
> *(ii) a facility through which financial products are issued; and*
>
> *(c) either:*
>
> *(i) that facility includes information about financial products in which the funds manager deals (the **funds manager's financial products**); or*
>
> *(ii) financial products in which the funds manager deals (also the **funds manager's financial products**) are issued through that facility.*

Proposed section 964B defines a *volume-based shelf-space fee* as follows:

> (1) The benefit is a ***volume-based shelf-space fee*** if:
>
> (a) access to the benefit, or the value of benefit, is dependent on the total number or value of the funds manager's financial products of a particular kind, or particular kinds, about which information is included on the facility or which are issued through the facility; and
>
> (b) the benefit is not a discount on an amount payable, or a rebate of an amount paid, by the platform operator to the funds manager for services provided by the funds manager to the platform operator (see subsection (2)).
>
> (2) The benefit is also a ***volume-based shelf-space fee*** if:

(a) the benefit is a discount on an amount payable, or a rebate of an amount paid, by the platform operator to the funds manager for services provided by the funds manager to the platform operator; and

(b) the value of the benefit exceeds the reasonable value of scale efficiencies obtained by the funds manager because of the number or value of financial products in relation to which the funds manager provides those services

The ban is expressed in the EM to ban the receipt of the benefit by the platform operator (see paragraph 1.45) from product issuers or funds managers to purchase shelf space or preferential positions on administration platforms.

The Subdivision will however only apply where the platform operator holds an Australian Financial Services Licence.

Given the broad definition of "volume based shelf space fee" it could catch a licenced insurance broker or other licensed entity in the general insurance and life risk insurance space that operates a facility through which financial services licensees and their representatives (e.g insurance brokers) can obtain information about financial products.

This ban was not intended to operate in relation to general insurance and stand alone life risk insurance and this provision needs to carve out such insurance in the same way as proposed by NIBA for the conflicted remuneration provisions above.

If not, a significant number of licensees in the general and life risk insurance space could be adversely affected, contrary to Government's and Federal Treasury's representations in the PCA consultation that this ban would not apply in relation to those products.

If you would like to discuss any aspect of this matter further do not hesitate to contact us.

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