

# Quality of Advice Review

## Key findings: General Insurance and Life Insurance

We set out below a snapshot of the data the Quality of Advice Review (Review) has considered on general insurance and life insurance.

### General Insurance

We have considered qualitative and quantitative data from a range of sources, including in relation to performance, distribution channels, remuneration arrangements and claims from general insurers and brokers, research by Finity Consulting, which was commissioned by the Australian Securities and Investments Commission (ASIC)<sup>1</sup>, and publicly available data and reports (including from the Australian Prudential Regulation Authority (APRA)).

The general insurance products considered by the Review were motor vehicle insurance; home and contents insurance (including residential strata insurance); sickness and accident insurance; travel insurance; and pet insurance.

The data demonstrates that the general insurance market is broad and complex and covers a large number of distinct insurance products, insurers and distribution models. According to APRA data, for the year ending 31 December 2021, the gross written premiums (GWP) for the general insurance industry was around \$59.1 billion.<sup>2</sup>

We found that:

- Home and contents insurance and domestic motor vehicle insurance, which together make up approximately 38 per cent of the general insurance market,<sup>3</sup> are predominantly sold directly by insurers to retail clients without any intermediaries (the direct channel) (approximately 70 and 80 per cent of the GWP for these products,<sup>4</sup> respectively). Approximately 5 per cent, by GWP, of both home and contents insurance and motor vehicle insurance are distributed through brokers.<sup>5</sup> We have been told that brokers play an important role in the general insurance market by providing consumers with expertise, geographical reach, access to niche and complex products and claims assistance. On the other hand, some other types of general insurance products, such as travel insurance, are mostly sold through intermediaries (such as travel agents and white label providers).
- Remuneration structures and commission rates differ according to distribution method and product type. For example, commission rates provided to brokers for the sale of home and contents insurance and motor vehicle insurance are estimated to range from 10 – 25 per cent of the GWP for these products.<sup>6</sup>

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<sup>1</sup> Finity Consulting (Finity) was engaged by ASIC to prepare a report on the distribution and remuneration arrangements of general insurance products sold to retail customers. Finity provided their report “*General Insurance Distribution and Remuneration Arrangements*” to ASIC in July 2019. The report is intended to provide an overview of distribution and remuneration arrangements at an industry level.

<sup>2</sup> APRA, *Quarterly general insurance performance statistics December 2002 to June 2022* (Statistics, June 2022) – accessed from: <https://www.apra.gov.au/quarterly-general-insurance-statistics>.

<sup>3</sup> Ibid.

<sup>4</sup> Finity, *General Insurance Distribution and Remuneration Arrangements* (Report, July 2019).

<sup>5</sup> Ibid.

<sup>6</sup> Ibid 6. The Finity report estimates that brokers receive an average commission rate of 15-25% for the sale of home and contents insurance, and 10-15% for the sale of motor vehicle insurance.

The general insurance industry is changing, voluntarily and in response to recent changes to the law. We have been told that, as a result of these changes, many of the key contributors to the misalignment between industry incentives and consumer interests (such as volume bonuses and junk products) have ceased or will shortly cease.

## Life Insurance

The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry recommended that, when ASIC conducts its review of conflicted remuneration relating to life risk insurance products, ASIC should consider further reducing the existing cap on commissions in respect of life risk insurance products (recommendation 2.5 of the final report).

On 21 April 2021, the then Minister for Financial Services announced that the review of the life insurance framework (LIF) reforms would be incorporated into the Quality of Advice Review, but that ASIC would remain responsible for reviewing advice files and collecting data from life insurers.

### Life insurance data collection (LIDC)

ASIC collected aggregate level data from a number of life insurers every six months, covering the period from 2017 to 2021 (inclusive). This data included information on premium rates, sales and adviser changes; sales data – new business and all-in force business for each six-month reporting period; commissions, full and partial lapse data as well as full and partial clawbacks. The LIDC found that:

- The overall number of new life insurance policies (including death, total and permanent disability (TPD), trauma and individual disability income insurance (IDII)) issued between 2017 and 2021 declined.
- The proportion of all types of new basic life insurance policies (i.e. life insurance policies without riders) sold through financial advisers (as compared to direct sales) increased from 70 per cent in the first half of 2017 to 83 per cent in the second half of 2021.
- Overall, the average premium across all new basic life insurance policy types increased by approximately 15 per cent between 2017 and 2021. There are a number of factors contributing to this including, an increase in the average sum insured, a change in the mix of product types being purchased, a change in the age of those purchasing life insurance, and a change in the underlying premium rate structure itself for some products. For example, for new death-cover, the average sum insured increased significantly (46 per cent) between 2017 and 2021 but the premium rate per \$1,000 of sum insured decreased.
- As expected, the commencement of the LIF reforms in 2018 resulted in a significant reduction in first-year commissions for all policy types between 2017 and 2021, with the average commission rate falling by approximately 20 per cent per dollar of premium, which corresponds to a 34 per cent proportionate decrease in the rate of commissions being paid.
- For death-cover sold through a financial adviser, the lapse rate appears to have decreased for all durations over the 2017-2021 period, particularly within the first two years of issue. However, it is too early to observe any trends in policy lapses for policies sold in the later data collection periods.

### Life insurance advice file reviews

The LIF Review compared two sample sets of life insurance advice files, 521 files from 2017 (before the LIF reforms were introduced) and 522 files from 2021 (after the full implementation of the LIF reforms). These life insurance advice files were assessed for compliance with the best interest duty and related obligations in the *Corporations Act 2001* (Corporations Act) and to determine whether there were significant concerns about client detriment/harm arising from non-compliant advice. The file reviews found that:

- Compliance with the best interests duty and related obligations had improved, with the pass rate increasing from 37 per cent of assessed files in 2017 to 58 per cent in 2021.
- There was a reduction in the number of files for which there was a significant concern about client detriment/harm from 12 per cent in 2017 to 7 per cent in 2021.
- The proportion of advice files with indicators of churn reduced between 2017 and 2021.
- The sample of advice files assessed were dominated by commission-based advice, with more than 90 per cent of the assessed files in both 2017 and 2021 involving the payment of a commission in connection with the sale of a life insurance product (as compared to clients being charged an advice fee).

While the data shows that the quality of advice has improved between 2017 and 2021, it is difficult to conclude that the improvement was because of the LIF reforms. This improvement could also be attributed to a number of other factors, such as the implementation of the professional standards, which introduced education and training standards for financial advisers.

The data also indicated an increase in the age and wealth of clients that received life insurance advice. This might indicate that lower commissions have encouraged advisers to prefer to provide advice to those with higher sums insured and higher premiums.

## Proposals for Reform: Conflicted Remuneration

Division 4 of Part 7.7A of the Corporations Act prohibits the issuer of a financial product giving conflicted remuneration to an AFS licensee or a representative of a licensee. It also prohibits an AFS licensee or representative of a licensee accepting conflicted remuneration. Broadly, conflicted remuneration is a benefit that could reasonably be expected to influence the choice of financial product recommended, or the financial product advice given, by an AFS licensee or a representative of a licensee to a retail client. The definition is expanded to include a benefit given to a licensee or representative in relation to information given to a person about a life risk insurance product or a dealing in a life risk insurance product (section 963AA of the Corporations Act). However, there are a number of monetary and non-monetary benefits that are excluded from the definition of conflicted remuneration.

This means there are currently benefits which would otherwise be conflicted remuneration because they are reasonably likely to influence the financial product advice given to a retail client by an AFS licensee or its representative which are not prohibited.

The Terms of Reference for the Review requires me to consider whether these benefits should continue to be able to be given. I have been persuaded that there are some benefits and some circumstances in which benefits which are reasonably likely to influence financial product advice should be retained, or should be retained subject to an additional requirement that the client provides their consent to the benefit.

Where the benefits relate to general insurance and life risk insurance products, financial advisers and insurance brokers continue to play an important role in giving consumers access to financial product advice about what can and should be valuable financial products. In forming this view I acknowledge that these benefits create a conflict for the adviser (or other recipient) and that this conflict creates a real risk that the quality of the advice provided by the adviser is not as good as it would be if they were paid a fee by the client for their advice.

That risk is diminished by a number of recent changes to the law: anti-hawking, deferred sales of add-on insurance, design and distribution obligations, and the caps on commissions payable in respect of consumer credit insurance and life risk insurance products. The risk should be further diminished by the proposals outlined in the Proposals Paper (<https://treasury.gov.au/sites/default/files/2022-08/c2022-307409-proposalsp.pdf>). These proposals will limit the opportunity for insurance products to be distributed using general advice and they will impose an obligation for a person who gives personal advice to give 'good' advice. Monitoring by ASIC and enforcement, where appropriate, will also be important. The proposals will also promote alternative sources of advice: digital advice and more direct advice. By reducing the cost of advice the proposals may also encourage more advisers to charge advice fees and more clients to turn to advisers who charge advice fees. In these circumstances, requiring a client to give their consent to the provision of a commission or other benefit should have more work to do: they will have alternatives.

The other key exceptions relate to advice and dealing in securities: stamping fees and brokerage. There is no evidence that leads me to think that these exceptions are not, in general terms, an appropriate and fair way to remunerate advisers for their services.

## General Insurance

### Current requirements

The Corporations Act provides exemptions to the ban on conflicted remuneration for benefits given in relation to a general insurance product and consumer credit insurance (see paragraphs 963B(1)(a), 963B(1)(ba) and 963C(1)(a) of the Corporations Act and regulation 7.7A.12G of the Corporations Regulations).

### Proposal

1. Retain the existing exemptions for benefits given in relation to general insurance products and consumer credit insurance, but require financial advisers (relevant providers), insurance brokers and other intermediaries who provide personal advice to retail clients in relation to general insurance products or consumer credit insurance to obtain their client's informed consent, in writing, to receive a commission or other benefit in connection with the issue of the general insurance product or consumer credit insurance.

In order for the consumer to be able to make an informed decision, the relevant provider, broker or intermediary must disclose to the consumer any commission and/or other benefits they would receive in connection with the issue of the general insurance product or consumer credit insurance.

This requirement would not apply to other distributors of general insurance or consumer credit insurance products (such as white label providers or retailers) that distribute these products on behalf of the insurer.

Where a general insurance product or consumer credit insurance can be renewed, consent could be sought prior to the initial issue of the insurance product and would not be required at each subsequent renewal, provided that the initial consent included the client's agreement to the adviser, broker or intermediary accepting a commission and/or other benefits on renewals.

**Reason for requiring consent: A financial adviser and broker are intermediaries who have undertaken to provide advice in the best interests of their client. If an adviser or broker will receive a benefit for the sale of the general insurance product or consumer credit insurance they recommend to their client, they should have an obligation to tell the client about the benefit and the client should have the opportunity to consent (or not) to the provision of that benefit. I acknowledge that disclosure and consent are not always (and perhaps not even often) effective consumer protection tools; nevertheless, a client should be put in a position to understand and consent (should they choose) to their adviser receiving a benefit from a product issuer.**

## Life risk insurance

### Current requirements

The Corporations Act provides an exemption to the ban on conflicted remuneration for life risk insurance products (other than group life policies in superannuation or policies issued in respect of default superannuation members), which allows commissions to be paid for the sale of life risk insurance products. This allows advisers to receive the following types of commissions for advice provided in connection with the issue of a life risk insurance product:

- Level commissions (i.e. where the upfront commissions is equal to the rate of ongoing commission); or

- Commission cap (i.e. 60% upfront commission and 20% trailing benefits) (see paragraph 963B(1)(b) of the Corporations Act)

#### Proposal

2. Retain the existing exemption for benefits given in relation to life risk insurance products, but require financial advisers (relevant providers) who provide personal advice to retail clients in relation to life risk insurance products to obtain their client's informed consent, in writing, to receive a commission in connection with the issue of a life risk insurance product.

In order for the consumer to be able to make an informed decision, the adviser must disclose details of:

- the commission the adviser will receive for the duration of the policy (e.g. any upfront and trailing benefits); and
- the nature of the ongoing service that the adviser will provide to the client in relation to the life risk insurance product (e.g. assisting the client pursue and settle claims).

**Reason for requiring consent:** A financial adviser is an intermediary who has undertaken to provide advice in the best interests of their client. If an adviser will receive a benefit for the sale of a life risk insurance product they recommend to their client, they should have an obligation to tell the client about the benefit and the client should have the opportunity to consent (or not) to the provision of that benefit. Again, I acknowledge that disclosure and consent are not always (and perhaps not even often) effective consumer protection tools; nevertheless, a client should be put in a position to understand and consent (should they choose) to their adviser receiving a benefit from the product issuer.

## **Time-sharing schemes**

#### Current requirements

The Corporations Act provides an exemption to the ban on conflicted remuneration if the benefit is given for advice that relates to an interest in a time-sharing scheme (see regulation 7.7A.12C of the Corporations Regulations).

#### Proposal

3. Retain the existing exemption to the ban on conflicted remuneration for time-sharing schemes under Chapter 7 of the Corporations Act for the time being, but the Government should undertake a separate review of time-sharing schemes and their distribution to determine whether the regulatory framework for time-sharing schemes under Chapter 7 of the Corporations Act is appropriate, in light of the reported evidence of consumer harm from time-sharing schemes (see ASIC report 642)<sup>7</sup>. As part of this review, consideration should be given to whether to retain the exemption to the ban on conflicted remuneration for time-sharing schemes.

**Intended outcome:** This proposal reflects my view that any recommendations made about the benefits provided to distributors of interests in time-sharing schemes should be made in the context of a broader review of these schemes and the way they are promoted. This is outside my Terms of Reference.

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<sup>7</sup> ASIC, *Timeshare: Consumers' experiences* (ASIC Report 642, December 2019) – accessed from: <https://download.asic.gov.au/media/5399786/rep642-published-6-december-2019.pdf>.

## Benefit given by the client

### Current requirements

The Corporations Act provides an exemption to the ban on conflicted remuneration where the benefit is given to an AFS licensee or its representative by a retail client in relation to financial product advice given by the licensee or a representative to the client (see sub-paragraph 963B(1)(d)(ii) of the Corporations Act). This exemption is expressed more narrowly than its description in the Explanatory Memorandum.

The Revised Explanatory Memorandum to the *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012* states that this provision: “ensures that ‘fee for service’ arrangements — where the client is the person paying the adviser — are not conflicted remuneration (even where the client pays a volume-based fee). The provision is intended to exclude from the definition of conflicted remuneration any fee for service paid by the retail client, whether the benefit is given directly by the retail client or is given by another party at the direction, or with the clear consent, of the retail client.”<sup>8</sup>

ASIC Regulatory Guide 246 *Conflicted and other banned remuneration* states that a benefit is given to an AFS licensee or its representative by a client if the benefit is given directly by the client or by another party on behalf of the client if the client has authorised the benefit, and if the client has used their own funds to give the benefit. A benefit is considered to have been authorised by a client “if the benefit is given at the client’s direction or with their clear consent”.<sup>9</sup>

### Proposal

4. Modify the existing exemption for benefits given by the client for financial product advice by expressly stating that the exemption also applies where the client directs a product issuer to pay a fee for financial product advice from the client's financial product to the AFS licensee or its representative.

***Intended outcome:*** This proposal is intended to ensure that the Corporations Act is consistent with the intention of the legislature, which is reflected in the Explanatory Memorandum, and ASIC guidance and remove any ambiguity or doubt about whether a benefit paid by a product issuer from a client's financial product is a 'benefit given by the client'. It is also intended to ensure that the exemption applies only to fees paid for the financial product advice provided by the relevant AFS licensee or representative.

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<sup>8</sup> Revised Explanatory Memorandum, *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2012* (Cth), pg 30, para 2.27 – accessed from:

[https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r4739\\_ems\\_c1902f04-f76c-455d-87bf-763755860827/upload\\_pdf/368171rem.pdf;fileType=application%2Fpdf](https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r4739_ems_c1902f04-f76c-455d-87bf-763755860827/upload_pdf/368171rem.pdf;fileType=application%2Fpdf).

<sup>9</sup> ASIC, *Conflicted and other banned remuneration* (ASIC Regulatory Guide 246, December 2020), pg 18 – accessed from: <https://download.asic.gov.au/media/5885872/rg246-published-10-december-2020.pdf>.

## Advice has not been provided in the previous 12 months

### Current requirements

The Corporations Act provides an exemption to the ban on conflicted remuneration where:

- a benefit is given to an AFS licensee or representative in relation to the issue or sale of the financial product to a person; and
- financial product advice in relation to the product, or products of that class, has not been given to the person as a retail client by the AFS licensee or representative in the 12 months immediately before the benefit is given (see paragraph 963B(1)(c) of the Corporations Act).

### Proposal

5. Remove the exemption to the ban on conflicted remuneration for benefits given for the issue or sale of a financial product (other than a life risk insurance 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.

This means that any benefit (unless otherwise exempt) given to an AFS licensee or its representatives, which could reasonably be expected to influence the financial product advice given to the client would be conflicted remuneration, regardless of the length of time that passes between when the advice is provided and the product is issued.

**Intended outcome:** This proposal seeks to simplify the law and to remove inconsistencies in the application of the conflicted remuneration provisions, and remove extraneous exemptions to the ban on conflicted remuneration.

## Benefits given to agents and employees of Authorised Deposit-Taking Institutions (ADIs)

### Current requirements

The Corporations Act contains exemptions for monetary and non-monetary benefits given to an agent or employee of an Australian ADI if access to the benefit is in whole, or in part, is dependent on the agent or employee recommending a basic banking product, a general insurance product or a consumer credit product (see section 963D of the Corporations Act and regulation 7.7A.12H of the Corporations Regulations).

### Proposal

6. It is proposed that these exemptions be removed. The removal of these exemptions would not prevent bank employees from being provided with performance-related benefits and incentives under a balanced scorecard approach that includes a broad range of criteria and which do not influence financial product advice provided to a retail client.

**Intended outcome:** Removing this exemption would remove inconsistencies in the application of the conflicted remuneration provisions, by providing that employees of Australian ADIs are treated in the same way as employees of other financial institutions, including when providing advice about the same types of products. It would also be consistent with the 2021 Sedgwick Review.<sup>10</sup>

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<sup>10</sup> Stephen Sedgwick, *Retail Banking Remuneration Review* (Final Report, May 2021), accessed from: <https://www.ausbanking.org.au/wp-content/uploads/2021/06/Retail-Banking-Remuneration-Review-Final-Report-2021.pdf>.



## Removing exceptions not related to the provision of financial product advice

The exceptions to the definition of conflicted remuneration are intended to be just that: exceptions for benefits that would otherwise be conflicted remuneration. The definition of conflicted remuneration turns on whether a benefit could be reasonably be expected to influence financial product advice given to a retail client.

### Proposal

7. The following 'exceptions' do not answer that description and should be removed:

- monetary and non-monetary benefits given by a retail client in relation to the issue or sale of a financial product (paragraphs 963B(1)(d)(i) and 963C(1)(e)(i) of the Corporations Act);
- a monetary benefit given to the provider by the client in relation to the provider dealing in a financial product on behalf of the client (regulation 7.7A.12E of the Corporations Regulations).

**Intended outcome: To simplify and rationalise the law by removing redundant exceptions (i.e exceptions that have no effect because the conduct to which they relate is not financial product advice).**

## Attachment A – List of exemptions to the ban on conflicted remuneration

Provision	Exemption	Proposal (if any)
Paragraphs 963B(1)(a) and 963C(1)(a) of the Corporations Act and regulation 7.7A.12G of the Corporations Regulations	Monetary and non-monetary benefits given in relation to a general insurance product	Retain exemption subject to client consent, where the recipient of the benefit is a financial adviser (relevant provider), insurance broker or other intermediary who provides personal advice to retail clients in relation to general insurance products
Paragraph 963B(1)(b) of the Corporations Act and regulations 7.7A.12EB and 7.7A.12EC of the Corporations Regulations	Monetary benefit is given in relation to a life risk insurance product (other than group life policies in superannuation or policies issued in respect of default superannuation members) where either of the conditions in sub-paragraph 963B(1)(b)(iii) of the Act apply	Retain exemption subject to client consent with the adviser to inform the client of the commission the adviser will receive (e.g. any upfront and trailing benefits) and the nature of the ongoing service (if any) the adviser will provide to the client in relation to the life risk insurance product (e.g. assisting the client pursue and settle claims)
Paragraph 963B(1)(ba) of the Corporations Act	Monetary benefit is given in relation to consumer credit insurance	Retain exemption subject to client consent (same as the proposal for general insurance products)
Paragraph 963B(1)(c) of the Corporations Act	Monetary benefit is given in relation to the issue or sale of a financial product (other than a life risk insurance product) and financial product advice about the product (or class of product) has not been given to the client by the recipient of the benefit in the previous 12 months	Remove the exemption – the ban on conflicted remuneration applies if the benefit could reasonably be expected to influence the financial product advice provided to the client, regardless of the time between when the advice is given and the product is issued
Sub-paragraph 963B(1)(d)(i) of the Corporations Act	Monetary benefit is given by the client in relation to the issue or sale of a financial product	Remove this exemption to simplify the law by removing redundant exceptions that have no effect because the conduct to which they relate is not financial product advice

Sub-paragraph 963B(1)(d)(ii) of the Corporations Act	Monetary benefit is given by the client in relation to financial product advice	Modify this exemption to clarify that it also applies where the client authorises a product issuer to pay for financial product advice provided to the client from the client's financial product
Regulations 7.7A.11C and 7.7A.11D of the Corporations Regulations	Benefit is given in specified circumstances in relation to: <ul style="list-style-type: none"> <li>information provided to a client about a life risk insurance product; or</li> <li>a dealing in a life risk insurance product</li> </ul>	Retain, with no change
Regulation 7.7A.12B of the Corporations Regulations	Monetary benefit is given as a stamping fee given to facilitate an approved capital raising	Retain, with no change
Regulation 7.7A.12C of the Corporations Regulations	Monetary benefit is given for advice that relates to an interest in a time-sharing scheme	Review the regulatory requirements for time-sharing schemes, and consider whether to retain the exemption to the ban on conflicted remuneration
Regulation 7.7A.12D of the Corporations Regulations	Monetary benefit consists of a brokerage fee	Retain, with no change
Regulation 7.7A.12E of the Corporations Regulations	Monetary benefit given to a provider dealing in a financial product on behalf of the client	Remove this exemption to simplify the law by removing redundant exceptions that have no effect because the conduct to which they relate is not financial product advice
Regulation 7.7A.12EA of the Corporations Regulations	Monetary benefit given as part of the sale of all, or part, of the AFS licensee or representative's financial advice business and the price is calculated in accordance with the formula prescribed in the regulations	Retain, with no change
Paragraph 963C(1)(b) of the Corporations Act and regulation 7.7A.13 of the Corporations Regulations	Non-monetary benefit is less than \$300 and identical or similar benefits are not given on a frequent or regular basis	Retain, with no change

Paragraph 963C(1)(c) of the Corporations Act and regulations 7.7A.14, 7.7A.15 and 7.7A.15A of the Corporations Regulations	Non-monetary benefit has a genuine education or training purpose relevant to the carrying on of a financial services business	Retain, with no change
Paragraph 963C(1)(d) of the Corporations Act	Non-monetary benefit involves the provision of information technology software or support related to the provision of financial product advice to retail clients	Retain, with no change
Sub-paragraph 963C(1)(e)(i) of the Corporations Act	Non-monetary benefit is given by the client in relation to the issue or sale of a financial product	Remove this exemption to simplify the law by removing redundant exceptions that have no effect because the conduct to which they relate is not financial product advice
Sub-paragraph 963C(1)(e)(ii) of the Corporations Act	Non-monetary benefit is given by the client in relation to financial product advice	Retain, with no change
Section 963D of the Corporations Act and regulation 7.7A.12H of the Corporations Regulations	Monetary or non-monetary benefit given to an agent or employee of an Australian ADI only providing financial product advice in relation to a basic banking product, general insurance product or consumer credit insurance (or any combination of these products)	Remove these exemptions to improve the consistency of the law by treating employees of Australian ADIs in the same way as employees of other financial institutions.  This would also be consistent with the 2021 Sedgwick Review