CHAPTER 3
A CASE FOR DISCLOSURE

The 1990s, I think, will have to involve restructuring from the demand side. In fact we can say that one of the effects of deregulation and restructuring the supply side is to provide more choice. But, if consumers are not in a position to have sufficient information to exercise that choice, then clearly efficiency in the workplace is not going to occur.[9]

The Issues

Superannuation Policy

3.1 If superannuation is to play its full part in the provision of retirement income, it is essential that contributions, premiums and fund earnings be conserved to the greatest practicable extent. Any avoidable outgoings place a brake on the accumulation of benefits. For this reason alone, the level of fees, charges and commissions paid by funds and/or contributors needs to be monitored to ensure that benefits are optimised.

3.2 Moreover, from the large number of complaints received by the Committee[10], both directly and through consumer bodies, as well as press reports and anecdotal evidence, it is clear that there is a public perception that fees and, in particular, commissions, are excessive and hidden in many cases. Whether this perception is justified or not is open to argument, but its existence is not. The Committee believes that excessive fees and commissions were the norm in some sections of the industry and although the problem still exists, in recent times competitive pressures have reduced these charges significantly.

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9 Professor Bill Melody, op cit, *Proceedings: Super Consumer Seminar*, p110.

10 Appendix 1 contains a table which summarises the nature of each consumer complaint received by the Committee.

3.3 Now that superannuation is virtually compulsory, the integrity of its providers is clearly a matter of public concern, as are any adverse perceptions which have the capacity to undermine that integrity.

3.4 As would be expected, the complaints covered a wide range of problems, but one theme predominated - the high level of up-front commissions paid on regular premium savings or superannuation products sold by life companies and the consequent high cancellation, exit or transfer fees. Other aspects of essentially the same problem were the failure at the time of purchase to disclose, or explain adequately, the impact of the commissions and fees, difficulties in understanding the 'fine print' in policy documents and the inadequacy, or sometimes complete absence, of responses to complaints and requests for explanations on termination.

Consumer Complaints

3.5 The ISC, the industry's regulator, does not have a specific brief to investigate and resolve individual consumer disputes. Moreover, the sudden growth brought about by the introduction of award superannuation and the complexities brought about by frequent changes in taxation and other operating requirements so stretched the Commission's limited resources that effective action in this area was out of the question. Now that the ISC has the resources and the Government proposes to legislate for a statutory review/dispute resolution mechanism, consumers of superannuation will be in an enhanced position.

3.6 The general area of consumer complaints was a difficult one for the Committee. Although its terms of reference were broad enough to permit it to examine individual complaints and make recommendations as to the general rules that should operate, it did not have the time, the resources, the expertise or the authority to undertake the quasi-judicial role expected of it by many of the complainants.

3.7 It did, however, develop a routine which enabled it to gain an appreciation of the issues involved. Submissions which reflected adversely on individuals or organisations were withheld from publication, and forwarded to those named for comment. Some were later published but many were dealt with *in camera*. In a few cases, the Committee's inquiries led to a satisfactory resolution of the complaints. Overall, the procedure has enabled the Committee to come to an understanding of both sides of the problems -

and to make recommendations which should both minimise their occurrence in the future and facilitate the resolution of those that do occur.

Fees, Charges and Commissions

3.8 In the specific area of fees, charges and commissions, the industry exhibited some reluctance to provide the required information and it was only after a strongly worded rebuke in the Senate that the required information was forthcoming[11]. On 22 July 1992, following the receipt of this information, the Committee convened a private hearing to discuss further the life office view regarding the disclosure of fees, charges and commissions. To assist the Committee's understanding of the issue, LIFA arranged a simulation of the sale of a typical personal superannuation plan which included a client needs analysis and discussion leading to the entering into a contract to purchase. The Committee found this hearing to be most informative and of considerable assistance in preparing this report.

3.9 In August 1992, the Committee published *Super Charges - An Issues Paper on Fees, Commissions and Charges in the Superannuation Industry* (the *Issues Paper*), which outlined some of the problems raised in a number of case studies, gave examples of a wide spectrum of commissions and other charges and identified the main issues for decision. The Committee used as its point of reference the standard competitive model, which assumes perfect information in a competitive market, and concluded that product knowledge is the key to the effectiveness of competition. The extent of disclosure of information is therefore a key element in market efficiency.

3.10 In March 1992, the Minister of *Justice and Consumer Affairs* referred the general subject of the role life insurance agents, including consumer complaints, problems of disclosure of information and the early termination of agreements, to the Trace Practices Commission (TPC) and directed it to consult with this Committee and other bodies carrying out relevant investigations. On 4 November 1992, the Committee joined with the TPC and the National Consumer Affairs Advisory Council in sponsoring a one-day seminar on consumer issues affecting the insurance and superannuation industries. This seminar, which was attended by more than 100 participants from a wide cross-section of the industry, was a most useful exercise in

[11] Senate Hansard, 3 June 1992, p 3351, *Interim Report on Fees, Charges and Commissions*, June 1992.

information sharing and analysis. The Committee, in reporting to the Senate on 12 November 1992,[12] tabled the proceedings of the Seminar.[13]

3.11 The TPC published its report *Superannuation and Life Insurance* in December 1992. The Committee believes that the TPC report provides an excellent survey of the issues and endorses the general thrust of its recommendations.

3.12 The Committee has had the benefit of all of these studies and activities as well as a most useful set of commentaries from the major providers and consumer bodies.

3.13 There is general agreement among consumer groups, life office agents and the personal superannuation industry that super products should become 'more competitive', that is, that more diversified products should be offered to meet individual circumstances and also that the costs and other relevant features of these products should be disclosed to allow a greater and more flexible consumer choice. It is also generally acknowledged that the provision of more information will lead to increased competition and industry efficiency.

Life Insurance Industry

3.14 The period under review has not been an easy one for the life insurance industry. The industry, along with other financial intermediaries, has encountered considerable difficulties generating high rates of return on investments, especially those with a high property weighting. A number of witnesses expressed their concerns on this matter and informed the Committee of their decision to cancel policies and receive a lower than expected benefit. Compounding this problem, and also causing an outflow of funds from life offices, were the financial difficulties being experienced by a large number of policy holders which had resulted in the cancellation of many regular premium superannuation plans. The problem of policy discontinuance has been compounded by the removal of certain tax concessions from employee SGC 'top up' superannuation. Table 3.1, which shows data on policy discontinuance rates in personal superannuation

[12] Super Consumer Seminar, Senate Hansard, 12 November 1992, p 2927.

[13] *Proceedings of the Super Consumer Seminar,* November 1992.

collected in 1992 by the TPC, illustrates the extent of policy surrenders. For example, if the data is representative of the industry as a whole, after four years 21 per cent of policies would have been discontinued.[14] Table 3.2 shows the overall impact of these discontinuances in dollar terms.[15] Table 3.3 shows the long term trends in policy discontinuances for the period 1982-91.

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[14] Op cit, Trade Practices Commission, p 72.

[15] Insurance and Superannuation Commission, Annual Report, 1991-92, AGPS, Canberra, p 16.

Table 3.1

Cumulative Policy Discontinuance Rates

Duration in Years	1	2	3	4	5	6	7	8	9	10
Percentage of Personal Superannuation Policies	9	12	17	21	25	28	32	35	39	42

Table 3.2

Superannuation Business - Annual Premiums

	12 months ended 31 December 1991 $m	12 months ended 31 December 1990 $m	Percentage Decrease
New Annual Premiums	1713.5	2083.0	17.7
Annual Previews Discontinued	1303.0	1478.4	11.9

Table 3.3

Discontinuances - Forfeiture and Surrender Rates

Year	Forfeiture Rate Ordinary (%)	Superannuation (%)	Surrender Rate Ordinary (%)	Superannuation (%)
1982	17	09	07	06
1983	22	14	08	07
1984	17	11	08	07
1985	14	10	08	06
1986	15	09	08	06
1987	15	10	08	06
1988	11	09	08	05
1989	15	09	08	06
1990	15	11	10	07
1991	15	14	23	06

Source: *Insurance & Superannuation Commission Annual Reports*

Notes

Forfeiture rates (ordinary & superannuation) are defined as the annual premiums forfeited in a year expressed as a percentage of the mean of new annual premiums written over a two year period ending six months earlier.

Surrender rates (ordinary) are calculated as the ratio of the total annual premiums discontinued by surrender in the year shown to the mean of the annual premiums in force at the beginning of the two previous years.

Surrender rates (superannuation) are calculated as the ratio of total annual premiums discontinued by surrender in the year shown to the total premiums in force at the beginning of the year.

3.15 The life insurance industry has undergone considerable staff and organisational restructure. During the inquiry a number of offices announced plans to rationalise staff and make substantial changes in market strategy. The industry, in keeping with trends in the other financial institutions, manufacturing and service industries has experienced its own brand of microeconomic reform.

3.16 Whilst it could be said that much of the restructuring has occurred in the context of a general economy-wide trend, the need for the restructuring is also a consequence of poor strategic planning and ineffective management by the industry. In respect of the latter point the Committee records its concern that some sections of the life insurance industry adopted investment practices contrary to sound diversification. In the strategic planning domain, attempts by some offices to engage in overly-aggressive marketing practices whereby some consumers were sold products which neither suited their needs nor matched their premium paying capacity, have also contributed to current problems. Under these conditions it was inevitable that, as soon as low returns or financial hardship prevailed, significant rates of policy surrenders would be experienced.

3.17 The industry watchdog, the ISC, reported to the Parliament on the trends in policy cancellation. However, whilst no doubt it was aware of the seriousness of some of the marketing practices (and the consequent results by way of policy discontinuance), nowhere in its annual reports to the Parliament is this concern expressly mentioned. The Committee believes it is necessary that the ISC under its strengthened and enhanced charter adopt a more critical, independent and forward-looking position in overseeing the life insurance industry, advising both Government and the Parliament of any undesirable trends or practices and recommending legislative intervention should this be required.

3.18 The advent of compulsory superannuation has resulted in a lower demand for the traditional personal superannuation products. The removal of some tax concessions, which greatly assisted the sale of life products, has placed further pressure on life offices.

3.19 In the interests of stability, it is of critical importance that the industry and the Government agree on a package of reforms which will both restore consumer confidence and engender greater efficiency. If this reform is not achieved it is likely that the Government's overall retirement income policy objectives will be thwarted.

3.20 The Committee is pleased that the industry has acknowledged that reform is both necessary and desirable and it commends LIFA on its May 1993 package of reforms (see Appendix F) which should result in more efficient market practices and enhanced returns for superannuation savers. However, the matter of disclosure of agent commission has not as yet been resolved and the Committee believes that the Government should implement change in accordance with Recommendation 3.4 of this report.

Current Disclosure Practice

3.21 Disclosure of information is currently provided for under regulation and in ISC guidelines.[16] Under the new disclosure guidelines which have applied since 1 July 1992, a fund must provide its members with information concerning:

- its investment strategy and earnings;
- details of any investments which account for more than 5 per cent of its assets;
- the names of trustees, investment managers or other financial advisers or consultants;
- the fund's crediting rate and reserving policy; and
- fees, charges and other expenses.

3.22 In his October 1992 statement on prudential supervision of the superannuation industry, the Treasurer indicated that disclosure guidelines will be further examined in the context of the review of three current inquiries:

> Through these measures, members will be better informed about the operation of their fund and will be able to evaluate its performance. Currently there are inquiries being conducted by the Trade Practices Commission and the Senate Select Committee, which are examining issues related to the marketing of life insurance and superannuation products. In addition, the ISC is reviewing the Life Insurance Act. The appropriateness

[16] OSS Reg 17 and ISC Circulars 276, 290, 291.

of the disclosure regime at the point of sale will be reconsidered by the Government upon the completion of these inquiries'.[17]

3.23 While the information required to be disclosed to consumers has increased, concerns remain about the timing of product information, the clarification of industry terminology and the disclosure of fees and commissions. In the Committee's view these are areas for enhanced requirements for the disclosure of information, which will result in increased competition and greater consumer protection.

3.24 According to the Roy Morgan Research Centre (RMRC) survey commissioned by the TPC, the most important source of information and advice for consumers is oral advice and information from life agents and intermediaries. Of the 517 recent purchasers of life insurance and superannuation products who were surveyed, two thirds (68 per cent) used this source and almost half (42 per cent) considered this as the most useful source.[18]

3.25 The research also found that consumers were inadequately informed about most of the seventeen categories of relevant information. The survey asked respondents what issues they discussed with the agent or adviser, which issues they would discuss today, whether the agent had told them about the issue and whether the issue had either not been mentioned or they could not recall. The results, which were classified by five possible responses from consumers, are shown in Table 3.4.

3.26 Consumers indicated on average they had asked about two of the 17 relevant categories of information as listed in Table 3.4, while nine had been told to them by the agent and five were not discussed. For example, the least mentioned information included commission arrangements between agent and the company (65 per cent did not mention), who they should complain to about problems with the policy (53 per cent), product performance comparisons between funds (41 per cent) and exit fees (36 per cent).

3.27 The survey conducted by Consensus Research for LIFA sheds further light on the key role that agents play in advising in the sale of

17 John Dawkins, *Strengthening Super Security*, AGPS, Canberra, p 13.

18 RMRC, *Report for the TPC on Consumers' Experience with Life Insurance Offices*, November 1992, p 3.

superannuation plans. In that survey of over 2000 consumers: 92 per cent of respondents said that their agent was honest, four per cent disagreed; 85 per cent expressed satisfaction with the advice, nine per cent expressed dissatisfaction; and 80 per cent said that appropriate policies had been marketed, 14 per cent disagreed.[19] In this context, it is worth noting that in the U.K. one of the 'observable trends' in the life insurance market is that 'reputation' is a key determinant of consumer choice of agent and product provider.[20]

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19 Op cit, *Proceedings of Super Consumer Seminar*, p 37.

20 London Economics, *Independent Financial Advisors and the Impact of Commission Disclosure*, October 1992, p 5.

Table 3.4: Policy Information by Whether Asked, Would Ask Today, Told by Agent or Adviser or Not Mentioned

Information	Asked when bought policy %	Would ask today %	Told or explained by agent or adviser %	Can't recall %	Didn't mention %
Recommendations on the best policies to meet insurance, superannuation or investment needs	16	3	51	9	22
Entry Fees	13	3	52	6	27
Exit Fees	13	3	39	9	36
Amount of deductions from amount paid to cover management costs, commissions, etc	10	5	48	5	31
Loss of capital investment if cashed in before maturity	9	7	59	6	20
Likely return or performance of policies	28	7	55	2	8
Possibility of decrease in value if downturn in financial markets	5	5	53	10	26
Current performance compared to competitors' policies/fund/plans	4	2	48	4	41
Commission arrangements between agent and company	3	6	19	8	65
Past performance of insurance or investment company	10	1	60	4	25
Past performance of policy	6	1	58	7	28
Ability to cease contributions without penalty	12	2	40	11	34
Current tax benefits	12	3	62	9	13
Whether tax benefits were likely to be dependent on future Government policy changes	3	5	46	8	38
Cooling-off period	2	1	54	10	33
Size and financial condition of insurance or investment company	6	2	54	7	32
Who you should complain to about problems with the policy	1	1	40	5	53

Source: Roy Morgan Research Centre (RMRC), Unpublished material prepared for the TPC.[21]

21 Roy Morgan Research Centre (RMRC), Unpublished material prepared for the TPC.

3.28 In light of these findings and recommendations made to it, the Committee believes that additional information should be given at the point of sale.

Recommendation 3.1:

The Committee recommends that information provided to potential policy holders be presented in a brief and standardised format which will allow consumers to compare different products. (This information would be in addition to the more detailed contractual information.)

The Committee further recommends that the brief and standardised information include:

- a written description of each investment option facing the consumer and an outline of the general policy and strategy of the fund;
- a written description of all fees and charges, (including any initial, on-going and/or termination fees/charges) and, where these are variable, the minimum and maximum charges;
- details of any penalties which may be imposed on early termination of the policy and the method of calculating these charges; and
- details of the dispute resolution process which can be accessed if the consumer believes the advice or information provided may be inaccurate.

3.29 The ACA believes that any adviser should be required to keep a written record of the consumer's financial situation and needs (as required in the UK).[22] This requirement would not involve the creation of a large bureaucratic support network, but firms selling superannuation products would need to maintain a file of such advice according to a standard format as prescribed by the ISC. According to the RMRC survey, in 18 per cent of recent life office purchases the quality of the investment decision was found to be poor and this was associated with the source of information and

[22] Sub no 227, para 7.8.