Submission to the Quality of Advice Review

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By email to: AdviceReview@treasury.gov.au

I am a financial adviser, accountant and business executive with experience in managing public and private companies. I hold the relevant qualifications including the legislated FASEA compliance.

I am a director of a specialist company holding an Australian Financial Service Licence (AFSL) and providing financial advice and dealing in Life risk insurance service and products.

As I have firsthand experience in the financial advice sector and particularly in the life risk advice segment, I submit my opinions to support the Government's objective to ensure that Australians have access to high quality, affordable and accessible financial advice.

Background of Life Risk Advice Issues

I refer to the Terms of Reference for Quality of Advice Review released by the Treasury on 11 March 2022 and in particular with regard to the **Issue Paper section 4.3 - Conflicted Remuneration, Life insurance exemption**. This section deals with the Financial Services Royal Commission Recommendation 2.5 - Life risk insurance commissions. It recommends further reducing the cap on commissions in respect of life risk insurance products and states that unless there is a clear justification for retaining those commissions, the cap should ultimately be reduced to zero.

The above recommendation followed-up the life insurance framework (LIF) reforms which took effect from 1 January 2018. The objective of the LIF reforms was to better the align adviser and consumer interests by introducing regulatory measures to reduce the conflict of interest risks to the provision of quality financial advice posed by the way financial advisors are remunerated. As a result, since 1 January 2020, a maximum up-front commission of 60% of annual premium has been payable on new life insurance sales.

Furthermore, APRA's review of income protection insurance and FASEA examination requirements as from 1 January 2019 have had a further effect on the Advised life risk insurance market. As a result, the total number of licenced financial advisers has been reduced from 28,561 in January 2019 to 17,492 in February 2022. This number includes 882 advisers, who must pass the exam before 30 September 2022 to continue practicing. Therefore, the number of advisers will likely fall further.

The impact of these changes has been profound. According to a research report by Plan For Life dated May 2021, the Advised life risk market reported a fall of new sales from $790 million in 2017 to $391 million in 2020. According to the report life risk adviser numbers have halved in this period. The report states that advisers have found it extremely difficult to adapt to the new commissions limit, which has effectively reduced initial remuneration by at least a third. Many adviser firms have indicated that they cannot survive under the changed commission requirements.

The combination of the above changes contributed to achieving the objective of the government's reforms - to ensure that Australians are provided high quality, affordable and accessible life risk advice. The exit of a large number of advisers who failed the FASEA examination or could not adapt their service model to the revised commission structure, have inevitably improved the quality of service provided by the remaining life risk advisers.

Simultaneously with the changes in Advised life risk market, the government undertook reforms in the Direct and Group life insurance market segments. These reforms also improved the quality of services in these life risk segments.

However, the impact of all these regulatory changes on the new life risk business written across the three segments has been substantial: in addition to the fall of new sales in the Advised life risk new business, Direct life risk insurance reported a fall from $421 million of new business in 2017 to $194 million in 2020. Group life risk insurance reported a fall in annual premiums collected by the industry and government funds from $4.76 billion in 2017 to $4.22 billion in 2020.

Since 2020 the decline in new life risk insurance business has ended but has not been substantially reversed. A Media Release from Plan For Life dated 16 May 2022 states that for the year ended December 2021, the Life Insurance Risk Total New Premium Sales rose only 2.2% year on year.

Importance of Life Risk Commissions

In the Advised Life risk market segment, life risk insurance commissions are the main mechanism by which the Advisers are remunerated for providing the Australian consumers with financial advice for their life risk insurance needs and recommending the appropriate life risk insurance products.

In my experience most of the consumers are very happy to receive life risk advice from licensed financial advisers and prefer dealing with them instead of buying insurance either directly from the direct insurers or via their group superannuation funds.

However, most of the consumers are unwilling to pay an advice fee for the provision of advice pertaining to life risk products. Consumers readily accept that the advisers will be paid commissions for advising them and arranging their insurances. In my experience, consumers understand the legal obligations on the Advisers who must act in the best interests of their clients and accept that fully disclosed commissions are a valid way of their life risk advisers being remunerated.

My personal experience of this consumer behaviour is supported by several research papers, including the following:

- Rice Warner and Zurich 2019 research report stated that just 8 per cent of consumers were willing to pay more than $1,000 for advice around life insurance, indicating that commission removal would make insurance advice unaffordable for the vast majority of consumers. The report stated *"Fee for service makes insurance advice unaffordable for 90-95 per cent of consumers and forces them to rely on inferior direct or group insurance products that generally cover less, cost more and deliver poorer claims outcomes; or even worse, consumers will not bother with insurance at all."*

- A 2020 report by the Insurtech platform Key Person Risk Management estimated that the removal of commissions from life insurance advice could cost consumers more than $15,000 over the life of a policy. The report estimates advisers will need to charge consumers between $3,000 and $5,000 for an initial review and implementation of life insurance advice on a pure fee for service basis, and between $600 and $1,500 per year to review their ongoing insurance arrangements. Furthermore, managing a claim for the consumer, will cost between $3,000 and $12,000 depending on the type of policy being claimed on.
- A survey by the Australian internet-based insurance broker Lifebroker indicate that consumers are apathetic towards life insurance. The biggest obstacle for purchasing life risk products is the perceived high cost of the insurances. The cost of advice pertaining to life risk products is even more resisted among consumers. The self-reported knowledge of life and income protection is poorer amongst the potentially more vulnerable groups, including those with larger mortgages and those with lower household incomes.

Given the above market dynamics and the observations of the customers behaviour, I recommend the retention of advised life risk insurance commissions.

Recommendation

In my observations, the objectives of the government reforms are on track to be achieved. Therefore, I recommend retention of the maximum up-front commissions equal to 60% of the annual premium on new life risk insurance sales and the retention of the ongoing commission of 20% on life risk insurance policies remaining in force.

Removing the most widely accepted mechanism of paying for life risk advice by removing commissions does not serve the best intertest of the Australian consumers.

If conflicted remuneration in life risk insurance is capped to zero (the life risk insurance commissions are banned), the Advisers advising in life risk products will be, largely, put out of business. This means approximately 2,600 experienced, FASEA compliant, specialist risk advisers will be lost.

However, the major long-term negative impact will be felt by the Consumers – the people purchasing life risk products and receiving benefits in the event of claim. They will be left to purchase mostly Direct insurances which are more expensive and with limited benefits, or Group insurances which are not underwritten, with insufficient default benefits and with limited cover. The worst outcome will be that the Consumers will not bother with insurance at all.

In my view retaining the unchanged life risk insurance commissions support the government's goal to design a market that meets the needs of the majority of Australians. These people will be missing out on the life risk advice they need if the commissions are banned or reduced. The current advisers' commissions are a market mechanism that meets their needs.

The economic theory and practical experience show that if the regulatory regime puts the advisers in unsustainable economic circumstances, ultimately the Australian consumers will pay the price for the market failure.

Best Regards,

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