Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016

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Economics Section

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Date introduced: 11 February 2016
House: House of Representatives
Portfolio: Treasury
Commencement: Sections 1–3 on Royal Assent; Schedule 1 on 1 July 2016.

Links: The links to the Bill, its Explanatory Memorandum and second reading speech can be found on the Bill's home page, or through the Australian Parliament website.

When Bills have been passed and have received Royal Assent, they become Acts, which can be found at the Federal Register of Legislation website.

All hyperlinks in this Bills Digest are correct as at March 2016.
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Purpose of the Bill

The purpose of the Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016 (the Bill) is to amend the Corporations Act 2001 to:

- remove the current exemption from the ban on conflicted remuneration for benefits paid in relation to certain life risk insurance products and
- enable the Australian Securities and Investments Commission (ASIC) to make a legislative instrument to permit benefits in relation to life risk insurance products to be paid—provided that certain requirements are met.

Background

What is conflicted remuneration?

Division 4 in Part 7.7A of the Corporations Act sets out a general ban on remuneration arrangements for financial advisors on the sale of financial advice and financial products to certain consumers. The rationale for the ban is that, because of the nature of the benefit or the circumstances in which it is given, the remuneration arrangements could reasonably be expected to influence the choice of product or advice given. The general aim of these provisions—which were part of the ‘Future of Financial Advice’ (FOFA) arrangements implemented by the Gillard Government—was to more closely align the interests of those who provide financial product advice to retail clients with the interests of their clients, and improve the quality of advice these clients receive.

Section 963B of the Corporations Act provides some exemptions from the general ban on conflicted remuneration in certain circumstances. These exemptions include, amongst other things, where the benefit relates solely to a general insurance product or where the benefit relates solely to a life risk insurance product, other than a group life policy for members of a superannuation entity or default superannuation fund.

The exemption for life insurance outside of superannuation, which was included as part of the FOFA changes, was based on concerns about affordability of life insurance and the potential for under-insurance.

Life insurance industry, products and remuneration arrangements

As at 30 June 2015 there were 28 registered life insurers operating in Australia, with net premium income in 2014–15 of $60.9 billion.

Life insurance generally covers a range of insurance products including:

- life cover—also known as term life insurance or death cover, pays a set amount of money when the insured person dies
- total and permanent disability (TPD) cover—covers the costs of rehabilitation, debt repayments and the future cost of living if the insured person is totally and permanently disabled. TPD cover is often bundled together with life cover
- trauma cover—provides cover in the event of a diagnosis of a specified illness or injury. These policies include the major illnesses or injuries that will make a significant impact on a person’s life, such as cancer or a stroke. It is also referred to as ‘critical illness’ cover or ‘recovery’ insurance and
- income protection—replaces the income lost through an inability to work due to injury or sickness.

Consumers generally purchase life insurance in one of three ways: through an advice provider (adviser); directly from an insurer; or through their superannuation fund and the group life cover offered by the fund.

2. Ibid., p. 5.
As at 30 June 2013 the Australian Securities and Investments Commission (ASIC) found that, for 12 life insurers participating in an ASIC survey, there were 2.6 million policies in force that were purchased through an advice provider (adviser). At this time, life only and income protection policies were the most common policies in force, comprising 32 per cent and 21 per cent of the total policies in force.

For life insurance distributed under personal advice models, advisers are typically paid under commission arrangements. In 2014 ASIC noted that upfront commission models—in which advisers were paid an amount upon the sale of a new premium—were the dominant remuneration arrangement by a significant margin, with 82 per cent of the remuneration in the industry in 2013 derived from these amounts (Figure 1).

**Figure 1  Life insurance remuneration models, 2011–2013 averages**

<table>
<thead>
<tr>
<th>Remuneration model</th>
<th>Percentage of remuneration</th>
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<tr>
<td>Upfront commission</td>
<td>84%</td>
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<tr>
<td>Hybrid commission</td>
<td>10%</td>
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<tr>
<td>Level commission</td>
<td>5%</td>
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<tr>
<td>No commission</td>
<td>1%</td>
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<tr>
<td>Salaried employee</td>
<td>0%</td>
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**Brief history of the future of financial advice changes**

The FOFA reforms were a package of amendments to change how financial advice is delivered to clients including:

- how financial advisers behave in relation to providing advice
- how clients are charged for this advice and
- the disclosure of fees to clients.

The FOFA reforms constituted the Rudd and Gillard Governments’ response to the 2009 report by the Parliamentary Joint Committee on Corporations and Financial Services of its *Inquiry into Financial Products and Services* (PJC report). The impetus for the PJC inquiry was a number of significant corporate collapses, including Storm Financial and Opes Prime.

The FOFA reforms were introduced into the Parliament in late 2011 and implemented by two key pieces of legislation:

- the *Corporations Amendment (Future of Financial Advice) Act 2012* which:

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9. Ibid., p. 18.
10. Ibid., p. 19.
12. Ibid., p. vii.
– enhanced the requirement for disclosure of fees and services associated with ongoing fees\(^\text{13}\) and
– enhanced the ability of the Australian Securities and Investments Commission (ASIC) to supervise the financial services industry, through changes to its licensing and banning powers for financial advisers\(^\text{14}\) and

- the \textit{Corporations Amendment (Further Future of Financial Advice Measures) Act 2012} which
  – required those persons who are providing personal financial advice to retail clients to act in the best interests of their clients, and to give priority to their clients’ interests\(^\text{15}\)
  – imposed a prospective ban on conflicted remuneration structures\(^\text{16}\)
  – applied existing regulatory mechanisms under the \textit{Corporations Act} more directly to individual advisers as well as to licensees.\(^\text{17}\)

The implementation date for most of the FOFA reforms was originally 1 July 2012. However, Government amendments during the passage of the legislation provided that the provisions would be voluntary until 1 July 2013, after which time compliance with the relevant requirements was mandatory.\(^\text{18}\)

Upon coming to office, the Abbott Government sought to make a number of changes to some aspects of the FOFA arrangements through the Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014, which was introduced in the House of Representatives on 19 March 2014.\(^\text{19}\) Some of the proposed changes included:

- removing the need for clients to renew their ongoing fee arrangement with their adviser every two years (also known as the ‘opt-in’ requirement)
- making the requirement for advisers to provide a fee disclosure statement only applicable to clients who entered into their arrangement after 1 July 2013
- removing the ‘catch-all’ provision, from the list of steps an advice provider may take in order to satisfy the best interests obligation
- better facilitating the provision of scaled advice and
- providing a targeted exemption for general advice from the ban on conflicted remuneration in certain circumstances.\(^\text{20}\)

Some of these proposals were controversial.

While the Bill was before the Parliament, the Government announced that it would implement some of the changes by regulation.\(^\text{21}\) These amendments were implemented through the Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014, which commenced on 1 July 2014.\(^\text{22}\) On 19 November 2014, the Regulation was disallowed by the Senate.\(^\text{23}\)

The Government then remade a number of time-sensitive elements of the disallowed Regulation. These changes were implemented through the Corporations Amendment (Revising Future of Financial Advice) Regulation 2014

\(^{13}\) \textit{Corporations Act}, section 962G.

\(^{14}\) These changes included various amendments to the \textit{Corporations Act} in relation to ASIC’s powers to make decisions to grant, suspend or cancel a licence and bans (including amendments to sections 913B, 915C and 920A).

\(^{15}\) \textit{Corporations Act}, section 961B.

\(^{16}\) \textit{Corporations Act}, Divisions 4 and 5 of Part 7.7A.

\(^{17}\) \textit{Corporations Act}, section 961.

\(^{18}\) The Treasury, ‘\textit{Implementation}’, Future of Financial Advice website; B Shorten (Minister for Financial Services and Superannuation), \textit{Government’s financial advice reforms pass the parliament}, media release, 20 June 2012.


\(^{21}\) M Cormann (Acting Assistant Treasurer), \textit{The way forward on financial advice laws}, media release, 20 June 2014.

\(^{22}\) \textit{Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014}.

Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016


The Corporations Amendment (Streamlining of Future of Financial Advice) Bill 2014, including amendments made by the Government, was passed by the House of Representatives on 28 August 2014. The Bill, with further Government amendments, was passed by the Senate on 24 November 2015 and agreed to by the House of Representatives on 1 March 2016. The key changes that were proposed in the Bill as introduced but not included in the Bill as finally passed by the Parliament were:

- changes to the Statements of Advice requirements
- repeal of the requirement that licensees send fee disclosure statements to pre-1 July 2013 clients
- repeal of the opt-in requirement for continuing an ongoing fee arrangement between a fee recipient and a client
- changes to the best interests duty and scaled advice and
- the general advice exemption from conflicted remuneration.

Policy development

The arrangements proposed by the Bill are a response to concerns held over a number of years about remuneration arrangements in the life insurance industry. These concerns were considered as part of the FOFA reform process.

While self-regulation was first proposed by the financial services industry in 2011, the idea did not receive universal industry support. This then led to a life insurance industry-commissioned review, which overlapped with the Government’s financial system review and ASIC research.

Further consultation by the Government after these processes concluded then contributed to the design of the measures included in the Bill.

Industry attempts at self-regulation

At the same time as the development of the FOFA package of measures in 2010 and 2011, the financial services industry was examining remuneration arrangements in life insurance to address issues associated with ‘churning’—whereby consumers with an existing life insurance policy are sold a new policy by a financial adviser that has no net benefit for the consumer. While churn can be a measure of competition within an industry and indicate that choice is exercised by consumers, relatively high levels of churn in some industries may also be associated with concerns about inappropriate marketing strategies or customer dissatisfaction with a supplier.

In August 2011, the Financial Services Council (FSC) recognised that churning impacted on both the quality and cost of life insurance products for consumers and on the profitability of the industry, with the CEO of the FSC noting:

Advisers that engage in churning do so to access the upfront commission on the sale, in the knowledge that the new policy provides essentially equivalent cover and benefits for the client, to the policy that has been replaced.

The practice also creates cost pressures for life insurance premiums that are simply wasteful and unnecessary.

This practice is not in the interests of consumers and the FSC has taken the clear view that it is inconsistent with the statutory requirement for financial advisers to act in their clients ‘best interests’.

27. Financial Services Council, Churning in life insurance, media release, 4 August 2011.
While this practice is not widespread, it is significant enough an issue to warrant industry action.\(^{28}\)

At this time, the FSC proposed the development of a voluntary industry standard (which would apply to members of the FSC) to address the practice of ‘churning’.\(^{29}\) The FSC proposal included:

- the removal of ‘takeover terms’ (that is, banning the practice of the relaxation of the standard underwriting process for replacement business) for a policy or a group of policies that are transferred by an adviser between insurers and
- the establishment of a consistent adviser responsibility period across the industry of two years—with 100 per cent commission clawback if the policy lapses with an insurer within one year, and 50 per cent commission clawback if the policy lapses with an insurer during the second year.\(^{30}\)

When this proposal was announced, the FSC intended that it would be finalised in 2012 ‘with an implementation date that would be consistent with the FOFA reforms’.\(^{31}\)

One year later, in August 2012, the FSC finalised its proposed industry standard, which was to be effective from 1 July 2013.\(^{32}\) Key elements of the proposed standard included:

- Where an advised policy lapses within three years of commencement, a three year adviser responsibility period will apply;
- A tiered commission claw-back provision will be introduced as follows:
  - 100% of remuneration paid by an insurer to an adviser if the policy lapses within the first year;
  - 75% of remuneration paid by an insurer if the policy lapses within the second year; and
  - 50% of remuneration paid by an insurer if the policy lapses within the third year.\(^{33}\)

By February 2013 however, the implementation of the standard had been abandoned by the FSC.\(^{34}\) The CEO of the FSC was reported to have attributed the decision to ‘no longer having the unanimity on this approach’ and that ‘the proposed framework raised a complex set of factual, legal and economic issues from a competition perspective, which meant that it would have required regulatory approval in order to be implemented’.\(^{35}\) The CEO of the FSC noted that the FSC ‘remains committed to ensuring a sustainable life insurance sector which will deliver outcomes for the community and the industry participants’.\(^{36}\)

**ASIC review**

On 9 October 2014, ASIC published a review of retail life insurance.\(^{37}\) The review, conducted between September 2013 and July 2014, examined:

- how life insurance is sold by advisers
- how advisers are remunerated for that advice
- the drivers behind product replacement advice to consumers and
- the quality of the personal advice consumers receive.\(^{38}\)

The purpose of the review, described as a ‘proactive surveillance of life insurance advice’ in the 2014–15 ASIC annual report, was ‘to better understand the quality of advice consumers receive’.\(^{39}\)

The ASIC review noted that life insurance policies are lapsing—when a policy ceases due to non-payment or cancellation by the client—at high rates, with policy lapses doubling from approximately seven per cent in the

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30. Ibid.
31. Ibid.
32. FSC, *New life insurance framework will reduce premiums*, media release, 3 August 2012.
33. Ibid.
35. Ibid.
36. Ibid.
first year to 14 per cent in the second year. After the initial spike, lapse rates remain high (above 14 per cent) for the next three years before tapering. The factors for these higher lapse rates included:

• product innovation by insurers, such as changing actuarial assumptions at underwriting or the redesign of key policy features such as definitions and exclusions, which leads to the repricing of policies
• age-based premium increases affecting affordability, and
• incentives for advisers to write new business or rewrite existing business to increase commission income.

The ASIC review also found a correlation between high lapse rates and upfront commission models.

The main recommendations of the review did not necessarily advocate a stronger role for government in regulating remuneration arrangements. Instead, the recommendations were for insurers and financial advisers to examine, individually or as an industry, the business models and remuneration arrangements:

We recommend that insurers:

(a) address misaligned incentives in their distribution channels;

(b) address lapse rates on an industry-wide and insurer-by-insurer basis (e.g. by considering measures to encourage product retention); and

(c) review their remuneration arrangements to ensure that they support good-quality outcomes for consumers and better manage the conflicts of interest within those arrangements.

We recommend that AFS licensees:

(a) ensure that remuneration structures support good-quality advice that prioritises the needs of the client;

(b) review their business models to provide incentives for strategic life insurance advice;

(c) review the training and competency of advisers giving life insurance advice; and

(d) increase their monitoring and supervision of advisers with a view to building ‘warning signs’ into file reviews and create incentives to reward quality, compliant advice.

**Trowbridge Review**

Following the release of the ASIC review, in December 2014, the Association of Financial Advisers (AFA) and the FSC established a Life Insurance and Advice Working Group headed by former APRA member John Trowbridge, to review the ASIC report.

**Interim report**

An interim report was published by the FSC on 17 December 2014. The interim report put forward five models to be considered for direct adviser remuneration:

• level commissions only (no extra commission in Year 1) and no other direct remuneration

• hybrid commissions as currently understood as the maximum commissions (for example, dictating a maximum upfront commission of 80 per cent and level commission thereafter)

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41. Ibid.
42. Ibid.
43. Ibid.
44. Ibid., pp. 7–8.
46. Ibid.
• modified hybrid comprising initial remuneration of a combination of commission at a level less than the current hybrid plus a fixed dollar payment. Renewal commissions could be as per current hybrid arrangements

• level plus fees comprising level commissions, at a rate to be considered, supplemented by an initial payment in the nature of a fee from the insurer to the adviser. Such a payment would not be a commission but a fee in the nature of cost recovery or expense reimbursement and

• level funded as a variation on ‘level’ where the commissions are level but to offset initial costs, on each policy inception the insurer lends the adviser funds that are repayable over say three to five years from renewal commissions. 47

**Final report**

The final report was released on 26 March 2015. 48 In relation to remuneration arrangements, the final report proposed a remuneration model that was based on a fixed level of commission (maximum 20 per cent of premiums) supplemented by an ‘initial advice payment’. 49 The recommendations were in two parts, with a ‘reform model’ (commencing from a date in 2018) supported by a three-year transition plan:

The Reform Model can be described as level commissions supplemented by an Initial Advice Payment available at a client’s first policy inception and then no more often than once every five years, where:

- the level commission is a maximum of 20% of premiums;
- the Initial Advice Payment (IAP) is paid by the insurer to the adviser on a per client basis (which would generally mean the insured life);
- the IAP is available to the adviser when a client first takes out a life insurance policy and subsequently no more often than once every five years and then only when a new policy is being taken out (the “five year rule”); and
- the IAP is a maximum of $1,200 or, for customers with annual premiums below $2,000, no more than 60% of the first year’s premiums.

…

The Transition Plan has two phases –

The first phase is where the five year rule is to apply on a best endeavours basis by insurers and licensees. It is recommended to commence as soon as possible, say 30 June 2015. In all other respects current arrangements would remain in place pending the second phase.

The second phase will require some form of regulation, to begin from a suitable date in 2016 and is where –

- the maximum commissions are to be on the current hybrid basis with a cap, so that the maximum initial commission is 80% of premiums capped at $8,000 and maximum renewal commission is 20%;
- for the purposes of the five year rule, the initial commission is to be treated as a recurring component of 20% and an IAP of 60% of premiums;
- this arrangement is to continue for two years pending full introduction of the Reform Model. 50

On 25 June 2015, the then Assistant Treasurer welcomed the release of the Trowbridge Review and noted that the Government would consider the proposals in the context of its response to the Financial System Inquiry. 51

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47. Ibid., p. 25–30.
49. Ibid., p. 6.
50. Ibid., pp. 6–8.
Financial System Inquiry

The Financial System Inquiry (also referred to as the ‘Murray Inquiry’ after its chair Mr David Murray AO), conducted over the period late 2013 to late 2014, included some consideration of remuneration arrangements in the financial services industry.

Interim report

In its interim report, released on 15 July 2014, the Murray Inquiry noted that ‘the principle of consumers being able to access advice that helps them meet their financial needs is undermined by the existence of conflicted remuneration structures in financial advice’.  

The interim report also sought some additional information about the extent of underinsurance.

Final report

In its final report, released on 7 December 2014, the Murray Inquiry made some specific recommendations about remuneration arrangements in the life insurance industry. The final report states:

With the exception of group life insurance policies inside superannuation and an individual life insurance policy for a member of a default fund, life insurance products are exempt from the [future of financial advice] ban on commissions. This allows individual life policies to be sold with high upfront commissions, creating an incentive for advisers to make a sale, rather than provide strategic advice. For example, these policies can have 100–130 per cent of the first year’s premium payable as upfront commissions, with an ongoing trail commission of around 10 per cent.

… Upfront commissions can affect the quality of advice. ASIC found that 96 per cent of advice rated as a ‘fail’ was given by advisers paid under an upfront commission model. ASIC also found high upfront commissions encourage advisers to replace a consumer’s policy rather than retain it. In some cases, this may result in inferior policy terms. To date, industry approaches to address the issues in life insurance have not worked.

The Murray Inquiry recommended that a level commission structure be implemented through legislation requiring that an upfront commission is not greater than the ongoing commission. The final report also noted:

Alternative models of remuneration, such as delayed vesting of commissions and clawback arrangements, may simply delay the issue of churn and are complex. At this stage, the Inquiry does not recommend removing all commissions, as some consumers may not purchase life insurance if the advice involves an upfront fee. However, if level commission structures do not address the issues in life insurance, Government should revisit banning commissions.

The Inquiry has not determined the percentage amount of the level commissions that should apply in the life insurance sector. This should be left to the market and industry.

Government response to Financial System Inquiry

The Government response to the Murray Inquiry was released on 20 October 2015. The Government response noted the release of the Trowbridge final report which had been delivered during the Murray Inquiry and proposed to proceed with the life insurance industry’s proposed reforms:

The Government agrees more can be done to better align the interests of financial firms and consumers. However, we intend to take a different approach to that recommended by the Inquiry for retail life insurance.

53. Ibid., p. 3-80.
55. Ibid., p. 219.
56. Ibid., p. 220.
57. Ibid.
We support the retail life insurance industry’s proposed reforms as announced by the then Assistant Treasurer on 25 June 2015. The Government will consider the extent to which legislation and/or action by ASIC may be necessary to implement the industry agreement.

A Government review in 2018 will consider whether the new industry arrangements for life insurance advice have better aligned the interests of firms and consumers. If the review suggests further reform, consideration would be given to the Inquiry’s recommendation for a level commission structure or further extending the existing Future of Financial Advice provisions on conflicted remuneration to life insurance advice.59

**Final policy decision and draft legislation**

On 6 November 2015 the Assistant Treasurer announced that the Government had reached agreement with the life insurance industry about remuneration arrangements.60 Key elements of the announced package included:

- phasing down upfront commissions to a maximum of 80 per cent from 1 July 2016; 70 per cent from 1 July 2017 and then 60 per cent from 1 July 2018, together with a maximum 20 per cent ongoing commission and

- introducing a two year retention (‘clawback’) period as follows:
  - in the first year of the policy, to 100 per cent of the commission on the first year’s premium and
  - in the second year of the policy, to 60 per cent of the commission on the first year’s premium.61

Treasury released draft legislation for consultation on 3 December 2015, with submissions due by 4 January 2016.62 The Assistant Treasurer noted in her second reading speech that over 20 submissions to the draft legislation had been received.63 At the date of publication of this Bills Digest, submissions to the draft legislation had not been published by Treasury.

On 15 December 2015 ASIC released a consultation paper seeking feedback on aspects of the proposed legislative instrument that would underpin much of the detailed arrangements that would be facilitated by the Bill.64 Comments on the consultation paper closed on 29 January 2016.65 Included in the consultation paper were the following proposed key thresholds in relation to maximum commissions and clawback arrangements:

- transitional arrangements for the setting of the maximum level of commissions at 80 per cent of the premium in the first year of the policy from July 2016, reducing to 70 per cent from 1 July 2017 and then to 60 per cent from 1 July 2018

- an ongoing commission for policy renewals will be set at a maximum of 20 per cent of the total of the premium paid for the renewal and

- a two-year clawback period for policies that have lapsed, with 100 per cent of the commission repaid if the policy lapses in the first year and 60 per cent of the commission repaid if the policy lapses in the second year.66

These key thresholds are consistent with the Government’s 6 November 2015 announcement.

**Broader policy considerations**

The Government’s 6 November 2015 announcement made reference to several other policies that were part of a broader approach to improving the quality of financial advice for life insurance and the efficiency of the life insurance industry. These included:

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59. Ibid., p. 20.
60. K O’Dwyer (Assistant Treasurer), *Government announces significant improvements to life insurance industry*, media release, 6 November 2015.
61. Ibid.
64. ASIC, *ASIC consults on implementation of retail life insurance advice reforms*, media release, 15-384, 15 December 2015.
65. Ibid.
• a Life Insurance Code of Conduct to be developed by the FSC by 1 July 2016. The Code would set out best practice standards for insurers, including in relation to underwriting and claims management
• financial services industry to have responsibility for widening Approved Product Lists through the development of a new industry standard. 67 This industry standard will be a joint effort of all industry participants, led by the FSC
• ASIC to commence a review of Statements of Advice from the second half of 2016, with a view to making disclosure simpler and more effective for consumers as well as assisting advisers to make better use of these documents. The review of Statements of Advice will also consider whether the disclosure of adviser remuneration could be more effective, including prominent upfront disclosure of commissions and
• amendments to the Corporations Act to facilitate the rationalisation of legacy products in the life insurance and managed investment sectors, with further analysis of the taxation implications explored in the context of the Government’s Taxation White Paper process. 68

A broader range of measures to improve the standard and quality of financial advice, through mandating educational standards and professional development standards, is also being pursued by the Government as part of its response to the Financial System Inquiry. 69

Committee consideration

Senate Economics Legislation Committee
The Bill was referred to the Senate Economics Legislation Committee (Economics Committee) for inquiry and report by 15 March 2016. 70 The Economics Committee received a similar form letter from 209 stakeholders and 56 other submissions. 71 Most submissions originated from persons working in the life insurance industry as advisers. They expressed a number of concerns, for instance:
• the legislation would have the effect of exacerbating Australia’s ‘chronic under-insurance crisis’ 72
• the amendments would create ‘barriers and impediments’ to those financial advisers who seek to improve education, operate honestly and in a trustworthy manner for the benefit of consumers 73 so that the industry will see a reduction in adviser numbers 74 and the Bill will not provide any identifiable benefits for consumers. 75

The Economics Committee recommended that the Bill be passed. 76 In additional comments, Labor members of the Committee noted the following concerns raised in submissions to the inquiry:
• the reviews preceding the reform focused on churning, and not appropriate methods of dealing with rogue advisers; the data sample used in ASIC’s review was inadequate; and not all stakeholders were consulted

67. An ‘approved product list’ generally refers to information about certain financial products put together by advice businesses to give their advisers the authority to provide advice about those products (Moneysmart, “Financial products and sales incentives: checking limits and connections”, Moneysmart website, last updated 14 August 2015).
68. K O’Dwyer (Assistant Treasurer), Government announces significant improvements to life insurance industry, op. cit.
70. Senate Economics Legislation Committee, Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016 [Provisions], The Senate, Canberra, 2016: Details of the terms of reference, submissions to the Senate Standing Committee on Economics and the final report are available on the inquiry homepage.
• the reform will adversely affect consumer choice and competition, and will see an increase in the cost of life insurance, coupled with the implementation of fees for advice and
• the life insurance advice industry will see a decline in adviser numbers and an increase in the market share of large institutions like banks.  

**Senate Standing Committee for the Scrutiny of Bills**

The Senate Standing Committee for the Scrutiny of Bills made no comment on the Bill. 

**Statement of Compatibility with Human Rights**

As required under Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011 (Cth), the Government has assessed the Bill’s compatibility with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of that Act. The Government considers that the Bill is compatible. 

**Parliamentary Joint Committee on Human Rights**

The Parliamentary Joint Committee on Human Rights has considered the Bill and concluded that it does not raise human rights concerns.

**Policy position of non-government parties/independents**

When the Bill was debated in the House of Representatives on 3 March 2016, the Australian Labor Party (ALP) indicated that it would support the Bill. While the ALP noted some issues of concern (such as separating out the cost of stamp duty and other government taxes in life insurance products), the overall position of the ALP was:

... [it] will make incremental improvement to the life insurance remuneration structures. We know that that view is not universal in the sector or in the community but we think all of these Bills are, on-balance calls and we think, on balance, this Bill is worth supporting.

As noted previously, while ALP Senators made some additional comments in the Senate Economics Legislation Committee inquiry into the Bill, the ALP Senators did not propose to oppose the Bill.

At the time of writing this Bills Digest, no other non-government parties or independent Senators or Members had publicly expressed a position on the Bill.

**Position of major interest groups**

In her second reading speech, the Assistant Treasurer specifically acknowledged the work of the AFA, the Financial Planners Association (FPA) and the FSC ‘in working together to achieve sensible reforms for the sector which will benefit consumers through the provision of more appropriate advice and the long-term sustainability of the industry’. 

The AFA has generally supported the development of the regulatory package. On 6 November 2015 the AFA welcomed a reduction in the clawback period from three years to two years, noting that this ‘brings greater fairness to the [Life Insurance Framework] and that [t]o succeed in having this reduced to two years is a great relief for our members, particularly those that own and operate small businesses’.

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77. Ibid., p. 25.
79. The Statement of Compatibility with Human Rights can be found at pages 23 and 24 of the *Explanatory Memorandum* to the Bill.
82. Ibid.
83. Ibid.
The FSC comments on 6 November 2015 also supported the proposed arrangements, noting that the proposed changes were ‘a positive first step in lifting industry practices to improve consumer outcomes’. 86

The FPA also welcomed the proposed arrangements, noting that they were ‘a sensible outcome that will ensure the sustainability of the industry’. 87 The FPA noted that the setting of the clawback period of two years was ‘a result of combined representation by the AFA and FPA’. 88

National Seniors Australia (NSA) supports the intent of the regulatory package. 89 However, while recognising that the package was a compromise solution, NSA considered that ASIC should be given the power to set level commissions and zero commissions and also that the clawback provisions should be strengthened to specify a minimum three-year period. 90

Consumer organisation Choice, also commenting on the 6 November 2015 announcement, was generally supportive of the regulatory package but was ‘disappointed that the reforms have been watered down since they were announced in June’. 91 Choice considered that the change from a three year clawback period was ‘the result of an aggressive lobbying campaign by financial advisers seeking to protect the conflicted remuneration models upon which their industry is built’. 92

Financial implications
The Explanatory Memorandum notes that the financial impact on the Commonwealth of the measures proposed by the Bill is ‘nil’. 93

However, the Regulation Impact Statement acknowledges:

For large and medium sized licensees, there will be implementation costs associated with updating IT and other systems. It is assumed that small licensees do not have advanced IT systems and so the IT costs are not likely to be material. All licensees will have additional costs associated with monitoring compliance with the new regulations.

Individual financial advisers will incur a small cost associated with updating their knowledge of the remuneration arrangements, including clawback.

It is estimated that the increase in annual compliance costs for the industry as a whole will amount to $27.8 million. 94

Key issues and provisions
Why regulate life insurance remuneration arrangements?
In her second reading speech, the Assistant Treasurer noted that the proposed changes ‘strike the right balance between protecting consumers and recognising the need for ongoing viability and industry stability’. 95

The balance needs to be struck in respect of two matters:

• first, balancing the objective for more people to take out life insurance and the remuneration arrangements that may contribute to inappropriate advice and life insurance products being chosen by a consumer and

• second, the form of regulation and the extent of government intervention required to achieve the desired outcomes.

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86. FSC, FSC statement on life insurance reforms, media release, 6 November 2015.
88. ibid.
90. ibid., p. 2.
91. Choice, Life insurance reforms a good first step; further reforms needed before consumers can trust advice is in their interests, media release, 6 November 2015.
92. ibid.
93. Explanatory Memorandum, Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016, p. 3.
Consumer interests

As noted previously, the exemption for life insurance outside of superannuation from the conflicted remuneration arrangements under FOFA was largely based on concerns about affordability and the potential for under-insurance.\footnote{Trowbridge, Interim report on retail life insurance advice, op. cit., p. 7.}

Commission-based arrangements for the sale of life insurance, where products can be complex and there exists asymmetric information between buyer and seller about remuneration arrangements, can lead to greater incentives to provide biased advice to unsophisticated potential consumers.\footnote{H Gravelle, ‘Remunerating information providers: commissions versus fees in life insurance’, Journal of Risk and Insurance, 61(3), September 1994, ProQuest database, p. 425.} Economic analyses suggest that a commission-based model can be superior to the alternative upfront fee-for-service approach, although this result can depend on the extent to which different consumers are prepared to directly pay for advice and the value they attach to the advice.\footnote{Ibid., p. 452–453.}

The approach proposed by the Bill dilutes, but does not remove, the influence of commission-based remuneration arrangements in part of the life insurance industry. It also steers a middle course through the proposals of the Trowbridge final report for a fixed level of commission (maximum 20 per cent of premiums) supplemented by an ‘initial advice payment’ and the recommendations of the Murray Inquiry which were for a level commission structure requiring that an upfront commission is not greater than the ongoing commission.\footnote{Financial System Inquiry, Final report, op. cit., p. 220; Trowbridge, Review of retail life insurance advice: final report, op. cit., p. 6.}

Form of regulation

There has been some history of self-regulation in parts of the financial services industry through the development of industry codes of practice or codes of conduct. The first such financial services code was adopted in 1989 whilst a code covering life insurance was developed in 1995.\footnote{This place of codes of conduct in regulating financial services, Griffith Law Review, 15(2), 2006, pp. 340–342.} Initially, such codes were viewed largely as part of an ‘enrolment’ process to draw industry into the regulatory system.\footnote{Ibid., p. 6.} While such codes are sometimes viewed as a defensive mechanism by industry, it is also arguable that they have become more forward-looking initiatives, ‘focusing on improving standards and providing genuine consumer protection’.\footnote{N Howell, ‘Revisiting the Australian Code of Banking Practice: is self-regulation still relevant for improving consumer protection standards?’, University of New South Wales Law Journal, 38(2), 2015, p. 552.}

As noted previously the life insurance industry, through the FSC, had attempted to develop an industry standard to address issues related to churning and inappropriate advice. However, the failure of the industry to self-regulate has arguably necessitated the government stepping in to regulate remuneration arrangements.

The Trowbridge final report supported government intervention, noting:

It is essential for the integrity of the recommendations on adviser remuneration and licensee remuneration that there be some kind of externally imposed regulation on the industry. An effective form of this regulation, given the nature of the regulation required and the ability of ASIC to maintain an associated compliance regime, is likely to be the imposition by ASIC of licensing conditions on life insurers. These conditions would oblige all life insurers, and through them all licensed adviser groups (generally referred to as licensees in this report) by means of the contractual relationships between insurers and licensees, to conform to the Reform Model, the Transition Plan and the avoidance of conflicts of interest by licensees.\footnote{J Trowbridge, Review of retail life insurance advice: final report, op. cit., p. 11.}

The Murray Inquiry also backed implementing its recommendations for a level commission structure through legislation.\footnote{Financial System Inquiry, Final report, op. cit., p. 220.}
A wait and see approach?
To some extent the regulatory model adopted by the Government adopts a ‘wait and see’ approach, with the success of the regulatory measures to be assessed by an announced ASIC review in 2018.\textsuperscript{105}

The Assistant Minister indicated that further regulation may be required, noting in her second reading speech that ‘[i]f this 2018 Review does not identify significant improvement in product churn and the quality of advice, the Government will move to mandate level commissions, as was recommended by the Financial System Inquiry’.\textsuperscript{106}

Facilitative provisions
The main elements of the Bill amend the conflicted remuneration framework in Part 7.7A of the Corporations Act to empower ASIC to make a legislative instrument which will regulate benefits paid to life insurance brokers and advisers on the sale of life insurance products. These include some key concepts and definitions.

Allowable commissions and clawbacks
Existing section 963E of the Corporations Act bans a financial services licensee from accepting conflicted remuneration. The term conflicted remuneration is defined as any benefit, whether monetary or non-monetary, given to a financial services licensee (or their representative) 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:

\begin{itemize}
  \item could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients or
  \item could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.\textsuperscript{107}
\end{itemize}

However, certain benefits are exempted from the definition of conflicted remuneration. In particular, paragraph 963B(1)(b) of the Corporations Act provides that a benefit in relation to life products other than a group life policy for members of a superannuation entity or a life policy for a member of a default superannuation fund is not conflicted remuneration. Item 3 repeals and replaces paragraph 963B(1)(b) to limit the extent of the exemption. Proposed paragraph 963B(1)(b) provides for a similar exemption for life insurance products outside of superannuation to that which currently exists—subject to either the benefit ratio for the benefit being the same for each year in which the product is continued or satisfying the benefit ratio requirements and the clawback requirements.

Benefit ratio requirements
Item 4 inserts proposed subsections 963B(3A)–(3C) into the Corporations Act. The benefit ratio is the ratio between the benefit (that is, the benefit paid to an adviser or broker) and the policy cost payable for the product for the year. The policy cost is the total of:

\begin{itemize}
  \item the premiums payable for the product, or products, for that year
  \item any fees payable for that year to the issuer of the product
  \item any additional fees payable because the premium for the product is paid periodically rather than in a lump sum and
  \item any other amount prescribed by the regulations.\textsuperscript{108}
\end{itemize}

The benefit ratio requirements are satisfied in relation to a benefit for a life risk insurance product if the benefit ratio for the benefit for the year in which the product is issued and for each year that the product is continued is equal to or less than that determined by ASIC, by legislative instrument, as an acceptable benefit ratio for that year.\textsuperscript{109}

\textsuperscript{105} Explanatory Memorandum, Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016, p. 1.
\textsuperscript{106} K O’Dwyer (Assistant Treasurer), ‘Second reading speech: Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016’, op. cit.
\textsuperscript{107} Corporations Act, section 963A.
\textsuperscript{108} Corporations Act, proposed subsection 963B(38).
\textsuperscript{109} Corporations Act, proposed subsections 963BA(1) and (2) inserted by item 5 of the Bill.
Clawback requirements

The clawback requirements are satisfied if:

- the arrangement under which the benefit is payable includes an obligation to repay all or part of the benefit if within two years after it is first issued to a retail client either:
  - the product is cancelled or is not continued within two years after it is first issued to a retail client, other than because a claim is made under the insurance policy or because other prescribed circumstances exist or
  - the policy cost for the product during a year or across two years is reduced within two years after it is first issued to a retail client and
- the amount to be repaid under the obligation is equal to or greater than the amount determined by ASIC, by legislative instrument to be an acceptable repayment.

Although the contents of the legislative instruments is not known, by way of guidance, ASIC’s December 2015 consultation paper proposed the following key thresholds in relation to maximum commissions and clawback arrangements:

- transitional arrangements for the setting of the maximum level of commissions at 80 per cent of the premium in the first year of the policy from July 2016, reducing to 70 per cent from 1 July 2017 and then to 60 per cent from 1 July 2018
- an ongoing commission for policy renewals will be set at a maximum of 20 per cent of the total of the premium paid for the renewal
- a two-year clawback period for policies that have lapsed, with 100 per cent of the commission repaid if the policy lapses in the first year and 60 per cent of the commission repaid if the policy lapses in the second year.

Transitional arrangements

Item 6 inserts transitional arrangements into the Corporations Act. Proposed section 1549A inserts the meaning of the term commencement day. This will be 1 July 2016.

The amendments in the Bill apply to benefits given under an arrangement that is entered into after 1 July 2016. They do not apply to benefits given under an arrangement that is entered into before 1 July 2016—provided that the life product is issued within three months of 1 July 2016.

Further flexibility in implementation is provided through a regulation making power to prescribe circumstances in which the arrangements do, or do not apply.

2018 Review

As noted above the success or otherwise of the proposed remuneration arrangements will be examined as part of a review by ASIC in 2018. The requirement for ASIC to undertake this review is not part of the Bill.

ASIC has existing powers under section 912C of the Corporations Act to facilitate the collection of relevant information from financial services licensees. Item 1 inserts new proposed paragraph 912C(1A)(e) so that such information may be collected in a specified manner (including in electronic form).

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110. Corporations Act, proposed subsections 963BA(3) and (4) inserted by item 5 of the Bill.
112. Corporations Act, proposed subsection 1549B(1) inserted by item 6 of the Bill.
113. Corporations Act, proposed subsection 1549B(2) inserted by item 6 of the Bill
114. Corporations Act, proposed subsection 1549B(3) inserted by item 6 of the Bill