

RECENT DEVELOPMENTS IN LIFE RISK INSURANCE REMUNERATION

Background

On 1 January 2018, the current conflicted remuneration regime for retail life risk insurance is set to change.

Those involved in life risk insurance sales need to re-examine their remuneration arrangements.

The changes will be implemented through the [Corporations Amendment \(Life Insurance Remuneration Arrangements\) Act 2017 \(the Act\)](#) and [Corporations Amendment \(Life Insurance Remuneration Arrangements\) Regulations 2017 \(the Regulations\)](#).

Products issued prior to 1 January 2018 and certain other products will be grandfathered.

The reform package is designed to:

- address issues in the quality of advice identified in ASIC's [Report 413 Review of Retail Life Insurance Advice \(2014\)](#);
- avoid significant Government legislative intervention based on recommendations from the [Financial System Inquiry Final Report](#) and [John Trowbridge, Review of Retail Life Insurance Advice Final Report](#);
- ensure that consumers can access unbiased and appropriate advice when considering purchasing life insurance; and
- prevent advisers from providing advice in circumstances where their own interest in significant commissions is at odds with the interests of the consumer i.e. unnecessary churning.

Overview

In summary:

- the Act removes the exemption in the Corporations Act from the ban on conflicted remuneration for benefits paid in relation to certain life risk insurance products will be removed so that prima facie they will be caught.
- the Regulations extend 'conflicted remuneration' to benefits given in relation to certain dealing and mere information giving services, in addition to the provision of personal or general financial product advice (which is currently within the definition). This is a significant extension likely to impact those involved in most aspects of direct sales.
- two key new exemptions have been created, which essentially exempt:
 - level commission arrangements; and
 - arrangements which both:
 - fall within certain ASIC determined limits (not yet specified); and
 - provide for the 'clawback' of benefits when a product is cancelled or not continued, or the 'policy cost' is reduced, within 2 years of the product's first issue.
- a number of existing exemptions are extended to benefits given in relation to information giving and dealing services from 1 January 2018. They may have greater importance with removal of the broader exemption.
- new broad exemptions for monetary benefits given in relation to consumer credit insurance (**CCI**) remove confusion caused by the current, more limited, CCI exemption.
- a change has been made to facilitate ongoing reporting to ASIC on policy replacement data.

Significant penalties apply for a breach of the relevant provisions, and may catch:

- Australian financial services licensees (**licensees**);
- authorised representatives;
- employers of a licensee or representative;

- issuers or sellers of a financial product; and/or
- representatives of a licensee (other than an authorised representative),

in circumstances set out in the *Corporations Act 2001* (Cth) (**Corporations Act**). There is no significant change in this regard.

WHAT IS CHANGING?

Removal of exemptions from the ban on monetary conflicted remuneration in relation to life risk insurance (subject to exemptions)

Currently, the *Corporations Regulations 2001* (Cth) (**Corporations Regulations**) and (to a more limited extent) the Corporations Act contain broad exemptions from the ban on *monetary* conflicted remuneration (see below for definition) in relation to life risk insurance. A monetary benefit is not conflicted remuneration if given in relation to a life risk insurance product, other than:

- a group life policy for members of a superannuation entity; or
- a life policy for a member of a default superannuation fund,

This exception applies where the benefit was given in relation to general and/or personal financial product advice provided to retail clients.

However, both of these exceptions will be removed from 1 January 2018. Consequently, monetary conflicted remuneration benefits given in relation to life risk insurance products will *prima facie* be banned unless within new or other remaining exemptions from the ban (discussed below).

These exemptions did not apply to *non-monetary benefits*, for which the position remains largely unchanged.

Life risk insurance products are defined as a life policy or a sinking fund policy within the meaning of the Life Insurance Act 1995 (**Life Insurance Act**) that is a contract of insurance, but excluding payments by employee associations, certain payments under the Life Insurance Act, funeral benefits and employee benefits paid by employers.

Extension of 'conflicted remuneration' for life risk insurance – monetary and non-monetary benefits

Currently conflicted remuneration means:

any benefit, whether monetary or non-monetary, given to a financial services licensee, or a representative of a financial services licensee, 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:

(a) could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to retail clients; or

(b) could reasonably be expected to influence the financial product advice given to retail clients by the licensee or representative.

(s963A Corporations Act).

As an example, volume based benefits and commissions are generally caught. This definition will remain unchanged, however a new section allows the Corporations Regulations to prescribe additional circumstances in which a benefit given to a licensee, or a representative of a licensee (**representative**), in relation to life risk insurance product(s) is conflicted remuneration.

New regulations make use of this power to extend the meaning of conflicted remuneration to include a benefit (whether monetary or non-monetary) given to a licensee or representative in relation to:

- **information given to person(s) in relation to life risk insurance product(s)** where:
 - access to the benefit, or the value of the benefit, is dependent on the number or value of products subsequently acquired or varied by the person to whom, or in relation to whom, the information is given; and
 - if the information is given *in the course of providing a financial product* - it is not given in the course of providing that product to person(s) as wholesale client(s).

We note that “*providing a financial product*” is not defined.

Such benefits are excluded if, because of their nature or the circumstances in which they are given, they could not reasonably be expected to influence the way that the licensee or representative presents, or whether they give, the information to the relevant person(s).

The example given by the Explanatory Statement to the Regulations (**Explanatory Statement**) of a benefit caught by this extension to the definition is a benefit given to a person who posts factual information on how to apply for life risk insurance products to consumers, without providing financial advice, where the benefit is based on the value or volume of life risk insurance products subsequently acquired by the mail-out recipients.

- **dealing in a life risk insurance product with person(s) as retail client(s)** where access to the benefit, or the value of the benefit, is dependent on the number or value of products to which the dealing relates.

Such benefits are excluded if, because of the nature of or the circumstances in which they are given, they could not reasonably be expected to influence the way that, or whether, the licensee or representative deals in the life risk insurance product(s).

The example given by the Explanatory Statement of a benefit caught by this extension to the definition is where a consumer requests a particular life risk insurance product from a firm without being provided with information or advice and the person facilitating the sale is remunerated based on the *value* of the life risk insurance product sold.

These extensions aim to ensure that all benefits linked to the sale of life risk products (not just benefits linked to the provision of financial product advice) are captured.

The provisions will apply in a hierarchical manner so that where a benefit relates to multiple activities, it will only be caught by one.

New exemptions from the conflicted remuneration ban for monetary benefits given in relation to life risk insurance

To limit the impact of the above changes, the Act and Regulations introduce two key new exemptions from 1 January 2018. The exemptions apply to benefits given in relation to life risk insurance (whether in relation to financial product advice, information giving or dealing), but not to:

- group life policies for members of a superannuation entity; or
- life policies for members of a default superannuation fund,

to which the ban will continue to apply.

1. Level commission arrangements

Applies where the **benefit ratio** for a benefit is the same for the year in which the product(s) are issued as it is for each year that the product(s) are continued.

The **benefit ratio** for a year is the ratio between:

- the benefit; and
- the policy cost payable for the product(s), or that part of the policy cost payable for the product(s) to which the benefit relates, for the year.

The **policy cost** for a year is the sum of:

- the premiums payable for the product(s), for that year;
- any fees payable for that year to the issuer of the product(s) for that issue;
- any additional fees payable because the premium for the product(s) is paid periodically rather than in a lump sum; and
- any other amount prescribed by the regulations (none currently prescribed).

This exemption applies in circumstances where there is not considered to be as high a risk of poor quality advice and incentives to churn.

There is no maximum cap under this exemption. It could, for example apply to an arrangement where the commission was 50% of the policy cost in the first year, and 50% of the respective policy cost for each subsequent year.

2. Benefit caps and clawback requirements

Applies where both the:

- benefit ratio requirements; and
- clawback requirements,

in the new section 963BA are satisfied in relation to a benefit.

The **benefit ratio requirements** will be satisfied if the benefit ratio for a benefit for:

- the year that the product(s) are issued; and
- each year that the product(s) are continued,

is equal to or less than the acceptable benefit ratio for that year, which ASIC determines by legislative instrument.

ASIC has not yet set these limits. However, the Hon Kelly O'Dwyer MP in her 9 February 2017 [media release](#) stated the changes will “*phase-down the upfront commissions paid to advisers to a maximum of 60 per cent from 1 January 2020, along with the introduction of a maximum rate of 20 per cent for ongoing commissions*”.

The **Clawback requirements** are satisfied if either:

- the arrangement under which a benefit is payable includes an obligation to repay all or part of the benefit if:
 - the product, or one of the products, is cancelled or not continued, other than because:
 - a claim is made under the policy; or
 - prescribed circumstances exist – circumstances prescribed in the Regulations are because:

- the person insured dies, commits an act of self-harm, or reaches an age that results in the product being cancelled or not continued under its terms; or
- an administrative error has been made; or
- the policy cost for the product, or one of the products, during a year or across 2 years is reduced, other than in prescribed circumstances - circumstances prescribed in the Regulations are because:
 - the person who issued the product and the person it is issued to agree there is a reduction in a risk in relation to an insured person;
 - the person who issued the product reduces the premium for the product without changing the risks covered, or the benefits available, in relation to any insured person;
 - a rebate is paid or a discount applied, where it is reasonable in all the circumstances to conclude that it is paid or applied to induce the person to whom the product is issued to acquire, or to continue to hold, the product;
 - a benefit payable in relation to an insured person has been, or is being, paid; or
 - an administrative error has been made,

within 2 years after the product is first issued to a retail client; and

- the amount to be repaid under the obligation is equal to or greater than the acceptable repayment, which ASIC determines by legislative instrument.

ASIC has not set acceptable repayment levels yet. However, the Hon Kelly O'Dwyer MP in her 9 February 2017 [media release](#) stated the changes will:

“introduce a two year commission ‘clawback’ period, which will clawback 100 per cent of an upfront commission in the first year and 60 per cent of an upfront commission in the second year in instances of a policy lapse.”

Previous ASIC indications were that for a reduction in premium, the repayment amount will relate to the amount of reduction in the premium i.e. it will be proportionate.

This was consistent with the industry proposal.

Extension of existing exemptions

A number of existing exemptions from the ban on conflicted remuneration may have greater importance to the life insurance industry when the broader exemption is removed. They include:

- ***For either monetary or non-monetary benefits:***
 - Certain benefits given by the client
 - Mixed benefits
 - Benefits relating to financial services provided to retail clients who are not in this jurisdiction
- ***For monetary benefits:***
 - Benefits paid as part of purchase or sale of licensee or representative's business
 - Fees paid for dealing in a financial product on behalf of the client (not extending to new information and dealing provisions)
- ***For non-monetary benefits:***
 - Low value benefits
 - Benefits with an educational or training purpose
 - Benefits for information technology software and support.

These exemptions will in most cases be substantially extended to benefits given in relation to information giving and dealing services from 1 January 2018.

New carve out for consumer credit insurance (CCI)

The Act and Regulations introduce new broad exemptions from conflicted remuneration for monetary benefits given in relation to CCI (the definition under the *Insurance Contracts Act 1984* (Cth) applies). Currently there is a more limited exemption.

This aims to ensure that the strict arrangements applicable to CCI commissions under the National Credit Code continue to apply.

Grandfathering arrangements

The amendments made by the Act and the Regulations commence on 1 January 2018, but will not apply to a benefit given in relation to a life risk insurance product if:

- the product is issued before 1 January 2018; or
- the application for the issue of the product is made before 1 January 2018 and the product is issued within 3 months of that day.

These only apply to remuneration arrangements made under pre-existing arrangements in relation to pre-existing policies.

If a benefit is given in relation to a group of life risk insurance products, some issued before 1 January 2018 and some after, products falling within the two bullet points above would be ignored for the purposes of applying the amendments.

- the product is issued to a person on or after 1 January 2018 (the **post-commencement product**) and:
 - the person held another life risk insurance product immediately before the commencement day (the **pre-commencement product**); and
 - the person acquires the post-commencement product either by exercising an option given to them under the pre-commencement product or because the pre-commencement product was cancelled due to administrative error.

The amendments do not apply to a benefit given to a licensee or representative to the extent that their operation would result in an acquisition of property from a person otherwise than on just terms (within the meaning of paragraph 51(xxxi) of the Constitution).

ASIC information gathering power

The Act amends an existing provision of the Corporations Act to facilitate ongoing reporting to ASIC on policy replacement data.

ASIC can request that data be provided to it in electronic form to assist it in its review of the reform (previously scheduled to occur in 2018).

ASIC previously proposed to use this power to require, by written notice, information from life insurers on insurance sold through both personal and general advice, and also where no advice provided (direct sales), such as:

- policy information, including number and details of policies in force;
- remuneration data, including historical data, remuneration models and levels adopted;
- lapse rates and reasons,
- clawback amounts on lapsed policies; and
- data on policies sold with personal advice, general advice or no advice.

This would impose a significant reporting obligation on the industry.