ASIC Report 413 - Review of retail life insurance advice

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Background

ASIC has conducted a review of the distribution of life insurance by advisers providing personal advice to retail clients to understand the life insurance advice consumers are currently receiving and to identify opportunities to promote advice that is in their best interests.

ASIC only considered advice on lump sum and income stream products, such as life and total and permanent disability (TPD) insurance policies and trauma and income protection policies (excluding group life policies).

This was done by way of:

- industry roundtables and a survey of 12 life insurers; and
- targeted surveillance of 70 Australian Financial Services (AFS) licensee life advisers selling a large amount of life insurance. ASIC reviewed 202 random advice files and included a spread of pre-FOFA and post-FOFA advice.

ASIC rated the advice against the relevant legal obligations in force at the time the advice was given. ie:

- pre-FOFA advice a pass if the advice was appropriate (i.e. it met the then test in s945A of the Corporations Act).
- post-FOFA advice, ASIC applied the new best interests duty (s961B), the appropriate advice test (s961G) and the client priority rules (s961J), and rated the advice a pass or a fail. Where there was some doubt as to the final rating, ASIC gave advisers the benefit of the doubt given the law was new.

As has released its report on its findings and this paper seeks to summarise and comment on them.

The bad news is the results were not good for life advisers.

The good news is that ASIC clearly acknowledged the value of personal advice which, as all insurance brokers know, is that it:

- is tailored to the client and their relevant personal circumstances;
- considers the client's insurance needs and balances those needs against their other priorities;
- does not rely on generic calculations to reach a sum insured or fail to make inquiries of the client to test or challenge their assumptions; and
- leaves the client in a better position.

The Financial System Inquiry interim report effectively acknowledges the failings of the current product disclosure regime, in terms of assisting customers in understanding insurance and other financial products.

The reality is that many consumers, no matter how clearly and concisely insurance documents are drafted (nirvana) won't even in this perfect state read or be capable of understanding them (i.e. consumer literacy issues). In such circumstances personal advice services are clearly more important than ever.

All insurance insurers and insurance brokers, whether general or life, should read this report given the valuable information and guidance it contains for conducting a personal advice business in a professional and compliant manner.

The risk for life insurance brokers is that the exception from the monetary conflicted remuneration ban will come under scrutiny given the poor results.

From a general insurance broker perspective, whilst a number of the issues are life specified, some are universal. It is crucial that similar mistakes are not being made or they too may have their exemption from the conflicted remuneration ban scrutinised. Forewarned is forearmed.

Industry Trends

ASIC found that life insurance policies are lapsing at high rates and the drivers behind these high lapse rates include:

- 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.

ASIC also found a correlation between high lapse rates and upfront commission models which was the dominant remuneration arrangement for advisers by a significant margin i.e. 82% - the other models were hybrid commission, level commission, no commission and salaried employee.

Advice quality

ASIC found that in its view:

- 63% of consumers received advice that met the standard for compliance with the law (Pre FOFA (94 files) 59% pass/Post FOFA (108 files) 67% pass);
- 37% did not;
- the way an adviser was paid (e.g. under an upfront commission model compared to a hybrid, level or no commission model) had a statistically significant bearing on the likelihood of their client receiving advice that did not comply with the law.

Of the 202 files there was a 55% pass rate for up front commission models against 93% under other commission models); and

- the impact of adviser conflicts of interest on the quality of life insurance advice is an industry-wide problem and addressing it will require an industry wide response given the risk of loss of business any insurer moving first to change remuneration arrangements would suffer.

For those that failed, ASIC is considering enforcement action or other appropriate regulatory action.

ASIC identified the following factors that it believes affected the quality of advice:

- adviser incentives;
- inappropriate scaling of advice;
- lack of strategic life insurance advice;
- weak rationales for product replacement advice; and
- failure to consider the relationship between life insurance and superannuation.

Key warning signs of poor advice identified included:

- high clawback rates; and
- high volumes of replacement product advice, bundling and upselling.

ASIC found evidence of poor life insurance advice that resulted in considerable detriment to consumers, including evidence:

- that advisers failed to adequately consider their clients' personal circumstance and needs, leading to situations where consumers received inferior policy terms, paid more for cover, had health issues excluded and, in some cases, had claims denied where they previously had cover; and
- of unnecessary or excessive switching of clients between policies to maximise commission income, with a failure to consider or recommend insurance that reasonably correlated to clients' personal circumstances or objectives.
- Of poor documentation which did not show the basis of advice given.

ASIC Recommendations

ASIC made a number of high level recommendations for insurers and advisers.

ASIC Recommendation to insurers

Insurers should:

- address misaligned incentives in their distribution channels;
- address lapse rates on an industry-wide and insurer-by-insurer basis (e.g. by considering measures to encourage product retention); and

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

Recommendation to AFS licensees (advisers)

None of these should come as a shock to a professional adviser.

AFS licensees/advisers should, at a high level:

- ensure that remuneration structures support good-quality advice that prioritises the needs of the client;
- review their business models to provide incentives for strategic life insurance advice;
- review the training and competency of advisers giving life insurance advice; and
- 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.

To reduce the risk that upfront commission remuneration arrangements may cause the AFS licensee's business to give advice that does not comply with the law, ASIC recommends that the AFS licensee needs to actively manage the risks and consider:

- declining to provide advice if they cannot do so in compliance with the best interests duty and related obligations;
- structuring remuneration arrangements so they receive some remuneration from clients for advice where there is no product sale;
- structuring remuneration arrangements to minimise the effect of conflicts of interest and create financial incentives for advisers to meet compliance obligations;
- ensuring they provide appropriate levels of training to improve adviser competence; and
- performing regular file audits.

ASIC proposes to engage with AFS licensees, advisers and their professional associations about the issues they need to consider in giving compliant life insurance advice.

Valuable ASIC Guidance and tips

The report includes a great deal of useful information for advisers that should not be ignored. Statistics about the life insurance market and adviser review and performance are of great interest.

ASIC has also included

- case Studies;
- a list of some warning signs of poor advice table included below; and

- a checklist of issues to consider when giving life insurance advice included below.

In conclusion, the report should be compulsory reading for any insurance adviser given the value that can be obtained from it from a compliance and business perspective.

Table 8: **Warning signs of poor advice**

Warning sign	Commentary
High clawback rates	High clawback rates per adviser may be a warning sign about the quality of the advice that the adviser is giving to their clients. Clawbacks can be a telling indicator that advisers are rewriting business to earn commission income and providing product replacement advice that is not in the best interests of their clients. AFS licensees should monitor clawback rates and policy lapses across their advisers.
High volumes of new business with 'no underwriting issues'	Advisers may write new business in online applications or under certain limits to avoid triggering any compliance concerns—to 'fly under the radar'. This may be a warning sign that the automatic underwriting process is being abused. Automatic underwriting means that advisers can ensure questions are answered in such a way so as not to raise any warning signs. This abuse of the automatic underwriting process can cause significant detriment to clients and expose AFS licensees to compensation claims from clients. Insurers should have robust systems in place to review new business and ensure that automatic underwriting is not being abused.
Poor or inadequate needs analysis	Failure by an adviser to ask the most rudimentary questions about the client's relevant circumstances may be a warning sign that the advice is not in the best interests of the client. Advisers who fail to perform and record an appropriate needs analysis of their clients present a significant risk to an AFS licensee's business. An appropriately detailed needs analysis is also important to ensuring that scaled advice is delivered appropriately. AFS licensees should actively review the quality of the needs analysis.
High volumes of replacement product advice, product bundling and upselling	AFS licensees should actively monitor files for advice to clients that recommends the client hold multiple policies where the recommendation suggests that the clients may be overinsured relative to their insurance needs and income. Where the business model is dependent on the incentives to advisers to write new business, AFS licensees should actively monitor representatives writing high volumes of new business, particularly replacement business written after the expiry of the clawback period on the previous policy.
Competency[29]	File reviews should consider the following warning signs that the adviser is not competent to provide the advice: • inadequate inquiries into the client's relevant personal circumstances; • poor record keeping and inadequate documentation on the file to found a basis for the advice; and • poor consideration of related issues of strategic importance for clients, such as the need for clients to nominate beneficiaries (and update nominations) for death benefits in superannuation.

Warning sign	Commentary
Insurance paid for using a high percentage of the client's superannuation guarantee contributions	Life insurance advice recommending a client pay insurance premiums using a significant percentage of their superannuation guarantee contribution may be a warning sign that the advice is not in the best interests of the client. AFS licensees should review files to ensure that the effect of this strategy is modelled to show the loss of retirement income over time and the extent to which the advice considers contribution strategies as appropriate to the client's circumstances.
Poor record keeping	Record keeping is essential to prove compliance with s961B(2) and to enable licensees to comply with their obligations to monitor and supervise their representatives. Poor record keeping should be a key warning sign to an AFS licensee that the advice may not be compliant.
Poor compliance with disclosure obligations and use of generic warnings	Generic warnings and non-specific information about strategy may be a warning sign that the advice may not be in the best interests of the client. AFS licensees should review files to ensure that the SOA includes relevant information about the basis on which the advice was given. This includes: • a clear and specific explanation to the client about the rationale for and implications of a recommended strategy; • the pros and cons of a strategy to pay for insurance inside or outside superannuation; and • consideration of the importance of the duty of disclosure where a client is given switching advice.

Life insurance advice checklist in the report

ASIC recommends reading the checklist alongside ASIC's guidance in RG 175.

Issue	Considerations
What are the client's objectives?	Good life insurance advice should ensure a client's objectives are specific, measurable and prioritised: see RG 175.218(c). Objectives may include: • debt reduction/repayment; • emergency/cash funds; • medical expenses or home renovation expenses; • education or business-related expenses; and • a lump sum amount to produce a level of regular income for financial dependants for a period of time. Note: This is not an exhaustive list. Good advice should be able to identify further client objectives relevant to insurance, such as: • nominating a beneficiary on the policy; or • seeking legal advice on a will. Good advice should also use a client's objectives to define the scope of the advice.
What are the client's financial situation and needs?	Good advice is founded on a solid strategy that requires identification of the client's relevant personal and financial situation and needs. The adviser should identify, discuss and document the client's: • financial position (income, expenses, assets and liabilities); • personal circumstances (age, relationship status and family circumstances); • foreseen changes to their personal or financial position (inheritance, home renovations, divorce, new baby, sale of business); • existing insurance arrangements (including insurance held inside their superannuation fund); • health status (including any hereditary or genetic conditions that may affect their ability to obtain insurance); • insurance needs (life, disability, illness or income) and the relative priority of these needs; and • willingness and capacity to pay insurance premiums and over what time period. Good advice should explore with the client alternatives that may be available if the client wishes to self-insure in part or in whole, and an insured event arises. Such 'self-insurance strategies' may include: • the client's leave entitlements, employee benefits and liquid assets; • the client's ability to rely on extended family support or to downsize their home to access capital; • returning to work or increasing working hours; and • any entitlements the client has to social security and/or workers or transport accident compensation arrangements.

Issue	Considerations
Providing balanced scaled advice	When providing scaled advice, good advice will respond to the client's stated objectives and implicit needs. For example, a client may state they wish to obtain cheaper insurance and the adviser and client agree to scope the advice to this issue. Good advice should include further considerations relevant to obtaining life insurance, including: • the costs and benefits of holding existing levels of cover and the client's priorities regarding their insurance; • the coverage of any replacement insurance product; • how long the client wants to hold the insurance and of what type; • alternative options, including revising down the sum insured or modifying the selection of optional extras; and • the merits and hazards of switching policies as a strategy to manage affordability (such as s29(3) of the Insurance Contracts Act). Good advice should also consider: • giving clear and specific warnings to the client about the cost impact of their insurances relative to their income, debt, insurance needs or retirement goals; and • giving practical guidance to the client about self-insurance strategies (see the list above on self-insurance strategies).
Making a recommendation to retain a current insurance product	An adviser must: • conduct a reasonable investigation into the financial products that might achieve the client's objective and meet the client's needs that would reasonably be considered relevant to the subject matter of the advice (s961B(2)(e)(i)); and • assess the information gathered in the investigation (s961B(2)(e)(ii)). Good advice should consider the client's existing insurance arrangements and consider whether the best solution for the client may be to retain their existing insurer but modify the type or amount of cover. An adviser may consider: • the amount of leave the client may have, including sick leave, annual leave and long-service leave; and • any alternatives that may be available if the client wishes to employ self-insurance strategies (see the list above on self-insurance strategies). In some cases, it is unlikely that a product recommendation will be appropriate. For example, a client nearing retirement may have accrued long-service leave, more than a year of annual leave and be a member a defined benefit superannuation fund that will pay out a defined lifetime benefit if the client ceases work permanently (even before retirement age). To achieve such a client's objectives of having sufficient income if temporarily disabled, a product recommendation is unlikely to be appropriate.
Making a recommendation to replace an insurance product	Replacement product advice must be appropriate to the client. Good replacement product advice should carefully consider important risks to the insured in switching policies. This is particularly important where an adviser recommends a switch to a cheaper premium because such a strategy can have significant risks for a client. In addition to documenting the client's objectives, financial situation and needs, good replacement product advice should: • consider and address affordability issues in the strategy for achieving the client's objectives. This may include self-insurance strategies (see the list above on self-insurance strategies); • carefully consider how long the client wants to hold insurance, along with careful consideration of the client's current and any foreseeable future health challenges; • clearly describe the long-term impact of a recommendation to pay the premium from the

Issue	Considerations
	client's superannuation benefits and consider options to ameliorate the impact on future retirement income as appropriate to that client's personal circumstances; and • carefully consider the operation of s29(3) of the Insurance Contracts Act. This provision represents a significant risk to consumers where product replacement advice is given because it allows an insurer to avoid a contract of insurance within three years of commencement where the client failed to comply with the duty of disclosure. The operation of this provision is particularly important for a client who has held an existing policy for more than three years and for whom the insurance represents a significant asset. Poor replacement product advice may risk the client losing the important protection of an existing insurance policy. Courts have recently held advisers liable for compensation to clients for misleading and deceptive conduct, and negligence, when switching clients from one insurance policy to another. The advice should clearly explain • why the new product is better than the old product; • what specific features are better and what has been lost. Where the rationale is 'better policy terms', those improved policy terms should be spelled out; • where software has been used to rate policies, advisers should spell out why a particular product has a higher rating, and what features will be lost in a switch; and • where new policies have waiting periods, such as trauma policies, advisers should exercise due care and diligence to ensure that extant policies are not cancelled while waiting periods are in force (e.g. where a client is managing a current illness or awaiting a diagnosis).
Making a recommendation to pay for insurance from superannuation	Good advice that recommends a client pay insurance premiums from their superannuation contributions cannot ignore the advantages and disadvantages of this strategy. Specifically, advisers should ensure their client understands that: • the insurance policy is owned by the trustee of the superannuation fund on behalf of the member; • the *Income Tax Assessment Act 1997* dictates how the proceeds are taxed, which differs from personally held insurance policies. If the client meets the SIS Act permanent incapacity definition and the trustee pays their superannuation (including total and permanent disability insurance) balance out, the tax payable depends on a range of factors, including age and the existing tax-free component of their superannuation; and • superannuation is not a personally held asset and generally is not dealt with by a person's will or estate planning. Clients must ensure their nomination of beneficiaries reflects their wishes and they must decide whether they need a binding or non-binding nomination of beneficiaries. If there is no nomination of beneficiary, the superannuation fund trustee will use their discretion on how to pay death benefits. Generic warnings to clients that paying for insurance from superannuation has cash flow benefits but will erode retirement savings are not adequate. Advisers should address the key risk of funding insurance premiums from superannuation funds, that is, that it may prevent the client from meeting their retirement objectives. Advisers should give adequate consideration to this risk when recommending this strategy. This should include consideration about making concessional or non-concessional contributions that at least negate the effect of insurance premiums on retirement benefits. If this option is not appropriate for the client's circumstances, the risks of the strategy need to be clearly explained to the client, including communicating the cost impact. Advice recommending a contribution strategy should also consider the impact on the client's cash flow. This may include comparing the value of making concessional and non-concessional contributions equivalent to the insurance premiums. We expect advisers to: • communicate that the cost impact of insurance is simply being deferred from today's cash

Issue	Considerations
	flow to future cash flow and that the client needs to actively consider the long-term impact of this and strategies to manage it; • inform and model for their client the impact on their retirement savings balance with and without insurance premiums over their retirement horizon (e.g. if the client is 20 years from retirement); • communicate that every dollar spent on the insurance premium is a dollar less invested for retirement, and this impact compounds over time where the client may otherwise have a long investment horizon; and • cover the fact that the client may need to work longer to save for retirement.
Statement of Advice	The SOA must clearly set out the basis on which the advice was given: see RG 175.159–RG 175.196. Good advice should clearly document in the SOA the strategy for achieving the client's objectives, including the product features and client circumstances relevant to the subject matter. Regardless of whether advice is comprehensive or scaled narrowly, an adviser who is acting in the client's best interests should actively engage with their client to gather sufficient information, and apply their knowledge and experience, to provide personal insurance recommendations. Where the client instructions may be *'I want to keep the same insurance cover, but I want a cheaper premium'*, the adviser should discuss why the client is seeking personal advice and explore the cash flow issues that inform that client instruction, as well as whether personal advice is appropriate in this situation. If the client wants personal advice, the SOA should document how the recommended amounts of insurance were arrived at, by reference to the client's circumstances. When a replacement product is recommended (in full or in part), the SOA must include information about: • the cost of the recommended action (i.e. the disposal of the existing product and acquisition of the replacement product); • the potential benefits (pecuniary or otherwise) that may be lost; and • any other significant consequences of the switch for the client.
Personal or general advice	Good advice should clearly communicate to the client whether the adviser has considered their relevant personal circumstances in formulating the advice.