



15 April 2016
Committee Secretary
Senate Economics References Committee
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Dr Dermody

Re: Scrutiny of Advice Life Insurance Industry Inquiry

The Financial Planning Association of Australia (FPA)¹ welcomes the opportunity to provide input to the Scrutiny of Advice – Life insurance industry inquiry into the operation of the life insurance industry. This inquiry provides the opportunity to make positive steps towards a stronger and fairer life insurance industry to better protect consumers.

Lasting change in the life risk sector will ultimately be brought about by higher educational and professional standards, the removal of financial and other incentives for misconduct, and improving the transparency and efficiency for consumers.

With many of these change elements already underway in the sector in relation to investment and superannuation advice, we urge the committee to support regulatory design principles in relation to life insurance which facilitates access to life insurance for more Australians, and which encourage transparency, comparability and efficiency in life product design in the best interests of consumers.

We welcome the opportunity to discuss our submission with the Government. If you would like further information about our submission, please contact me on (02) 9220 4544 or email: ben.marshan@fpa.com.au.

Yours sincerely

Benjamin Marshan

Professional Standards and Advocacy Manager

¹ The Financial Planning Association (FPA) represents 12,000 members and affiliates of whom 9,000 are practicing financial planners and more than 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- We banned commissions and conflicted remuneration on investments and superannuation for our members in 2009 – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Mark Vincent, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 150,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. All new members of the FPA are required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board



Scrutiny of Advice Life Insurance

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Access to Insurance Products

The FPA is conscious that much work and time has gone into implementing the Life Insurance Framework through the development of the Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016, associated drafts of regulations and ASIC legislative instrument. We note however that this framework has added significant cost pressure to the financial planner through decreasing revenue at the same time as compliance costs have gone up due to FoFA. This cost burden falls disproportionately on small businesses, particularly small financial planning firms which are less likely to be able to bear the cost of reforms, especially in the face of large institutional life companies who can cross subsidise the additional cost burden. We would therefore encourage consideration be given to policy settings which may provide cost savings to consumers who seek out life insurance advice through a professional financial planner.

Acknowledgement also needs to be made of that fact that no insurance product even provides full cover of an individual. Individuals will always retain a residual risk, and financial planners are able to assist consumers in understanding this residual risk in a life insurance policy. With this in mind, for the benefit of consumers and where they seek advice from a financial planner, we believe the principle should be that insurance products are easily comparable. At present insurers define product features, definitions and standard terms differently. They compete over complex policy definitions creating knowledge asymmetry for consumers of their products and all but the most skilled intermediaries. Documentation between insurance products is not easily comparable as insurance contracts and PDSs all have differing formats and non-consistent section ordering. This all adds to a perception that life insurance companies are hard to deal with by consumers and adds to the financial disengagement and underinsurance epidemic in this country.

The FPA therefore recommends that consideration be given to defining a standard for describing product features, use of standard definitions in product contracts and descriptions, and a requirement that insurance policy documentation should have a standard ordering. These considerations would make it significantly easier for consumers and their advisers to compare products to allow the selection of the most appropriate product to provide risk cover for the consumer. Under the current regulatory settings, it is significantly difficult and costly for financial planners to comply with the product comparison requirements under the FoFA best interest duty to the detriment of consumers.

We also note that it has also been raised in the past that the medical profession have significant issues with assisting consumers in providing medical reports to insurance companies. Each insurance company has its own medical questionnaire, so where a consumer is applying for multiple life insurance products from multiple providers, a doctor may need to complete a number of different medical reports just for the purposes of underwriting. This again adds significantly to the complexity and cost of obtaining insurance cover. **The FPA would therefore also recommend that a single medical request form be developed which can be shared across insurers to better assist consumers in getting medical exams and obtaining cover.**



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Life risk regulation

The FPA provided recommendations in our submission to Treasury² to the Financial System Inquiry (FSI) Final Report, on regulation of life insurance products. Recommendation 24 of the final FSI report, established the goal of aligning “the interests of financial firms with those of consumers by raising industry standards, enhancing the power to ban individuals from management and ensuring remuneration structures in life insurance and stockbroking do not affect the quality of financial advice.”³ Our consistent position has been that the financial system should serve the public interest, which requires the interests of financial intermediaries and end users of the system to align towards commonly-held economic, social, and political values.

To that end, we recognised that remuneration structures in the life risk sector create conflicts of interest that can misalign the interests of financial intermediaries and users of the financial system. Our ambition, which we urged in our submission to Treasury was that the Government and Treasury share the burden and help to facilitate the life risk sector to move away from structural impediments towards values alignment. With respect to financial planning, our ambition is that life risk advice will eventually move from conflicted remuneration structures towards structures that align the interests of advisers and clients. The recent Life Insurance Framework implementation is a pragmatic step in this direction.

It should continue to be noted however that life companies themselves contribute to policy changes by consumers as they compete not only on pricing but also terms and conditions. Therefore this structural change requires initiative and commitment across the financial services sector, as well as the political willpower of the Government and of professional associations who contribute to the culture, values, and standards in the life risk sector. This structural change, like the structural changes that have occurred in the wealth management space, cannot occur simply through banning upfront commissions.

We therefore replicate some considerations here from our FSI: Final Report⁴ response.

Suitability regulation

The FPA supports the implementation of suitability regulation through a targeted and principles-based product design and distribution obligation. In our view, product issuers are key gatekeepers in the Australian financial system, and decisions made by these financial intermediaries have significant consequences for the end users of the financial services system.

Suitability regulation with respect to financial product manufacture and distribution requires financial intermediaries to form judgements about the financial capability of the clients they serve. In other jurisdictions, the term ‘financial product governance’ constitutes similar regulations and professional obligations with respect to the manufacture and distribution of financial products.

These obligations may require financial intermediaries who produce and distribute financial products to tailor their disclosure obligations to the needs of their intended client. These regulations may also require these intermediaries to reasonably adjust the scope of their professional obligations to those needs as well.

² FPA Submission: Financial System Inquiry: Final Report (March 2015) - http://fpa.com.au/wp-content/uploads/2015/09/2015_03_31_FPA-Submission_to_Treasury_on_FSI_Report_FINAL.pdf

³ Financial System Inquiry, ‘Final Report’ (December 2014) p 217

⁴ FPA Submission: Financial System Inquiry: Final Report (March 2015) - http://fpa.com.au/wp-content/uploads/2015/09/2015_03_31_FPA-Submission_to_Treasury_on_FSI_Report_FINAL.pdf



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Our second-round FSI submission⁵ made the following recommendation:

Recommendation 16:

The Final Report should review whether the existing product licencing conditions are sufficient to regulate the conduct of product issuers. If the Panel are of the view that these conditions are insufficient, the Report should recommend that statutory duties to the consumer and/or to protect the stability and transparency of the Australian financial system should be implemented.

Following from that position, in our second-round submission we wrote that:

“[I]t is difficult to argue that product issuers would be able to understand and cater to consumer demand in a market without having a general sense of what the consumer’s interests might be. However, there should be a clear distinction between a guarantee of the suitability and effectiveness of the product for an individual, and a guarantee that minimum standards of conduct and design apply to the product, and has been designed for consumers with particular needs in mind. Commercial realities will rarely admit black-and-white distinctions, but professional judgment can and should be applied in the relevant circumstances.”⁶

We are broadly in support of regulations which enhance the role of financial product governance arrangements in Australia. The FSI Final report explains the role of these obligations at three stages:

“During product design, product issuers should identify target and non-target markets, taking into account the product’s intended risk/return profile and other characteristics. Where the nature of the product warrants it, issuers should stress-test the product to assess how consumers may be affected in different circumstances. They should also consumer-test products to make key features clear and easy to understand.

During the product distribution process, issuers should agree with distributors on how a product should be distributed to consumers. Where applicable, distributors should have controls in place to act in accordance with the issuer’s expectations for distribution to target markets.

After the sale of a product, the issuer and distributor should periodically review whether the product still meets the needs of the target market and whether its risk profile is consistent with its distribution. The results of this review should inform future product design and distribution processes. This kind of review would not be required for closed products.”⁷

We note that similar practices exist in the European Union but are more comprehensive than the Murray Report’s recommendation. Following from the European Securities and Markets Authority’s (ESMA) report into Structured Retail Products published in July 2013, ESMA published an Opinion on good practices for product governance arrangements for these products.⁸ This Opinion indicates that the manufacture of Structured Retail Products (as well as their distribution to investors) ought to be accompanied by product governance arrangements on the following matters:

- a. general organisation of product governance arrangements;

⁵ FPA Submission - Financial System Inquiry – Final Report (August 2014). http://fpa.com.au/wp-content/uploads/2015/09/2014_08_26_FPA-Submission_Financial-System-Inquiry_FINAL1.pdf

⁶ Financial Planning Association, ‘Financial System Inquiry: Second-round submission’, p 24

⁷ FSI, above n 2 at p 198

⁸ European Securities and Markets Association, ‘Structured Retail Products – Good practices for product governance arrangements’ (March 2014)



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- b. product design;
- c. product testing;
- d. target market;
- e. distribution strategy;
- f. value at the date of issuance and transparency of costs;
- g. secondary market and redemption;
- h. review process⁹

Each of these matters is a principles-based obligation, and is explained in significant yet practical level of detail in that Opinion. ASIC ought to adopt a similar approach when issuing guidance and reporting on product design and distribution obligations.

Following from this, ESMA published its Final Report and Technical advice on MiFID II and MiFIR in December 2014, which provides detailed principles for financial product governance.¹⁰ The Technical Advice requires product issuers and product distributors to consider a variety of factors before producing and distributing financial products, including:

- That product design and product distribution methods comply with proper conflicts of interest management (including remuneration), and that the product design and features do not pose risks to consumers or market stability.¹¹
- Competency and training requirements so that the staff of product issuer firms understand the products which they manufacture.¹²
- Continuing review of product governance arrangements in order to detect any risk of non-compliance after the point of issuance.¹³
- Identification of the product's target market in sufficiently granular detail, and tailoring of the product to that target market.¹⁴
- Undertaking scenario analyses of products.¹⁵

The FPA endorses these forms of product suitability requirements and financial product governance arrangements, and we also endorse the ESMA Technical Advice in so far as it applies to suitability regulation and financial product governance.

⁹ ESMA, above n 21 at p 4

¹⁰ European Securities and Markets Authority, 'Final Report: ESMA's Technical Advice to the Commission on MiFID II and MiFIR' (December 2014).

¹¹ ESMA, Final Report at n 23, pp 55-56

¹² ESMA, Final Report at n 23, p 56

¹³ ESMA, Final Report at n 23, p 56

¹⁴ ESMA, Final Report at n 23, pp 56-57

¹⁵ ESMA, Final Report at n 23, p 57



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Product intervention powers

The FPA supports the FSI Final Report recommendation to grant ASIC product intervention powers. We have some concerns about inconsistencies in the conceptual framework within which these powers might sit, but we nonetheless are of the view that this addition to ASIC's regulatory toolkit is useful.

As identified in section 2 of this submission, the product intervention powers recommended by the Murray Report include powers such as requiring amendments to marketing and disclosure materials, and warnings to consumers, which are more closely aligned with a disclosure-based regulatory framework.

However, the recommendation also includes distribution restrictions and product banning powers, which are much more closely aligned with conceptual frameworks that recognise the political and social objectives of the financial system, and the regulation of financial products on their merits.

The FPA has called for an overhaul of the conceptual framework of the Australian financial services system. A fundamental theme of all our recommendations has been that a richer concept of financial citizenship should underpin the legislation, professional values, and ethical conduct of financial intermediaries in the Australian system.

As a consequence, our view is that product intervention powers, much like suitability regulation and financial product governance, should not be used solely to rectify product disclosure. Instead, our view is that a limited form of merits regulation, along the lines of regulating for product safety, market integrity, and/or systemic stability, would be an appropriate use of product intervention powers.

A similar approach has been adopted by the European Union and the European Securities and Markets Authority. These product intervention powers are implemented by Articles 40, 41, and 42 of MiFIR as an investor protection mandate and a systemic stability mandate. In particular, the ESMA's temporary product intervention mandate states that it shall only use product intervention powers if all the following conditions are fulfilled:

- (a) the proposed action addresses a significant investor protection concern or a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of the whole or part of the financial system in the Union;
- (b) regulatory requirements under Union law that are applicable to the relevant financial instrument or activity do not address the threat;
- (c) a competent authority or competent authorities have not taken action to address the threat or the actions that have been taken do not adequately address the threat.¹⁶

ESMA published its Final Report and Technical advice on MiFID II and MiFIR in December 2014, which provides detailed principles for the use of product intervention powers.¹⁷ Some of these factors and criteria include:

¹⁶ Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012, article 40(2).



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- The degree of complexity of the financial instrument or type of financial activity or practice and the relation to the type of clients to whom it is marketed and sold.¹⁸
- The type of clients involved in an activity or to whom a financial instrument is marketed or sold.¹⁹
- The degree of transparency of the financial instrument or type of financial activity or practice.²⁰
- The particular features or underlying components of the financial instrument or transaction, including any leverage a product or practice provides.²¹
- The degree of disparity between expected return or benefit for investors and the risk of loss in relation to the financial instrument, activity, or practice.²²
- The pricing and associated costs.²³
- The degree of innovation of a financial instrument, an activity, or practice.²⁴
- The selling practices associated with the financial instrument.²⁵
- The situation of the issuer of the instrument.²⁶
- Whether a financial instrument or practice would threaten the investors' confidence in the financial system.²⁷

The FPA endorses these criteria and the ESMA Technical Advice in so far as it applies to product intervention powers.

¹⁷ European Securities and Markets Authority, 'Final Report: ESMA's Technical Advice to the Commission on MiFID II and MIFIR' (December 2014).

¹⁸ ESMA, above n 55 at p 191

¹⁹ ESMA, above n 55 at p 192

²⁰ ESMA, above n 55 at p 192

²¹ ESMA, above n 55 at p 193

²² ESMA, above n 55 at p 193

²³ ESMA, above n 55 at p 193

²⁴ ESMA, above n 55 at p 194

²⁵ ESMA, above n 55 at p 194

²⁶ ESMA, above n 55 at p 194

²⁷ ESMA, above n 55 at p 195