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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Reference: Disclosure of commissions on risk products

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JOINT COMMITTEE ON CORPORATIONS AND FINANCIAL SERVICES

Wednesday, 5 March 2003

Members: Senator Chapman *(Chair)*, Senator Wong *(Deputy Chair)*, Senators Brandis, Conroy, Murray and Mr Byrne, Mr Ciobo, Mr Griffin, Mr Hunt and Mr McArthur

Senators and members in attendance: Senators Brandis, Chapman, Conroy, Murray, Wong and Mr Ciobo, Mr Griffin and Mr Hunt

Terms of reference for the inquiry:

To inquire into and report on:

The requirements under the Financial Services Reform Act 2001 to disclose commissions on risk insurance products.

WITNESSES

ADAMS, Mr Mark, Director, Regulatory Policy, Australian Securities and Investments Commission 40

BROWN, Mr Bill, ACT Life Insurance Brokers 16

BROWN, Ms Kristen, Manager, Government Affairs, Institute of Chartered Accountants in Australia 2

BRUINING, Mr Nick, NC Bruining and Associates Pty Ltd, Board Member, Financial Planning Association of Australia Ltd 2

CERCHE, Mr Mark Nicholas, Chairman, Corporate Superannuation Association 2

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ENEVER, Mr Brian Joseph, Vice-President, Insurance Advisers Association of Australia 16

FOSTER, Mr Darryl Robert, Committee Member, Life Advisers Action Group........ 16

GEORGE, Mr John Richard, Managing Director, MGA Insurance Brokers Pty Ltd........ 16

GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association Ltd 2

HAJAJ, Mr Khaldoun, Adviser, Policy and Government Relations, Financial Planning Association of Australia Ltd 2

HANKS, Mr John Anthony, Consultant, National Insurance Brokers Association of Australia........ 2

HRISTODOULIDIS, Mr Con, National Manager, Policy and Government Relations, Financial Planning Association of Australia Ltd 2

JOHNSTON, Mr Ian, Executive Director, Financial Services Regulation, Australian Securities and Investments Commission 40

MAHER, Mr Dave, Analyst, Consumer Protection Unit, Financial System Division, Department of the Treasury........ 40

McALISTER, Ms Pamela, Director, Legal and Technical Operations, Financial Services Regulation, Australian Securities and Investments Commission........ 40

MENKENS, Mr Leo Ignatius, Chairman, Authorised Representatives' Association........ 16

MITCHELL, Mr Dugald, Political Research Officer, Association of Financial Advisers 16

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RAY, Mr Nigel, General Manager, Financial System Division, Department of the Treasury 40

ROSS, Mr Robert (Private capacity) 16

ROSSER, Mr Mike, Manager, Consumer Protection Unit, Financial System Division, Department of the Treasury 40

SQUIRE, Mr David William, Director, National Insurance Brokers Association of Australia 2

VANDERWOLF, Mr Ross, Director, Authorised Representatives' Association 16

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WHELAN, Mr Neal, Chief Executive Officer, Australasian Association of AMP Advisers, Regulations Committee, Financial Planning Association of Australia Ltd..2

WOLTHUIZEN, Ms Catherine Nicole, Senior Policy Officer, Financial Services, Australian Consumers' Association..2

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Committee met at 5.05 p.m.

CHAIRMAN—I declare open the public hearing of the Parliamentary Joint Committee on Corporations and Financial Services. On 14 November 2002, the committee resolved to inquire into and report on the disclosure of commission for risk insurance products. This followed earlier debates on the matter during the committee's previous three inquiries into the financial services reform legislation, the most recent being the committee's inquiry into the regulations and ASIC policy statements made under the Financial Services Reform Act 2001, and is also consequent on the continuing watching brief which the committee was required to give to this issue under the terms of the amendment to the motion for the second reading of the Financial Services Reform Bill.

The committee advertised nationally on 22 and 27 November 2002, inviting submissions from interested parties. Altogether, we have received 48 submissions. The committee is to hear evidence from a number of organisations and individuals with interests in the disclosure matter. Officers from the Department of the Treasury and the Australian Securities and Investments Commission will also be appearing before the committee.

The hearing is taking the form of a roundtable discussion, after which officers of the Department of Treasury and ASIC will appear to give evidence. During the roundtable discussion, committee members may direct a question to a specific witness or ask a general question to which anyone at the table is invited to respond. At the end of the discussion, I will invite witnesses to give a brief summary of their views. This summary should not take each witness who wishes to respond more than a few minutes.

Before we commence taking evidence, I reinforce for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction or fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before this committee is treated as a breach of privilege. These privileges are intended to protect witnesses. I also remind you that the giving of false or misleading evidence to the committee may constitute a contempt of the parliament.

Unless the committee should decide otherwise, this is a public hearing and, as such, all members of the public are welcome to attend.

[5.08 p.m.]

BROWN, Ms Kristen, Manager, Government Affairs, Institute of Chartered Accountants in Australia

BRUINING, Mr Nick, NC Bruining and Associates Pty Ltd, Board Member, Financial Planning Association of Australia Ltd

CERCHE, Mr Mark Nicholas, Chairman, Corporate Superannuation Association

GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association Ltd

HAJAJ, Mr Khaldoun, Adviser, Policy and Government Relations, Financial Planning Association of Australia Ltd

HANKS, Mr John Anthony, Consultant, National Insurance Brokers Association of Australia

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NEGLINE, Mr Anthony Francis, Technical Consultant, Institute of Chartered Accountants in Australia

RABBITT, Mr Michael James, Principal, Prism Financial Planners

SQUIRE, Mr David William, Director, National Insurance Brokers Association of Australia

WHELAN, Mr Neal, Chief Executive Officer, Australasian Association of AMP Advisers, Regulations Committee, Financial Planning Association of Australia Ltd

WOLTHUIZEN, Ms Catherine Nicole, Senior Policy Officer, Financial Services, Australian Consumers' Association

CHAIRMAN—I welcome the group that we have before us, which is generally the group regarded as being opposed to the relaxation of disclosure rules. The Financial Services Authority in the United Kingdom has recently proposed that non-investment life insurance advisers will have to disclose commission quantum only if clients ask for that disclosure. This is the same requirement that exists under the Insurance (Agents and Brokers) Act 1984 here in Australia. The reasons that the Financial Services Authority gave for that decision were that the cover is known up front, that the transparency of premiums makes it easier for customers to compare policies and spot poor value products and that disclosure could lead customers to the possibly erroneous conclusion that lower commissions meant better value and better policies. Other reasons were that calculation costs for firms are substantial and that very detailed rules would be needed to prescribe the disclosure of a commission equivalent, presumably to

overcome the competitive disadvantage posed by disclosure of back office costs. At the time that the Financial Services Authority in the UK is proposing that disclosure of commission quantum will not be necessary for non-investment life insurance, it is proposing not to change the requirement for commission quantum disclosure for investment based products. Would the members at the roundtable before us at the moment like to comment on that decision of the FSA?

Mr Gilbert—This is not an argument about particular products; it is more about having uniformity, simplicity and transparency in the sale of a range of products. Having regard to the efforts that the parliament has gone through to get the FSRA in place, it is important that we have a simple regime. In my industry, we have managed investment products, life insurance products, risk products and superannuation products, all of which need comparable and uniform disclosure. If we move back from that, we will have another one out and another one out. At the end of the day, we will have more debate on whether these things should be in or out than on whether people should be investing in these products. We say that, overall, good public policy should prevail. All products that my members offer should have full disclosure of commissions.

Mr Hristodoulidis—I would like to add something to what Richard said about the comparability and universality of the legislation. From an adviser's point of view, what is important is that they are open and transparent in terms of winning the trust of their clients about any potential influences. In the Australian market, with things like risk commission products or investment products, there is variability in the commission available to the adviser. If there is variability, there is potential for bias. We believe that, because of that variability, there should be disclosure of that commission.

Ms Wolthuizen—Having gone through the process of implementing a regulatory model that is very much focused on disclosure of product features and commissions and attempting to place the consumer in the position of making those decisions and choices on the basis of uniformity of availability of information, any carve-outs will substantially undermine those expectations. There are also the attempts to educate consumers about what they can reasonably expect when going to seek financial advice or advice about particular products, be they insurance or investments. We would be very concerned if we saw a carve-out in this area because of the impact on trying to educate consumers about what they could reasonably expect and the issue of whether it was to lead to other carve-outs.

Mr Negline—It is probably recognised that the UK regulatory regime is a few years—maybe as many as five years—behind the Australian regulatory regime for financial services. Given the position that the FSA has decided on over there, it may be one step and then another step in a few years time to where we should be looking to go now.

Mr Hanks—We have some sympathy with the view that has been expressed. We have worked under the agents and brokers act for many years and we have found it to be an effective piece of legislation. However, things have moved on in Australia. We have had legislation. We are happy to work within that legislation. It is compromised legislation and it is probably not perfect all round for everybody, but we believe that we can work with it and that it is sensible to continue with the current legislation rather than swap, change and go back. As was mentioned earlier, we do have consistency; there are benefits in the legislation. We are happy to wear it as part of a total industry picture.

CHAIRMAN—One of the issues that the FSA raises in coming to this conclusion concerns the fact that they say that the cost involved in calculating accurate commission figures for disclosure could be substantial and also that, to ensure a level playing field, they would need to consider requiring insurers selling directly to disclose a commission equivalent. They say that this would also require detailed rules; otherwise it would be an advantage to salaried advisers against commission advisers. What is your response to that view of the FSA?

Mr Gilbert—Our industry has been working on disclosure, be it under determination 153 or in relation to managed investment products through the other side of the regulatory regimes. We have been doing this for eight or nine years. Systems are in place and there is an automaticity for these things to be disclosed by both the prospectus documentation and in the work that our financial planners do that is connected with our businesses. Perhaps the FPA representative might be better placed to answer that.

Mr Hristodoulidis—A fair bit of work has gone into developing templates and guides to help advisers in terms of outlining or disclosing their commission to their clients. Even as we speak, there is some consumer testing going on amongst a number of the participants at this table as to the financial services guide under the new regime—whether consumers can understand it and whether it is easy for them to comprehend what is contained in it in terms of disclosure of fees and commissions and any other remuneration the planner gets. We have invested a fair bit of effort in this. We are still investing effort into it. The fact that it is difficult should not preclude us from actually trying to find a model that works for everybody.

Mr Bruining—I speak from a practical point of view because I am a practising financial planner based in Perth. We have been working with the disclosure regime since I became a practitioner member of the Financial Planning Association in 1994. Disclosure has never been a problem for us on risk or investment products. The agency agreements that I hold with the companies that provide me with the products to distribute have their commissions and brokerages summarised on one page. It tells me quite simply that, if a life insurance product is sold, the commission is 104 per cent of the first year's premium and the ongoing commission is 11 per cent from one particular manufacturer. I have difficulty in seeing how it is complicated to explain. It is not that dissimilar to what we are doing now with investment products.

CHAIRMAN—The issue I was referring to here is the issue in relation to salaried advisers selling insurance products and the fact that their back office costs—

Mr Negline—It is not an impossible job to work out a uniform framework. It is just a matter of everyone sitting down and acting in good faith, whether they have a salaried planning work force or not. If you are a member of the Institute of Chartered Accountants you are required under the code of professional conduct of that association to clearly display to a client what your level of remuneration is. If that can occur in one association, there is no reason why it could not occur across all associations or be required by regulatory change.

Mr Hanks—It is not just a question of disclosing or not disclosing. It is a bit more of what, when and where. The proposals which we are working under at the present time take away a lot of those problems, because they do not require the disclosure in the product disclosure statement. That is where a lot of those complexities would arise. You have to look at the total picture—where the disclosure is and what it is rather than just the straight yes-no answers.

Ms Wolthuizen—It seem to me as well that, if we are going to have a regime or if there was to be an exemption or a retention of arrangements where this information would have to be provided upon request, all of these issues would continue to arise. There would still be occasions where consumers would request information as to the quantum of the commission, and any practical difficulties that might arise under a mandatory regime would still present.

CHAIRMAN—There is also the issue that the Financial Services Authority raised in coming to their decision concerning the case where the premium for two policies is the same but the commissions are different. Do you agree with their conclusion that there is a danger that that might encourage the consumer to pick the product with the lower commission?

Mr Hristodoulidis—In having consumers shop around, having openness and transparency is not a bad outcome. I think that is an outcome we are looking for. It is also the job of a professional adviser to explain to the consumer the differences in the products in terms of what they offer—the type of cover, the level of cover and all sorts of other things that are attached to that product. I do not think it is a bad outcome that consumers are actually asking advisers questions like that when the commissions are disclosed.

Mr Bruining—Can I perhaps again put it into perspective as to what happens at the consumer level. That is the people I am dealing with on a day by day basis. I will just recount a story of something that happened a couple of months ago. We had some people come to see us who clearly were in some financial difficulty with cash flow. She had lost her job and we were trying to restructure their finances so that they could cope. One of the things we looked at was their insurance policies. They had quite recently taken out a life insurance policy through a major company. They had gone to a life insurance agent who suggested that they take out a policy of about $96,000 as a stand-alone product. Interestingly enough, in the needs analysis that the adviser should have done he would have also discovered that the insurance policy that he sold to the clients was offered by their employer superannuation fund.

We did some checks and discovered that the premium that they were paying for $96,000 worth of cover, which included death and total and permanent disability for a 40-year-old, was $41.66 per month. Had the adviser done the job properly and done it through the employer superannuation fund, that same premium, offered by the same company as an insurer, would have been $19.90 per annum. The difference was that the commission was 105 per cent in the case of the stand-alone product and was nothing in the case of the insurance taken out through the employer superannuation scheme. On analysis, doing the right thing by the client, we advised that they should incorporate that within their employer superannuation scheme, which was more than suitable for what they needed to do. By doing it that way, we were also able to incorporate it as salary sacrifice, thereby making it tax deductible to them as a premium, an option which was not there in the first place.

My point in this is that, in my view, having these commissions and stuff certainly cloud the sorts of products that are recommended to clients. One of the things we saw through the 1980s and 1990s with the disclosure of investment products was that it pulled apart all the mystery—the fees and structures that were going on inside them. We saw the disappearance of those policies where people paid in for two years and, after 18 months, through circumstances, had to suspend their premiums and discovered they had absolutely nothing of value in the account. The disclosure regime that came through in that period pulled it all apart and allowed us to use products that are quite consumer friendly. Compared to those products, they are much better

priced. That is a result of the disclosure regime that came in then. I would like to think that, through a healthy disclosure regime on risk products, we would see much the same thing, where people can truly compare the cost of those products and the advisers can properly advise what is best for the consumer.

Senator WONG—Can I just clarify something? Are we comparing apples with apples? Was it precisely the same product?

Mr Bruining—Yes. It was a death and total and permanent disability cover offered by exactly the same company. One was through their employer superannuation scheme and the other was a stand-alone policy.

Senator WONG—Correct, but there are different death and disability covers around.

Mr Bruining—Perhaps, but if you define it down to death I do not think there is much dispute over what that constitutes. The total and permanent disability terms may have been slightly different, but I was not able to examine that.

CHAIRMAN—So it was not necessarily 100 per cent.

Mr Bruining—Perhaps not, but you would question whether the premium would have accounted for a doubling of it by virtue of some changes in the definition of total and permanent disability.

Senator WONG—Notwithstanding the fact that there might have been different clauses affecting TPD entitlement, was the level of cover the same?

Mr Bruining—Yes; it was identical.

Mr Hajaj—In our last submission to the PJC in its inquiry into the application of the FSR Act we argued that cost return and service are the key factors influencing consumers in their decision to buy or not to buy a particular risk product. As a result of this, a significant proportion of our members—and industry itself—have gone about extensively and systematically disclosing all commissions on the risk products they market, sell or distribute. As an example of these, we have engaged in a shadow shopping exercise of our own at the FPA. We have come up with some interesting results from a financial planning organisation, the details of which we will not disclose.

The interesting thing about their disclosure was that they have selected three potential products—product 1, product 2 and product 3—and they have systematically outlined, in dollar terms and percentage terms, what the overall commissions on those sales would be. Seemingly, that sale went through as well, and the customer was very happy. We have no reason to believe that any consumer would be spooked by the level of disclosure or by the level of commissions. We believe that, given that consumers concentrate on cost and service, this level of disclosure will merely empower them to make a better choice as opposed to being spooked altogether. By the time they select a financial planner, we like to believe that they already understand some of the key issues and what the needs are. If I may, I will table an example of this.

Ms Wolthuizen—I think it is important to remember why we have a disclosure regime as part of the Financial Services Reform Act. That is that—rather than capping or outlawing commissions, or capping or regulating the levels of fees and commissions—we locate the decision about whether to avoid commissions or accept the level of commissions offered with the consumer. Having an open and transparent disclosure regime that is uniform across all financial services is absolutely critical to that. When it comes to the consumer experience, if they are presented with product advice with commissions disclosed at high rates or rates they find unacceptable, it is their decision to avoid that.

It is also a question of how we as consumers exert pressure on costs and remuneration levels, which do impact on premium levels within industries, without knowing how much they are and whether we want to avoid paying for advice that is remunerated at such high levels. That decision is up to consumers. We at the ACA might have our own particular views about the acceptability of commissions and advice that is remunerated by commission, but at the end of the day we accept that it is for the consumer to decide whether that advice is acceptable at the cost and the level at which it has been remunerated.

Mr Squire—There is another part to the equation: other benefits that are paid to advisers. The commission may not be the beginning and the end of it; there may be other benefits an adviser is getting. They might be getting convention tickets, an office fit-out or supplements—there might be a number of other things. So, when you are comparing two products, you should not just look at the premium and the commission; you should also look at those other things. This also goes to the heart of your previous question. They were talking about how difficult it was in the UK. I think our regime is flexible enough in that, if you cannot disclose a dollar amount, you should give a good description of what other benefits will influence you. That includes people in banks and other businesses where they are salaried. The mere fact that they are employed is an influence. Even if they are getting movie tickets and so on, that is still creating an influence for them to push a particular product.

Mr Whelan—The proper authorities that apply to the AMP advisers have dictated that disclosure of all products is part and parcel of their proper authority. In fact, we have found that, in the interaction with clients, the disclosure issue is a critical part of that interaction. We do not have a problem at all in terms of disclosure. We cannot understand that we would create inconsistencies in having one product range disclose as against another. Consistency is a big issue and we believe, through the proper authority basis, that that ought to be applied. Clients understand that advisers giving advice need to be remunerated. Particularly when the proper authority holder is explaining to the client the services and the advice that are being granted, again, it is not a problem.

Mr Rabbitt—Just with regard to a comparison of two risk policies: the same principle applies with investment or superannuation products. You might have two products that are the same—the same fee structure and the same remuneration by way of commission—and we explain to the client what the difference is between those two products so that they can compare and then make an informed decision. The same principle applies with the risk products. If you have two policies where the commission is the same, there might be different features, coverage and payout arrangements from the insurer. So it is a matter of comparing them and providing information to the client so that they can then make an informed decision.

Mr Bruining—I just wanted to follow on from what Mr Whelan said. In our practice it has certainly made us far more accountable to our clients in what we actually provide as a service on an ongoing basis. If we were to pick up a brokerage of $25,000 on $50,000 worth of insurance for someone, we would have to account for the service we would provide for that amount of brokerage or commission. In managed investments—with that disclosure and, say, $500,000 rollover—we saw that people quite rightly said, 'Hey, you could potentially get $20,000 brokerage out of this!' That then forced us to reduce the brokerage in that case. But, more importantly, we were more accountable for the services that we provided.

CHAIRMAN—Mr Whelan, when you say that there is an inconsistency in having disclosure on one lot of products but not on the other, is it fair to respond to that that you are dealing with different types of products? If you are dealing with an investment based product, obviously the amount of commission that is deducted from the payment made by the client may affect the final return on that product because you have less of the payment actually invested to earn the income for the final outcome, whereas with a risk insurance product the commission does not affect the final outcome; it is a fixed outcome subject to a particular event occurring.

Mr Whelan—Our view is that risk is still part of an overall financial plan. In some instances a financial plan review might not touch on the risk because it is deemed to be adequate at that point. In other instances part of the financial plan might only focus on risk. The reality is that, if a full financial plan is done, including the risk component, it becomes very difficult in terms of the adviser disclosing all the elements of the financial planning products, as against the risk products, if they are incorporated in that plan.

Mr Hristodoulidis—We need to get back to the objectives of the FSRA. The FSRA, under 'disclosure' has set three levels of disclosure: the PDS, the FSG and the statement of advice. There is no argument that at the PDS level those types of things will get picked up. However, the FSG and the statement of advice are in place to pick up what influences the adviser in their decision making and in their recommendations. If we adhere to the principle of what does influence or what can potentially influence the adviser, and if you have variability in commissions on different risk products regardless of the type of services they offer to the client, you cannot move away from the fact that you need to disclose that variability to give the consumer the opportunity to make an apples and apples comparison.

Mr Hajaj—This is particularly pertinent, I guess, in a bundled environment, where there is a potential to mislead consumers by loading up commissions on the risk product and, as such, making the investment product look a lot more attractive to the consumer by virtue of the fact that all the costs that would normally be embedded into it are removed, making the return seem far healthier than it otherwise would be.

Mr Squire—Just picking up on Con's point, the ultimate objective of FSR was to make sure that consumers received advice and ended up having recommendations for products that were appropriate to their needs, circumstances and objectives. That is the starting point. To have full disclosure across a full product range means that then it is transparent with regard to the bias towards the particular products being recommended. So I would have thought that also from the adviser's point of view, at least with the transparency, it will certainly encourage them to comply with the law and at the same time make a reasonable income.

Ms Wolthuizen—Just getting back to the objectives of the act, the first objective as stated in the act is to promote informed and confident decision making by consumers. If they are not given the full information about any potential influences on advice, I cannot see how that objective would be met.

CHAIRMAN—The final issue that the FSA raised in their comments as to why they were not going to proceed with commission disclosure requirements on this product was what they termed 'the risk of information overload' and because consumer research has shown a need to prioritise information given to customers. They said:

In terms of priorities we think product disclosure and firm status disclosure are of greater importance than commission disclosure.

What is your reaction to that statement by the Financial Services Authority?

Mr Hristodoulidis—At the end of the day it gets back to the principle that, if there is going to be an influence or a potential influence, that needs to be disclosed. If you seek advice from an insurance agent or a financial planner, and they look at your profile and make a recommendation based on your profile of what type of products you need, they are providing them as a professional service. If you are providing a professional service, why would you not want to disclose what the cost of that service is? If you are a fee-for-service adviser, you would be telling them you are charging X dollars per hour. If you are a commission based adviser, you get remunerated for that service through the commission system. There is no harm in being remunerated for the service. Why not disclose it?

Ms Wolthuizen—There is always going to be a tension about making information on complex financial products and advice meaningful for consumers. But that is why we have the FSG and the SOA, where advisers and anyone else providing financial advice are required to set out the reasons for the advice and any potential factors which might influence the advice that has been given. We can survey and we can test means of making that meaningful to consumers, but at the end of the day commission disclosure does not present some of the problems that might apply to other forms of disclosure. Yet we have not held back on moving forward and developing appropriate means of disclosing such things as fees and charges on very complex products—again stemming from the belief that it is very important that consumers are given that information.

Mr Hristodoulidis—Before we move off the FSA's role, I would like to reiterate Tony's point about the UK people being a few years behind the Australian model. I know you have representatives from Treasury and ASIC appearing later this evening. It would be worth while asking them how often they come and visit and actually use the FSRA as a benchmark, in terms of the reforms in the UK. You will find, as Tony said, that the reforms being implemented in the UK at the moment are at the same stage of approach as we are at the moment. We are the benchmark and we should be using the UK as a benchmark for us.

CHAIRMAN—It is in the eye of the beholder, in a sense. At the meetings I have had with the FSA in London, they believe they are ahead of us. They believe there are shortcomings in our twin peaks structure and that their single structure is much more efficacious. Only time will tell, I guess. Colleagues, do you have questions?

Senator WONG—You may have touched on this, or someone may have touched on this: what do you say to the argument that disclosure puts the person on commission at a disadvantage to the salaried person in terms of selling their product? It has been a view that has been put.

Mr Negline—If that salary is not disclosed in some format, and there does need to be reform in that area, you could argue that there is some form of discrimination. With every party involved, whether they be an organisation that specialises in providing services through salaried advisers or whether they are an organisation that specialises in providing services through commission based advisers, there needs to be commonality, hence the need for negotiation. However you receive that remuneration, whether it be soft dollar, whether it be commission, whether it be salary, whether it be through an office fit-out, whether it be through a binder for your office or a free fax machine—whatever it is—it needs to be detailed, or there needs to be commonality in how that is explained to the client.

Mr Bruining—We are the small dealer. There is none smaller. There is a secretary and me, and that is about as small as you can possibly get. We have a hybrid system running. We have a fee per hour and brokerage. We offer the client the opportunity to apply the brokerage against their account with us. The client can say, 'That is fine. We are happy for you to receive the brokerage and that will pay our account.' That is often required because they may not have the funds on hand to be able to pay our fees. On the other hand, clients say, 'We would rather you send us an invoice, and we will simply pay you for the time that we have spent.' So our clients have a choice.

This disclosure business has not affected us at all and, as I said before, we have been doing it since 1994. The issue of people working for a salary or working for a commission is about the service that you are providing. If you can substantiate what you are delivering to the client, frankly the commission does not become an issue. That is what we have found to the extent that we are so full, I am glad to say, that we are turning away clients at the moment. We have found that clients are very accepting of that approach to providing their financial planning advice, which includes thorough and complete risk analysis.

CHAIRMAN—It has been claimed that the financial services guide and the statement of advice do not assist the comparability of financial products because the FSG can only specify ranges of commissions received, which in themselves can be quite complex on ranges of products offered by a provider. The statement advice only relates to the recommended product and, in fact, NIBA said:

> It is argued that disclosure makes the transaction transparent by alerting the customer to potential conflicts. While this argument for commission disclosure does [have] merit, it should be noted that disclosing commission on the product purchased does not provide the client with sufficient information to assess any possible bias. It does not provide any information about the commission payable on comparable products not purchased and consequently the customer is not necessarily in a good position to judge whether or not the seller was influenced by the commission payment.

Could the panel comment on the issue in that quote from NIBA, and whether you believe it is correct to say that the FSG and SOA do not assist the consumer to compare products? Assuming that, wouldn't this tend to rule out opportunities for a consumer to detect bias?

Mr Hanks—We are happy to live with the statement we made in the submission. We do not wish to change it in any way. We believe it to be correct that you can work the commission

arguments just a little bit too far in NIBA's view. However, that said, we have a system in place that appears to be going to work. It is effective. It is a compromise. It is a system that is not reflecting everybody's view 100 per cent. It was devised by compromise, and we are happy to live with that compromise because we believe it will work in practice.

Mr Hristodoulidis—I would like to go back to why we have an FSG and a statement of advice. The FSG is there to alert a potential client of not only the way a planner is remunerated but also the skill base and the experience of the planner. That is the purpose of the FSG. The statement of advice is a detailed plan which outlines to the client the strategy and the recommendations of products. That is where that comparability would come into it. If you applied the logic of the NIBA argument, you may actually want to extend that to investment products too. However, we do not think that is the right way to go because, again, you get to this point of being secret about the way you are remunerated. The important point to the client is that you do a complete needs analysis of their financial situation and then, based on that, you make appropriate recommendations. You then disclose to the client the cost of preparing that plan and you also disclose to the client the cost of the ongoing advice that goes with that plan. I think the FSG and the statement of advice model set up in the FSRA is a very robust model that we should not be moving away from.

Ms Wolthuizen—The information that is provided to consumers in those documents is all about justifying the recommendations and the advice that has been provided. It is entirely relevant information and it is entirely appropriate that that would be where a consumer would look for not only information but also justification from the adviser as to why particular products are being recommended and also information about the value proposition that is put to the consumer—that is, 'I'm recommending you this product. I am paid this amount to do so, but I still believe it is in your interest.' The consumer is then in a position to ask the hard questions of the adviser and get them to appropriately justify why it is that they are being recommended that particular product.

CHAIRMAN—Another issue that has been raised in relation to the disclosure of commissions is the argument that risk insurance is sold not bought. In that sense, it is again a different type of product from the investment based products which are bought. I will again quote from the briefing paper:

> In contrast to financial planners who are selling an investment product, it is not commercially feasible for risk insurance advisers to charge a fee for service as an alternative to commission, for instance. That is reflected in the dominance of the commission driven distribution model in the risk insurance industry. In the context of the recent survey of the financial planning industry, to apply that measure to the risk insurance industry as an argument for disclosure is not valid.

Would anyone care to respond—particularly with regard to the comment that with investment products customers are looking for a vehicle for their savings to be invested and so on, whereas with the risk products there is not an up-front attractiveness about it and people tend to avoid it?

Mr Hajaj—Whilst I think there is some truth to the statement that risk products are sold as opposed to being bought, I think the community is amidst a cultural sea change in this regard, whereby increasingly more and more members of the community are actually purchasing those products and are seeking those from their financial adviser. However, even it was a product that was being sold, it does not mean that a consumer needs to be stripped or disempowered of disclosure or their need to know exactly what the product costs. As I mentioned earlier, it is increasingly changing, but that does not mean that a consumer need not know what it costs. In

fact, consumers who do know what it costs will probably value the product a lot more than otherwise would be the case.

Mr Bruining—The counterargument to that is that equally if disclosure was there it might also change the pricing of those products and make them more affordable so that more consumers could take advantage of them. I go back to my example of the insurance through the superannuation fund. They could have had double the amount of cover for the same amount of premium.

Mr Hanks—There is something to the argument because quite clearly the problem with general insurance is that it is undersold, not oversold. We saw in the fires in Canberra that something like one house in five was not insured at all. The problem is underinsurance, not overinsurance, in the industry. I do not think, however, the issue of commission would solve that one way of the other. But there is not miss-selling to the same extent in general insurance and risk products as there is in savings products.

Ms Wolthuizen—I think there are always going to be questions about the extent to which insurance is viewed as a grudge product by consumers. But at the end of the day, if they are going to be paying for it, they should have all the information to hand to make the decision about whether they indeed need the product and need it at the price at which it is being sold or with the features that come with it. The onus is being very firmly placed on the vendor of these products to justify to consumers why it is in their interests to pay the particular premiums for the insurance that they are being sold and why it is in their interest to take out these policies.

I cannot see why we would implement a different expectation with respect to insurance simply because we are frightened that if we actually tell consumers about the commissions or give them more information about them they will decide it is not worth taking up. I think that is a decision that is most appropriately left with the consumer.

Mr Squire—I think you can take that one step further, too. To a large extent, while you really have to sell insurance because a lot of people are averse to buying insurance—particularly when you are talking about death insurance—at the end of the day a financial planner more often than not is selling financial products as well. The client may well think they want certain products; but at the end of the day the good financial planner will make sure that the products match and are right for the client's needs and objectives. To do that, they are really selling a different range of products, perhaps, to what the client had in their mind in the first place. The argument could be used in both contexts, whether it is investment or insurance, I would think.

Mr Negline—We certainly do not necessarily follow the logic that, because life insurance or risk insurance tends to be sold not bought, that therefore implies that commissions should not be disclosed. Cost and service are not the only issues that are used to determine whether or not a product of this type is purchased. Where the need is strong enough the cost and the service element are often irrelevant and in actual fact most life advisers who I have dealt with over the last 15 years do not sell on price; they sell on need. Often if the client feels attracted enough to that need, whether it be a buy-sell arrangement or to protect their family's assets or their business assets or whatever it may be, the cost is really irrelevant. It does not mean, though, that the client should not know what the level of commission is, given that commission is a major expense in all of these products and is a major cause for a lot of the complexity that arises in these products.

Mr Whelan—I agree with all those comments. It is an interesting fact that in most product providers there is dial-down commission facilities. I would suggest that has been driven mainly from the advisers putting pressure on the product providers to provide that. There are instances, particularly with big cases, where an up-front premium of $45,000 is not justified by the time and effort applied by the adviser. Something of a lesser amount is more appropriate and most planners and advisers I deal with are happy to discount down to something that is reasonable for the time and effort put into that particular plan.

Mr Negline—Having said that, though, I think it does need to be acknowledged that writing these sorts of products is extremely time consuming. A very good adviser would spend at least eight hours completing one sale, for want of a better term. You could probably double that for the average adviser. And that is for what the industry would call a cleanskin case, where there are no underwriting complications, there are no complications about getting medical reports, there are no complications about getting premium payments and so on. For very complicated cases—large sums insured and so on—you could easily double that amount of time.

If someone was being paid $150 an hour for their professional time, which is a low rate, you are really looking at somewhere between $1,200 and $2,500 for that professional time for a very efficient adviser. There does need to be some form of remuneration. The thing is that, given that it is the client who is actually paying for that, they have a right to know that they are paying for it one way or another, whether it be via a third party or directly through fees.

CHAIRMAN—That brings me to the next issue I want to raise, which is the argument that the disclosure of commissions will lead to a standardisation—in effect, a driving down—of commissions by the product manufacturers.

Mr Negline—They are driving down anyway. In the last 10 years we have seen commission rates drop from about 100 per cent—maybe 120 per cent—of initial premiums, plus volume bonus, down to somewhere between 30 per cent and 50 per cent up-front, to no volume bonus, to 20 per cent to 50 per cent trail commission. So they are dropping anyway.

CHAIRMAN—Will this in turn cause a move away from the commissioned agents towards the salaried advisers who do not provide the claims handling service, for instance, that the commission agents do? Will that be to the detriment rather than to the benefit of the consumer?

Mr Negline—It might slightly change the way that the commissioned adviser operates. There were a lot of claims in the late eighties, early nineties, when there was a requirement to disclose commissions on savings products—you know, 'Next year we'll all be ruined.' That certainly has not been the case. Financial planning is probably about the fastest growing industry in Australia. Given that risk insurance is a major component of financial planning, that is likely to continue, whether it is through salaried, commissioned or direct cost to the client, through billing.

Mr Hristodoulidis—I support Mr Negline's comments. If we look at the disclosure regime in place on the investment side—which has been through the Corporations Law and has pretty much been picked up in the FSRA—the growth of small licensed financial planners and proper authority holders has far outstripped any growth in any part of the Australian economy in terms of an industry or profession. There has not been that shift back to salary on the investment side, so I would not expect it to occur again on the risk side.

Ms Wolthuizen—That argument seems to suggest that commission agents cannot justify the commissions that they receive. If they were forced to disclose the fact that they are remunerated by commission, without actually demonstrating why they are worth that commission or why they might be worth any additional expense, consumers would switch over to salaried agents where commissions are not a factor. It seems to me that that would be one of the best reasons to bring commissions out in the open and make it that agents have to justify why it is that they are a better option for a consumer. It seems to me that is one of the fundamental principles that underlines the FSRA.

Mr Hajaj—Likewise, as Anthony suggests, businesses which take a fee for service have a greater resale value than businesses which purely rely on commissions.

Mr Hanks—The general insurance industry is very competitive at the distribution end. If it is not effective, direct sellers move into the market. So there is competition, not only with agents and with brokers but also with direct sellers.

Mr Squire—I think it is fair to say that, with the direct sellers, in the more complex cases where the direct sellers employ people to do those sorts of functions, they cannot afford the overheads to be spending the amount of time that they need to on complex risk management cases. That is putting it back into the small business operators and small brokers area to deal in that sort of business. I do not think it pushes it towards the direct seller, employed type adviser market at all.

CHAIRMAN—If the commissions are forced down, so the agent does not have the financial resources to provide that service, what happens then?

Mr Squire—The point I was making is that, if it is pushed to the direct sellers, they simply will not do it anyway because they cannot afford to absorb those sorts of overhead costs and make a margin on the product at the same time.

CHAIRMAN—Don’t they just sell the product and then, when the time comes for a claim, are not there to assist?

Mr Squire—That is right.

Mr Negline—That is quite common amongst advisers taking commissions, unfortunately.

CHAIRMAN—Are you saying it applies to commission agents as well to direct sellers?

Mr Negline—Lapse rates for risk insurance, for a whole host of reasons, are quite high. Probably most life insurance companies would expect to have no more than 20 per cent of the life policies that they are writing today in existence in five years time. For a whole host of reasons, products get superseded, people change their needs, and so on. One of the reasons is that life agents are not following up—they are not staying close to the client. They are probably doing a review with a client every 18 months on average. The reviews take quite a long time. For a variety of reasons—maybe they leave the industry or get kicked out—some of these guys’ business is put into a pool. But, at the same time, some of the guys are not following up.

CHAIRMAN—Thank you for your evidence. We look forward to seeing you at the concluding remarks stage of the hearing.

[6.00 p.m.]

BROWN, Mr Bill, ACT Life Insurance Brokers

COLLINS, Mr Russell, Member, Association of Financial Advisers

DIXON, Dr Philip Norman William (Private capacity)

ENEVER, Mr Brian Joseph, Vice-President, Insurance Advisers Association of Australia

FOSTER, Mr Darryl Robert, Committee Member, Life Advisers Action Group

GEORGE, Mr John Richard, Managing Director, MGA Insurance Brokers Pty Ltd

MENKENS, Mr Leo Ignatius, Chairman, Authorised Representatives' Association

MITCHELL, Mr Dugald, Political Research Officer, Association of Financial Advisers

MORGAN, Mr Murray Kenneth, Chief Executive Officer, Insurance Advisers Association of Australia

MURPHY, Mr Michael, Vice President, Association of Financial Advisers

ROSS, Mr Robert (Private capacity)

VANDERWOLF, Mr Ross, Director, Authorised Representatives' Association

VEIVERS, Mr Gregory John, Committee Member, Life Advisers Action Group

YATES, Mr Robin, National President, Association of Financial Advisers

CHAIRMAN—We now have before us at the roundtable a group generally characterised as being opposed to the quantum commission disclosure. I welcome you to the hearing and thank you for your contribution to our hearings. In your submissions to us, both in relation to this inquiry and in relation to our earlier inquiries, a number of you have argued that the disclosure of the quantum of commission will adversely affect the viability of your businesses. I was wondering if you could elaborate on that particular issue and provide some evidence to sustain those claims.

Mr Brown—I am a licensed life insurance broker. Like the sole practitioner in the previous group, I am a single licensee. In my submission, I provided some detailed examples of a circumstance where I interviewed a person and made recommendations, and I provided you with a chart providing disclosure of commissions as best I could. As a general rule, brokers do not get paid extra bonuses. There is a commission, and perhaps an overrider, but that is it. I do not get taken on trips; I do not get any freebies. I occasionally have a free Chinese lunch.

If you look at attachment C in my submission, you will see that the product down the bottom, in my view, and sustained by the information that I provided previously, is in my professional opinion the most appropriate for that client. I will not talk to this in any great detail, but let me give an example. If you go to the particular contract across the top, with a commission of $1,842, that particular product has a clause in it which says that, if the life insured is disabled while overseas, they will be paid a benefit for six months, and that is it. If they remain disabled for longer than six months, they will not be paid.

I consider that an important issue in the case I have submitted to you of a computer professional. A lot of computer professionals go overseas. They get attracted by large rates in London and they will go overseas for six, 12 or 18 months or two years. In that circumstance, as an example, that contract, in my opinion, would be unsuitable for that client. I would recommend so. There are other reasons why it would be unsuitable.

The whole point of the exercise was to say to you—and I know this went around the table here before, but it was skipped over—that a client sitting there looking at that situation is inclined to go for the cheaper premium and the cheaper commission. That is what they will do. If we get into a long and involved argument where, as somebody else on this committee said before, we have to substantiate and sell our services, yes, I will—yes, I do every day—but the problem I have is that it distracts and confuses clients.

We are talking here today about stuff that is not compulsory. If you inherit $300,000, you really have to go and see an adviser. You do not have to by law, but you really should. However, people who come to see me think they might like to look at income protection. They do not have to buy it. It is not compulsory. If they get distracted and confused, they will walk out. That is the whole issue. While I have the microphone for a second, I would like to say that, with the exception of one gentleman, none of the people around that table before were at the coalface. None of them were out talking to clients—none of them.

Mr Collins—I think the disclosure of the commission quantum is misleading because it does not bear any relevance to the cost of doing business. We never support, for example, our commissions if we disclose them with a profit and loss statement to say, 'Here is what happens to the money that I earn,' nor is there any provision in the CIB, as yet, for that to be set aside. Just to give you an example of where it also does not make any provision: I had one case that I completed and submitted in February of last year, and the underwriters finally turned it down last month. It took a year to go through the underwriting department. I did not get paid a cent for that. There was a lot of lead-up work to that. The second case—which was a rather large case—involved people in the country who had required me to do a lot of to-ing and fro-ing there. It got into the underwriting and then it got knocked back because the chap, after his medical, discovered he had things that he did not realise he had.

When you give a figure up-front, for example, people do not understand what is going to be involved in that, nor are they aware that, if the policy lapses within a certain period of time, the insurance company takes the money back. So I think the quantum can distort the person's perception versus the reality on that aspect there. You may not be aware of this, but we have to set ourselves between the inefficiency of the life insurance company's staff and the promise that we tell our clients we will deliver, and there is a cost involved in that. You cannot explain that to people as well in terms of a quantum.

Mr Ross—I come from Brisbane, and I am a licensed broker's representative. I spent 10 years as a technical training manager with prudential corporation and some years with Colonial. You asked: if commission has to be disclosed, why do we feel it would impact on our business or our practices? It would impact because, as has already been suggested by an earlier group here, it is likely that commission would be driven down. That sounds fine from a consumer's point of view; it is like buying a product from a local electrician who gives you a 12-month guarantee. He beats everybody else on price, and 12 months or eight months later when you go to get the guarantee honoured, he is no longer in business because he did not charge enough.

We do not set commission; the product providers set it. I have not had a history of many years as an agent, so when prudential was bought by Colonial, I had my own reasons why I should leave and become an adviser myself. I bought the practices of other people. In my submission on page 7, I referred to one of those practices. The practice has a turnover of $500,000 a year and makes a net profit of $60,000. It would require commission to go down by only 10 per cent for that practice to make no profit at all. The two principals had salaries of $60,000, a car and a modest superannuation contribution of about $10,000 a year each. In actual fact, the principals' remuneration was about $85,000 a year. There are a lot of professional people who would not work for $85,000 a year.

The practice was in Toowoomba, and sometimes those principals would drive 300 kilometres to see a client and not make a sale. If they had to disclose commission, there is always the possibility that the customer will think the commission that he pays goes into that guy's pocket. What he may not realise is that for every sale the adviser may have made two submissions, and one bought and one did not. I referred in my submission to my own experience when I bought airconditioning and got three quotes. I read an article recently from the Consumers Association that said 'shop around'. They must know what they mean: put somebody to a lot of effort for nothing to get the best deal for you. That only works for a short while, because sooner or later those guys who do not get the sale will have to charge a fee.

Recently the Consumers Association in cahoots with ASIC had about 120 shadow shoppers go to a financial planner and ask for advice. I noted in the report that there was criticism of lower income people being able to access a financial planner. How are they going to be able to access an insurance adviser if he charges them $1,500 for the eight hours which somebody else says it would take to do the analysis and make the recommendations, even if they did not buy the insurance. That would make it even more difficult for low-income people to buy insurance.

CHAIRMAN—I do not want to interrupt your whole train of thought, but in the context of what you are saying does that mean, therefore, that there is an element of cross-subsidisation in the structure as it currently works through the commission?

Mr Menkens—It is just the nature of the business. It is a numbers game. I am Chairman of the Authorised Representatives' Association of aligned advisers with ACSA. There are 640 members of the association. It was basically a risk writing group before, but now it has migrated to financial planning as well. We surveyed those members—not like the FPA, of which I am also a member. They did not survey their members to come up with their conclusion to oppose or to be pro the risk disclosure. We surveyed them, and not one member of our association was for disclosure.

In answer to your question, yes, there is cross-subsidisation. It is just like any other field of selling: it is a numbers game where you will see some people, you will make some sales and that will cover your overheads. The more efficient you are, the better you will be and the more money you can perhaps make to provide service to your clients.

One member of the previous group mentioned what everyone here has failed to talk about. He said that he watched a $46 premium per month go down to $19 per month. I did not notice that he had a collar on backwards like a missionary; I bet he got paid. So he must have charged a fee for service for that. Looking at that the other way round, that same adviser did say that the client pays somewhere. I have now been in this industry for 15 years and there have been several claims made. During that time, I wonder how those people could have afforded the time to pay an adviser. In most cases, if it is a clean skin claim, it is no problem; the institution will pay. But if not, as everyone knows—and I think the IFSA representative has gone from here—the first thing they do is hand it to their claims department and obstacles are put in their way in every way, and it is getting worse.

One of my clients recently was denied a claim, and he came to me about it. I was informed by my dealer group to say, ‘Now, under the act’—because I was getting too close to the truth and showing this bloke how to do it. I was advised and reminded of what the terms of the arrangement are. That means I work for the institution, not for the client, as opposed to the brokers who do it here. I said to the client, ‘Go to fix, go to the industry tribunal,’ and they denied him assistance because it was a large claim. So I said, ‘All right, go to your solicitor.’ His solicitor said, ‘Put $15,000 in the trust account otherwise I cannot do anything.’ That fellow has been sent bankrupt, I am sorry to say. I sold him a policy some years ago in good faith, and I believe he has been denied justice.

Just this week I had a claim that was declined after three years of being paid. The fellow was being paid for income protection, and the institution did an investigation and decided to cease paying. Six weeks later—and through my intervention—he now has his claim back and is being paid. They had said, ‘No, it was fraudulent nondisclosure at time of application.’ That was what they put out there, but it was not and we proved it. I had been paid commission up-front by that guy 4½ years ago. He did not pay me now. You talk about cross-subsidisation: that is our business; that is what we do. So in those instances—and we are talking about noninvestment; I am also a financial planner—where full disclosure of anything to do with investments is a must, it is a given. In this case here, you asked, ‘Would there be an impact?’ A client will come through and ask me what the premium is, say, with a big case and, at the same time, he can go to the banker or to somebody else, and for a slight difference in premium, he will go down the road for $1,000 less. This is the issue that comes about with disclosure of premium, because he did ask me what my disclosure was.

CHAIRMAN—Mr Ross, I am sorry you were interrupted. Would you like to continue?

Mr Ross—When all is said and done, insurance itself is cross-subsidisation. Everybody puts money in a pool and they all hope to God that they are not going to be the one who gets the money out. People who get money under a life insurance policy, if you would only understand it, are the lucky ones: they are dead and they get paid. The unlucky ones are the people who pay premiums year after year after year and neither do they die nor are they disabled. The sale of life insurance is tough. I listened to that experience of the guy in Perth. Unfortunately in this room there seems to be a ‘them and us’ attitude. I do not like that because this is supposed to be

a public hearing for the benefit of consumers. I must say that I am a stranger in the House. I do not come from Australia, and I was invited to a state of origin match and I had never been to one before. Tonight as I have sat here I have thought: this reminds me a little bit of being there in that there is the same atmosphere here but there is no cheering.

It seems to me that a man convinced against his will will be of the same opinion still. Whether I had five minutes or five years, I am very doubtful that I could convince what I will call 'the other side' that commission disclosure is harmful to the consumer, and I suspect that it would be the same if the attempt were made on me. It is like asking Saddam Hussein to give up his weapons—he is not going to do it.

I responded to an advert. I saw this invitation in the press; I saw an invitation in the *Sydney Morning Herald* to make a submission and so I thought, 'I will make one.' As a matter of interest, did any members of the public make a submission?

CHAIRMAN—Who are not involved in the industry or the consumers association?

Mr Ross—Yes.

CHAIRMAN—No.

Mr Ross—There was a request in the *Courier-Mail* three weeks ago inviting people who felt that Australia should not go to war to meet at New Farm park and 200,000 people turned up. Why hasn't one member of the public who is a consumer made a submission here if they are so concerned about it? They could not care less.

Senator CONROY—Maybe it is because they do not know what they are paying; maybe it is because they do not have a clue about what they are being charged.

Mr Ross—But they could have made a submission, couldn't they?

Senator CONROY—Not if they are not told what they are paying.

Mr Ross—The advertisement in the paper, which I have a copy of here, just invited interested persons to make a submission. What I think the public is interested in is this: if you buy a can of a certain kind of beans, what information do you need to know? You are going to tell me the contents of that can of beans and the price; isn't that so? So you know the contents of that can of beans. If you are going to buy that can from a different store, you do not need to ask about the contents because the contents are the same. So what do you need to know? The price. That can was $1.99 and the other can was $1.67. So which can would you buy? You would buy the second one. But what if you went to Coles and you could get that can for $1.17? Why would somebody pay $1.99 for a can of beans when they can get it for $1.17? The answer is that Coles open at 8 a.m. and close at 6 p.m. This guy is open seven days a week for 24 hours a day. We could ask: is it a level playing field?

I went to Perth to work with an adviser and we had to go to Broome to see a client. I had never been to Broome before and I was simply stunned at the distance that we had to drive to get there. Yet, when that adviser sells a policy, he will get the same commission as though

somebody had walked in off the street in Canberra and bought a policy. Therefore, you are never going to have a level playing field. There is a whole heap of issues and, if I got on my soapbox, we would not be going home tonight.

But people come to us for advice. In Coles they could have bought that can of beans. This can is not one of those they could have bought in Coles. People need to know the difference between what is in one can and another; they need to know what is good value. But none of those stores, incidentally, even though I asked them, told me what their mark-up was—and I did ask. I could see the price and, strictly speaking, I did not need to ask; I know what I am paying for.

I get disturbed because I wonder: what is the motive in all of this? Commission arguments have been going on for 10 years. It is almost like the republic: it just keeps on coming back until one day they win, and that will be the end of it because it will never come up again. However, I feel that it is worth the fight because it is too damaging to Australians. Somebody has said that one Australian in five did not have insurance on their house in Canberra; yet the antihawking legislation stops an agent knocking on doors and just saying, ‘Do you have insurance?’ and, if the person says no, asking, ‘Would you like me to help you with some?’ If people do not have insurance, the responsibility falls back on the rest of the community.

Naturally I am against commission disclosure. It will harm businesses if it drives commission down. Customers do not understand the cross-subsidisation, as you quite rightly put it. They will think, ‘That’s your money to pocket.’

Mr Morgan—Initially I would say that, with FSRA, we have this principle that one size fits all. It is very simplistic and it sounded wonderful when we were talking about it before. We also heard the words, ‘Let’s keep it simple by having the one set of rules.’ It is very simple for, I think, the regulator but not necessarily the practitioners. I am sure that everyone is more interested in the practitioners than in the regulators. We are really trying to compare not apples and oranges but apples, oranges, grapes, pumpkins and tractors. I heard some fantastic commission rates discussed before—110 with 30 per cent trail. The poor old part of financial services is the general insurance industry. If you are getting 25 on something, you have done very well. If you are getting five for helping someone with a third-party motor vehicle policy, you are doing the right thing but you are losing money. You are cross-subsidising.

Let us not get carried away with the thought that all these deals will turn out $20,000 or $40,000 of commission for the person who is making the sale; it may be $5. Just think about it. A guy has travelled some distance to help some old pensioner fill out their third-party-only policy. He has spent an hour there, he has had two free cups of coffee—and a scone, if he is lucky—and, with all the forms, he has filled out exactly the same amount of paperwork as the guy who is going to make $10,000 or $20,000, but the difference is that this guy is only going to make $5.

We see this becoming even worse in a country town. Our members are very small; in most cases, agents are smaller than brokers and the average sale would probably be between $100 and $200. Our members are mainly in the country; city people tend to go for brokers and direct marketers. In the country, if you are lucky enough to have a large account—say $10,000 plus all the government charges, and after those it may be a $20,000 account; but for commission purposes it is a $10,000 account—the commission overall may be $1,500. If you have to

disclose to someone you know at the golf club or the school that your commission up-front is $1,500, they will say, ‘Well, Murray, we’ve been friends for a while. I’m not going to shop this around, but you give me $750 discount and you can make $750, because I reckon $750 is a pretty fair cop.’ That has killed the good deals that carry cross-subsidisation. That is where we come from—that we are not all the same. It may be simple to have the one set of rules for everybody, but we are not the same.

Mr Brown—Mr Chairman, previously you picked up that table. That table is an example of a number of claims that I have had where I am looking after the claimant in income protection claims. We have just referred to commission. On two of those claims I have spent 50 unpaid hours fighting the companies referred to here. One of those cases is going off to court and I am probably going to get involved in it. The only one who will make any money out of that is a solicitor, not me. In one of those columns you will see the commission I originally made. The one that owes me best at $125 an hour is $5,625. I made a whole whopping $500 in 1994.

This is cross-subsidisation at its worst. This is what we are doing. Everyone at this table is operating now in an environment in which the insurance companies are not being very nice about claims. I will not say what I was going to say, so let us put it that way. I am sorry to drag Elizabeth into it, but they are abusing FICS. There is a $5,000 upper limit on income protection claims. Under that, you can use FICS. Over that, you cannot. None of the people sitting at this table—who I assume all earn more than $80,000 a year—could use FICS because your income protection benefit would exceed $5,000 a month. Those companies are abusing that. When they do that, we the advisers get involved in this; we have to. It is an article of faith. I cannot, though, when disclosing to a client the $3,000 commission I mentioned before, explain away what I do by saying, ‘Look, I could spend 50 hours fighting for you for a potential income claim that may or may not occur.’ Do you know what that client is going to say to me? He is going to say, ‘Bill, this is all too damn hard and I am not going to do it.’

This brings me to my final point on this thing. New business premiums for income protection to September 2002 last year were $176 million. Enforced income protection premiums were $824 million. But, let me tell you, it is secret men’s business trying to find out how much has been paid for claims. No-one discloses that. APRA does not collect it. ASIC does not collect it. No-one can tell you. But I do know that the sickness benefit costs the Commonwealth government, in benefits alone, $93 million. And that does not account for what it costs to administer it. I am suggesting to you that that $93 million is going to look very sick if a lot of people stop taking out income protection.

CHAIRMAN—Can I go back for a minute to Mr Ross and his cans of beans, which were very illustrative. You said that the risk product is different from the investment product. If there were a continuum of products, and you had an investment product, a risk insurance product and a can of beans, where would you place them on the continuum in terms of similarities?

Mr Ross—These cans of beans are identical, but the prices were all different. This is not an issue of price, although I believe it is. I think the customer wants to know the price. There are some people in this room who believe that the customer wants to know the commission. I do not believe that. Life insurance policies tend to be very similar, but they are not exactly the same. My firm pays about $250,000 a year in professional indemnity insurance premiums. I will repeat that: we pay a quarter of a million dollars on PI insurance premiums. We have never had a claim; why do we pay that? It is because, if I say to this customer that this can of beans is

more appropriate to his needs than that can of beans and it turns out in 15 years time that I was wrong, he will sue me.

I was involved in the writing of the code of practice and I was stunned when I spoke to ASIC last week to find that some people there had never read it. For the benefit of this particular committee, I provided a copy of the code of practice. The code of practice requires an adviser, before they give advice, to have already analysed all the circumstances of the client, to detail the whole lot and then recommend a product suitable for their needs. We are brokers. What we do is, when we finally recommend the product for the client, we give them a list of 10 products that we considered. Then we list them on a score from the best product to the poorest product based on benefits and then list the same 10 products based on price. We do not put commission in any of those. The customer then compares the product with the price. Insurance products are different. Let us go back to the example of the adviser in Perth, which I felt was a criticism of the agent who was not here to defend himself. The agent sold a life insurance policy for death and TPD—and I forget what the premium was, but it was considerably higher than the group scheme which was inside the super fund.

Mr Murphy—It was $41 versus $19.

Mr Ross—We must realise that the circumstances in which a super fund can pay a total and permanent disability benefit is contained in section 2(1)(a)(iv) of the SI(S) Act. The SI(S) Act states that a person can receive a total and permanent disability benefit if, in the opinion of the trustees—and they need two doctors to support this—the person is so disabled that he will never be able to work again. That is the first thing we have to note. If the policy was owned by the individual in his own right, it would normally be an own occupation TPD. That means that if you cannot do your own occupation, you are totally and permanently disabled. The rules for superannuation do not allow that. Therefore, perhaps the agent was quite right to sell the policy directly to the client.

Next there are the regulations relating to who the benefits can be paid to. Under section 62(1)(a) of the act, death benefits can only be paid from a superannuation fund to the dependents of the member as defined in the act. Sometimes years after a person has bought a policy he may want to use that policy for a different purpose. He may have bought the policy to provide for his wife, his mortgage or his kids. Fifteen years later he may have a business and he may now want to use the policy as part of a buy-sell agreement for another business partner. Under the memorandum of transfer at the back of the policy, he can transfer it. He cannot do that with a superannuation policy. There is a hell of a lot more to it than just a tax deduction or the cheaper premium.

Further, when he reaches the age of 60, under the group scheme if he leaves the employer he can no longer transfer the benefits to himself. Every group scheme is identical. When you reach your 60th birthday, you cannot take the benefits even if you retire. Who retires at 63? The answer is people who have had heart attacks or strokes and who, believe it or not, actually want to take the insurance because insurance is a bit of a gamble. You bet with the insurance company. Most folk do not even know that before there was an insurance act, there was the gaming act and insurance was governed under the gaming act. It was a wager: ‘I bet you $100,000 I will be dead this time next year.’ They say, ‘We bet you $100 you won’t be.’ I put my $100 on the table and they put their $100,000 on the table. Whoever is right collects—and it is them; I am still alive. They say, ‘Do you want to play the game again?’ That is for the second

year. I say, 'Yes, I still have a wife, mortgage and kids, so yes, I will play.' However, they change the rules. I am a year older. They say, 'Okay. We will still pay you $100,000 but you have got to put $110 on the table.' And I do this year after year provided I have an automatic continuation right. When I reach a certain age as defined in the policy—it might be 60, 65 or when I leave the employer if it is a group—I might leave. However, I might leave because I am dying. So far I have played the game every year, but this year I am going to win because I have been diagnosed as having terminal cancer. However, the group scheme may not pay me the benefit. They may say: 'You've left the employer. You are over 60 and you cannot take that benefit with you.' The very time I need the insurance is the time I do not have it.

It is an adviser's job to calculate all of that before he recommends a policy. It is not just a case of what your commission is. If it simply came down to what your commission is, I would be for disclosure. However, I quoted in my submission that Amanda Vanstone said that Centrelink has 6.2 million customers. That is one-third of the Australian population. Every time I sell a policy to a client I am giving this guarantee to the community: my client will never be on Centrelink benefits. If they get sick they will have income protection benefit and they will not have to seek a disability benefit under Centrelink. If they die, the wife will not need to go to Centrelink and apply for a widow's benefit with all those embarrassing questions like, 'How many men visit you each week?' and 'Do they stay more than two nights?' People do not know that those questions are in the widow's questionnaire.

I have done this job for a hell of a long time, and I have had to sit face to face with people. I have had a man who said, 'I don't want to buy life insurance, Robert.' I said, 'That's okay. I don't give a rat's arse, to be blunt. I'm rich already; I don't need the commission. But if you die, are you going to help your wife fill this form in?' Just like the can of beans, I took out of my bag an application form for a widow's benefit. I said, 'Do you know the questions your wife is going to have to answer when she goes for a widow's benefit?' When he read the questions, he said, 'What are the questions on the life insurance policy?' So I think that the commission issue, frankly, is destructive to the industry and to customers because it takes us away from the real issue, which is that people need life insurance.

Senator BRANDIS—Mr Ross, I want to draw you a bit on this. Your advocacy persuaded me—and I did not need persuading—that your product was worth while. But, with respect, it did not seem to bear particularly on the question of the desirability of disclosure. You said at the beginning of your remarks that most people are not interested in what the commission is or in disclosure. How do you know that?

Mr Ross—In the middle of my remarks I asked whether any members of the public had made a submission.

Senator BRANDIS—I am interested in the disclosure of my agent, I must say, even if only out of curiosity. What you have pointed to is a whole series of consequential issues.

Mr Ross—Okay, to answer your—

Senator BRANDIS—If I may finish. But none of them seem to me to address the in-principle question, which is: why ought not there to be transparency as a matter of principle?

Mr Ross—You asked how I know. My adviser services guide, which I give to every client, says, ‘Remuneration: we will be paid (a) a commission, (b) a fee charged by you, or (c) a combination of commission and fee. Which one would you prefer?’ It also says, ‘If we are paid commission on insurance products, you may ask us and we will tell you the commission we receive.’ Nobody has ever asked me; that is why I think they are not interested.

Mr Brown—Could I elaborate on that? This is a two-page example that I used to calculate the table that I showed you before. It is from a research company. It says: ‘female person, 36 next birthday, $7,500 a month, 30 days benefit, age 65’. I show that to my clients. It happens to be in premium order. I have a disclosure like Robert has, and I say to my clients that those products have a rate of commission within five per cent of each other. That is proven in the other document that I showed you. I then say to them, ‘They all pay me commission. Do you want to know what I am paid?’ I have been a registered life insurance broker since May 1999 and I have been asked once. As an agent for multiple products for 10 years I think I got asked twice. People do not want to know. The reason they do not want to know is that they know I am getting commission, they know what services I provide and they know I am going to be there.

Senator BRANDIS—Mr Brown, this legislation does not proceed on the premise that the disclosure of commission is a necessity; it proceeds on the premise that it is desirable. It may be gratuitous, but none of the arguments I have been listening to have persuaded me why it is undesirable. It may be gratuitous, but I do not see why there is something wrong with the idea.

Mr Collins—Who says it is desirable? In the lead-up to the legislation being drafted, how many practitioners were—

Senator BRANDIS—I think the transparency of a transaction a priori is intrinsically desirable, don’t you, Mr Collins?

Mr Collins—Yes.

Mr George—Perhaps we can bring a different spin to the discussion here tonight. I represent MGA Insurance Brokers Pty Ltd. I am the principal of that company. We employ 140 personnel in 18 offices throughout the country and we have a premium turnover of around $95 million. Ninety-eight per cent of our income is from fire and general insurance. I do not know how many practitioners there are here tonight who are in the fire and general insurance industry to that extent. I may be a voice in the wilderness, but I can tell you that I was surprised by some of the commission amounts that I heard about earlier, such as 100 per cent and 110 per cent. Our group would gross about 14 per cent on turnover a year. It is a reality that since the early eighties the majority of Australian insurers, because of shortages of qualified personnel and an unwillingness to provide direct customer service, have outsourced their services to insurance brokers.

CHAIRMAN—These are insurance companies that are outsourcing?

Mr George—Insurance underwriters. With the capital that has been taken out of the insurance market both locally and globally—we have had HIH, we have had September 11 and we have had the collapse of the equities market; that would have taken out something like $150 billion worldwide—underwriters are looking to cut their costs even further, so they are pushing more and more of those services and backroom services towards the intermediary. These

include the development of products, the servicing of those products, the handling of claims and the payment of claims on their behalf, the issuing of renewals and the issuing of accounts to clients and collecting the premiums from clients and paying the underwriters. We are probably doing about 70 per cent of their work.

It is our contention that full commission disclosure for these sorts of things is flawed, as much of the commissions that we earn are actually for those back-driven functions; they are a fee for service by the underwriter. We would estimate about 20 to 25 per cent of the income that we are paid by underwriters would go to salesmen at the front end of the business. This is something that does not affect the life insurance industry to the same extent, and that is why I am saying I am a voice in the wilderness, but there are 900-odd registered general insurance brokers in this country and we believe it is a very compelling argument.

Mr Enever—I am with Mr George here. We are coming from the angle of fire and general, which is purely about risk products. We all realise that the FSR legislation is there for consumer protection, but no-one has come out and said, 'Why on risk products should commission disclosure be there?' All they come out and say is that it gives the consumer an informed decision on buying a product.

I will give you an example, and we are talking about simple car and house insurance. Everyone around the room has to buy car insurance or house insurance. We will take a simple car policy. The premium is $500. The client rings up—he is shopping around—and I quote him $500. That nets out to about $420 before government charges, and I get a lousy $42 from the $500 premium. Forty-two dollars commission would hardly cover my cost in writing it, but you do that because you are there to provide a service for your clients. Can somebody convince me or my members that commission disclosure on that product—telling the client that I am going to get $42 out of it—is going to affect him in buying that product or not? He wants to buy it to protect his car, his asset, in case there is a claim. I have been in this industry since 1965 and there has never been one client who has asked me what my commission is on a product.

Mr Foster—I would like to make a comment, and concur with Bill and Robert Ross, that insurance is not bought; it has to be sold. Senator, you made a comment regarding the financial services authority and that in England they have now said there is no disclosure on stand-alone risk products. I wonder if you are aware they have had disclosure since 1995, when they had their regime modified at that particular time. So one could be forgiven for thinking that in those six or seven years there has not been enough risk insurance sold, because the quantum has reduced and it has put a social security burden on their government—but it has been in force since 1995.

The second point I would like to make is that, while we talk about uniformity—and IFSA mentioned the life offices' stance that they want uniformity over all products—in the act we do not have uniformity over all products. If you take an investment contract, you disclose the commission, which we agree with, and you disclose the life office margin to the consumer. On a risk contract it is only the poor old adviser disclosing. The quantum you mentioned will come down. It will make a saving to the consumer if the life office reduces the premiums, but one would be also forgiven for thinking they will not be reduced and any shareholder profits will remain with the big end of town. It is a big concern, but it is not uniformity: you have it on investment but you do not have it on risk.

The second issue, which you talked about in the previous meeting, is the banks. Certain banks around the place are now converting their people to salaried advisers. That is not a problem but they have their own badged products in the banks—their own insurance licence—so their distribution costs are built in but are not disclosed. It is a similar issue. I would like to bring that to the attention of the committee.

Mr Veivers—I would like to reiterate what Darryl has said. It is simply this: we are not financial planners. We are risk professionals and we just sell products, unlike the financial planners. I did note that the Consumers Association came in 27 days late, after they had had a look at everybody's submission. It is quite interesting. But the majority of that submission is all over the place with the joint submission. I am not sure whether they know the difference between risk specialists and financial planners. There is a big difference. I would like to inform the financial planning side that, on behalf of all of us who are in the industry—and around this table we have some 254 years of experience—financial planners at this point are not writing, in the main, any risk. I am a bit perplexed about that but, generally speaking, if they are in the business of writing it they are doing it under a different banner and they are not disclosing in the main.

I am really disappointed that those bodies that had so much to put in gave so little. As far as we are concerned, it would seem that taking commission is a bad thing. We sell commodities—insurance—just like, for instance, some people sell fridges and white goods, and fruiterers sell fruit and they do not disclose. We are talking about having a level playing field. If we were to disclose I suspect that everyone should be disclosing as well. If we are here for small business, which we are, it is only fair that we all get treated equally. I am a bit disappointed that, as small business people who employ quite a few people, who represent a lot of our clients from the big end of town—who, I may add, are not prepared at this point to be forthcoming in paying claims—this time around is probably the toughest time I have experienced in 32 years. If the Consumers Association are for real and are concerned about the consumer then they ought to be with us, trying to sort out the big end of town as to why they are reneging on a lot of things on which once upon a time they paid up.

In taking that one step further, with regard to disclosure of commission—and we know what it is going to happen: the big end of town have ulterior motives but they are not sharing it with you—if they bring it down to a level playing field by having a level commission, as Robert Ross explained previously, you will diminish the income streams that we get. You will not have young people coming into the business. Our average age at the moment is 53. We are seeking out young people to keep this industry alive. I have a 28-year-old who is really keen and excited about the business, and it is great for the business to have such a fire, but there are few of us around the place that have somebody of that ilk.

On the commission disclosure, the big end of town will start to manipulate things down and you will find that if it gets too tough it is just simple maths; you will find something else to do. As I have said at previous meetings, I think it is sad that those persons out there called consumers who need as much support as possible are getting ill-directed information from their so-called supporters. I feel that commission disclosure across the board has the potential of being invasive to us. It serves no benefit to the client, the industry, the economy or the nation.

CHAIRMAN—We will have a short interruption as the senators attend a division.

Proceedings suspended from 6.50 p.m. to 6.59 p.m.

CHAIRMAN—I call the committee to order. I think Dr Dixon was about to make a contribution.

Dr Dixon—I have been a multi-agent and risk specialist since about 1974 and I have no desire to be a financial planner or involved in the investment side of things. As far as I am concerned, it is a totally different business from the insurance business that I have been running for many years. In today's world, with the complexities, the regulatory side of things and the professional indemnity side of things, I think personally that it is very dangerous to mix a highly specialised business, like providing life insurance coverage and income protection coverage, with investment and savings matters. They are two totally different things, and both are becoming much more complex all the time.

On the insurance side, as other witnesses have mentioned, if something goes wrong the adviser is likely to be sued. At the moment there is a bit of a trend to try to encourage people who have been investment-only advisers for many years to start dabbling in risk insurance. I think that is very dangerous. I think that there are people who are going to be misadvised as far as their insurance needs are concerned, and insurance misadvice is potentially much more damaging to the consumer than investment misadvice. For example, if somebody dies and the family does not get paid the money that they need to be able to survive and kick on with their lives because of incompetent advice, that is a very serious thing.

The way I see it is that, one way or another, the regulators and the industry have been trying to impose, under one umbrella, vastly different types of businesses. In my business, I have an underwriting department that deals with the insurance companies on a daily basis on underwriting matters and a claims department whose job it is to take care of the customer, see them through the claims process and continue to provide that service on an ongoing basis. The cost of putting business on the books in the first place is very high. My business specialises in unusual health risks—people who have trouble getting cover of one sort or another—and we have in the past accepted the fact that something like 50 per cent of all the proposals that we submit to insurance companies ultimately will not be accepted, for which of course we get paid nothing, but we have structured our business accordingly. The only way that we can continue to provide that service with the current type of remuneration structure, which at the moment is that in effect we get paid $10 in the first year and 50c or thereabouts ongoing in subsequent years, is to have an up-front loading that basically covers the cost of putting the business on the books.

Last week I attended a conference in Melbourne of some of my peers, risk specialists, under the auspices of one of the major insurance companies that we all place business with. We have all been multi-agents; in other words, we deal with a whole lot of different companies in the field. The purpose of the meeting was that the insurance company was interested to know how we were going to handle and cope with risk commission disclosure. In the focus groups that we had down there, the general consensus was that that $10 up front, 50c ongoing model would change to something like $2.50 up front and $2.50 ongoing. In some ways that is a positive thing, in terms of adding to the capital value of our business over time, but the negative part of it is that any new business that we place on the books is a losing proposition. That means that somebody has to put up capital to enable existing companies to make that transition. We were very interested to hear what the insurance company, which is owned by the banks, had to say about that. Quite frankly, their attitude was: 'Tough luck, guys. Anyone who doesn't have the

capital or can't raise the capital—can't mortgage their home or whatever—I guess is just going to have to drop out of the business.'

CHAIRMAN—Is that also potentially a barrier to entry for new entrants?

Dr Dixon—That is the other thing. Greg was saying his son would like to come into the business. His son might be able to come into the business because Greg has been in business for a long time and maybe if he is an absolutely top adviser one of the insurance companies, to retain his business, will fund him. That could well apply to probably the top 20 per cent of advisory firms. But the rest of them will be thrown to the dogs and at least half of those will go out of business. So there will be a lot of attrition in a lot of small businesses. They will be wiped out with commission disclosure.

As far as bringing new people into the business, it is changing from the situation when we all came into the business where one of the things that attracted us was using our interpersonal skills—our ability to be able to relate to people and create a relationship in an area which most people did not want to talk about: death, dying, illness and sickness and all that sort of thing. It requires a special kind of interpersonal skill to be able to deal with that. Essentially, among us, that is an important skill that we have. One of the attractions also was that, as young men coming into this industry, we did not require large amounts of capital. With that $10 and 50c model that I was describing, with the up-front payment, effectively the insurance companies were financing your entry into the business. Under the new regime—the new situation that will evolve very quickly once commission disclosure comes in—the insurance companies will no longer be providing the capital for young people to come into the industry. Where are they going to get it from? They are not. Unless they are connected family wise, or they have family assets, nobody is going to fund them into the specialist risk insurance business, so they will go into some other area.

Essentially, two things evolve from that. One is that a lot of the body of knowledge—as Greg was saying earlier, just among us here there is 250 years of experience in our industry—will be lost very quickly and it will not be replaced by new entrants into the industry. Quite frankly, that is not for the benefit of the consumer. There is another aspect which in my opinion is detrimental to the consumer. Back in the early seventies, all life insurance was distributed by what they called tied agents. They were the people—the AMP guy, the National Mutual guy et cetera—who in their contracts were not allowed to deal in the products of other companies. So for somebody buying an AMP policy, that was it—there was no alternative. The person who was looking after them, the tied agent, was not allowed to discuss other kinds of improvements that might be happening in the marketplace, and the marketplace did not change much under that regime. When the Trade Practices Act came in in the early seventies, that was all changed and a new breed of adviser came up called a multi-agent, of which I was one of the first.

We were, in effect, the ones who started moving the industry forward in terms of providing choice to the consumer and developing the marketplace. So a consumer used to buy an AMP policy and be locked into it forever because nobody was going to come along and offer him anything else. Now we have a situation where, for example, the long-term trend for increasing life expectancy has translated into a long-term trend of falling price in the cost of life insurance. Under the old system, first of all, life insurance companies did not pass that on to the existing policyholders. Secondly, the AMP agent who sold the policy in the first place would not go back to his customer and say, 'Hey, listen, National Mutual just dropped their rates 10 per cent.'

Obviously he was not in a position to do that. Then multi-agents came into the picture. In our practice, for example, we saw life insurance as a commodity; it is completely price driven. If we saw premiums that were 20 per cent lower because another company had come into the marketplace and lowered their premiums, we would inform our client of that and the client could then decide whether he wanted to take advantage of that value added situation as far as he was concerned. That is the way it has been in the marketplace.

Gradually, more and more multi-agents and brokers have come onto the scene. The marketplace has become much more competitive. The consumer has up to the minute advice from informed advisers and has every opportunity to get the best value in the marketplace at any particular time. I feel that where we are heading with commission disclosure, where we come down to that model of $2.50 every year, is that we are going back to those days where the large institutions had a stranglehold on the marketplace. The customer will be locked into a situation where he is not going to be able to take advantage of better value in a rapidly evolving market. The market is now going to settle right down. There will be half a dozen big players. There will not be collusion as such, but there will be very little change in marketplaces, and consumers will no longer have the choice they had previously. I think that is a very detrimental part of what commission disclosure is going to create.

Mr Murphy—Mr Chairman, I would like to go to your opening remark, when the previous witnesses were sitting up here, that the UK has made this decision after five years of going the other way. I think it would be a very sad thing for the government here to go down that track and, five years later, want to reverse the decision again, when they have a fundamentally well operating environment now. The whole of this legislation has been driven by the financial services industry. It has had a big focus on financial planning. It was proven in consumer surveys—that is in the surveys that were done—that most of the work that was judged, however poorly or well, focused on financial planning. There was not a large element of life insurance within those financial plans that did not come up too well. So I think it would be a retrograde step for the government to now take a position that the UK has found has not worked.

Secondly, I find it very disappointing—and I must vent this—that we sit here as self-employed advisers at our expense and speak to empty chairs. We find that quite offensive. At the break a number of people said, ‘Who are we speaking to?’ We do these submissions in our own time, we represent in our own time, we come up here at our own expense and, quite sadly, we do not have a lot of people listen to us. Sure, they read reports, but how well do they read them? Do they get the empathy of what we are saying? It is disappointing. However, we come back again.

I would like to add that this whole bill has been driven by the financial planning industry, which does not seem to include risk insurance. The policy statement we have seen come out from ASIC—62 pages, I believe—does not mention life or disability insurance on one of those pages. Where are we going? That is really what I would like to ask.

Let us look at the Financial Services Reform Act itself, and this is apart from commission disclosure. Most people in our industry have relied on the life insurance companies for information and fund managers are now owned by banks. They do not understand the information they are disseminating to their advisers. Not many advisers working in the industry know or have been told by these dealers that from March next year they will be employees of dealer groups and will have lost all access to their assets. What I am saying is that there has

been subterfuge and deceit and a lot of other things in the whole communication of this bill from what I believe are the people who have influence in this industry. The advisers have been left out in the cold. We are virulent about it and we want something done, and we thank you for supporting us, but we need more government support. That is all I have to say.

Mr Menkens—We have talked about being more prescriptive. We are seeing now that those same institutions are trying to make those advisers who are aligned with them far more aligned to them. In other words, there are the inducements that are not being mentioned and that you would not have to disclose. I give the example of the value of your business. They have a thing called ‘buyer of last resort’. In other words, the institution says, ‘When you finally retire, we will buy your business.’ The value of that business is dependent upon how much of their product you write; that is one of the criteria. The industry evolved from people being tied agents to people having flexibility, whether through central sourcing or multi-agents et cetera. Say we move back into a tied or aligned situation that is going to come, one way or the other, through the transition that is occurring now where the majority of advisers will be under some form of constraint to sell the product of their particular institution-owned dealer group. If, as Michael said, it is true that those people who are not corporate advisers or do not have a corporate agency become employees of those same dealer groups, can you imagine how prescriptive that could be?

I am talking about life insurance here, because the investment product market will not turn back the clock in being prescriptive and only being able to sell or recommend one institution’s investment product—but on the risk side of things that will become very much the case. If, under the new rules, I, the adviser, have to take to task the product manufacturer because he is going to deny a claim by one of my clients—even though they talk about a Chinese wall between the product manufacturer and the dealer, where the dealer owns them—can you imagine him funding the dealer to assist my client to fight the manufacturer to get a claim? We have problems with this whole thing.

Take the wonderful institution called the FPA. I would like them to disclose how much they receive in sponsorship and grants from those same institutions to push the barrow that they want to have pushed. I have a concern about the big end of town, the big institutions, getting undue influence in this whole debate so that we will come up with a result that will not be for the good of the clients—and that is what we should all be focusing on. I know everyone has said it will help them make informed decisions, but I know there are generally only four things that my clients ever look at when making a decision about a risk product. I have put these in our submission. The first thing they look at is the ability of the company to pay the claim when the time comes; they do not want to be involved with a HIH. The second thing they look at is the attitude to claims of that same institution; they want to deal with the claims department, not the legal department, at claim time. Then they look at the contract. Some product may have bells and whistles, so you go through those things and if it is a good contract they are happy. The last thing they look at is price. It is like going and buying a fridge or a block of land. They do not ask what the commission rate is. They just want to be happy and assured that those four things have taken place. As I said, come claim time they rely upon the adviser, the intermediary, to go and assist in sorting it all out.

Mr Yates—I would like to make a couple of short comments on this. Firstly, because I come from Tasmania I probably suffer from some sort of a disadvantage in this situation: most of the activity in this country revolves around Brisbane, Sydney and Melbourne. We would like to

think it went to other places as well. Some people would say, 'There's only 500,000 of you down there, so it doesn't really matter.' We say, there are two million, because we have recently done a head count.

That aside, I would like to bring your attention to a couple of small issues. I joined this industry in 1975, have been through the ropes fairly well and have quite a deal of experience in staff and other issues, as well as all the things that Dr Philip Dixon was talking about—managing claims and being an underwriter. I have a proper authority and am also a life broker. We deal with people's woes, sad tales and everything else every day of the week—all the time. That is part of the business and part of the undertaking that you give in this business.

I really fear for the future of the industry as a whole in the sense that, whilst there is this constant drive—mainly perpetrated by the major life offices—to drive down commissions to a level playing field or to level commissions, it takes away from the rest of Australia. It takes everything away from country Australia. Country Australia, in terms of the life risk business and the advisers in these large country towns around Australia, is bleeding like you would not believe. Towns like Shepparton, Wodonga and smaller towns all around the country, used to have good, well-qualified advisers serving the farmers and the people. Because of the way the industry has turned and because they are trying to drive down commissions by the life offices, there are less and less people giving less and less service throughout Australia—a quarter of what there was.

It is a sad thing that in many instances there is going to be a generation of young people coming through totally uninsured or not even understanding anything about it at all. I think we should take some kind of responsibility for the situation that we are getting into, which is perpetrated mainly by the greed and push and shove that is going on in this industry. It should be aligned more closely with the needs and wants of real people all around this country—not the way it is going right now.

I will not go on any more, except to say that I noticed that one gentleman made a comment about how he came across somebody who was paying $46 per month and how he could have fixed it up for them for $19 per month under superannuation. I do not know whether he has heard of the SI(S) Act or early release and all the benefits that would perhaps not flow on to that person if you examined all those things quite closely. I am sure that Tony Negline probably picked up on it—and he knows enough about the business. It just goes to show that long-term experience in the risk business, understanding of group and corporate superannuation and all these other things are not learnt in five minutes—not at all. We are about looking after the people who we around this table have looked after in some cases for two and three generations. Thank you.

Mr Brown—I would like to take up a few points that were made by the FPA. The first thing I will reiterate is that, if they are selling risk, the life officers do not know about it, because, when I ask them whether their financial planning members sell risk, they say, 'very little'. The second thing is that it is a very common practice with members of the FPA to sell risk on a level commission basis—that was referred to here before with the $10 and the $2.50. But every disclosure I have seen from a financial planner did not say to the client that the 25 per cent level commission was not only paid in the first year but for every year of the life of that policy. You do not have to be a mathematical genius to work out in the long term you are ahead.

This brings me to the next point: I believe that level commissions, which some life officers would like to introduce—and which may well be introduced—are anticonsumer. It is anticonsumer because the adviser sits there and says to himself, 'I've got to keep this business on the books for five or six years to make up what I would have got under the other arrangement.' Those people are disinclined to review. They are disinclined to look at alternatives. It is anticonsumer; it cannot be anything but anticonsumer.

Someone said before that, under the agent and brokers act, brokers are required to disclose commission if asked. You do not have to do it; if you are asked, you are required to do it. No-one yet has defined for us what they mean by 'influence'. The AFA has consistently asked Treasury and ASIC to please tell us what they mean by 'influence'. They cannot tell us.

But I have something here that I thought I would quote from. It is two years old. You may recall that in 1999 ASIC entered into an enforceable undertaking with Westpac. That was done because Westpac's advisers and the staff organising their interviews were saying to potential customers, 'We only have salaried advisers; our advisers do not take commissions.' Someone did a review and it was suddenly discovered that that was not the case. But the whole inference gained from the staff and the advisers was that they were different because they did not take commission, because they were not working for reward—and that was not the case.

This advisory services guide came out after that undertaking. It has been slightly revised, but the essence of it is still there. Under the heading 'Other benefits', it states that 'advisers may receive other benefits each time a customer purchases a product that they have recommended; the cost of these other benefits is paid out of the amount Westpac receives'—and, by the way, that is 100 per cent of the premium. It then refers to 'payment for professional membership fees'—there is the FPA—and 'merchandise incentive points'. As far as I know, banks do not sell anything other than financial products, and so I have no idea what that means. Would someone please explain to me how that can be quantified in any meaningful disclosure? It then refers to 'Conference qualification' and states that 'high performing financial advisers and planners can attend conferences'. What is 'high performing'? Is it someone selling 10, 20, 30 or 40 policies? I do not know. It refers to a 'career service bonus' and states that it is 'based on the financial planner's total sales over his or her career with Westpac'. What does that mean? When do you reach the scale? Is it a scaled system? We do not know. How on earth can that be disclosed in a meaningful way? It is not.

I look at this document as an insider in this industry and I know that they are telling porkies. They are not disclosing it to the consumer—and I understand that this was consumer tested; ASIC insisted that it was consumer tested. As I think Senator Brandis alluded to before, people need to know. But it is the old story: you need to know enough to ask the right questions, and clearly in this case not enough was known. Then there is superannuation. I am sure that Robin would have mentioned before that these employees get paid superannuation and are given car allowances and everything else. We are at a distinct disadvantage when we are competing with these people because they are not up-front.

In my opening statement I said that a distracted or confused person considering the purchase of a life insurance risk product will take the easy option: they will not do anything. Senator Brandis alluded to one other thing I want to raise—and, in case he did not, I will allude to it for him: the issue of full and meaningful disclosure. After 2004, if you do not hold your own licence, as mentioned by Michael before, we will all be employees. Everyone who works for a

dealer/life broker/licensee, whatever you want to call them, after 2004 is going to lose between 15 and 25 per cent of their commission. It will be sucked out of the commission as it comes through from the life office to the licensee. It does not go to the dealer's representative; it goes to the licensee. The licensee owns the client, and no-one denies that. The licensee has the contract with the life office. The 100 per cent commission that people were rattling on about before disappears into the hands of the licensee. They then go, 'Thank you very much, I will have 25 per cent of that,' and they send the AD off. But he is nowhere in anyone's plans. I have not heard the FPA, who are an organisation frankly in my view representing dealers and fund managers say anything about that. Why aren't those people required to disclose that of that commission 25 per cent is in the hands of the licensee? That is not mentioned; there is not one word of it. I think I have taken up enough time, thank you.

Mr Mitchell—I have talked to a lot of people and I have not found anybody who thinks that commission disclosure on risk will help the consumer. I am quite happy with people disclosing commission. I think, if people or the association want to do that, that is fine. But I do not think the industry should have it forced on them.

The fact is that there is less and less life assurance being sold. It may interest you to know that none of the rugby union players from Forbes who were killed in the Bali bombings had life assurance, and they were family people. As John Hanks from NIBAA said earlier, insurance is undersold at the moment in Australia; it is not oversold. I think this idea of commission disclosure on risk will cut down further on the amount of insurance that is sold, and I do not think that is good for Australia.

I also want to make the point that most people you talk to think that commission disclosure on life assurance and risk will lead to level commissions. It depends on how long the insurance is in force for but, as Bill has already said, if that happens, it might not be in the client's interest because it will probably force the cost of life insurance up.

Mr Brown—I have one other point to make. Louise Sylvan on the *Four Corners* program where financial planners did not come up looking too flash—especially those from the big end of town, I might add—made a comment at the end of that program. She said—I hope I am quoting her correctly—that disclosure is one issue; the real issue is ownership. I assume that she was referring to the ownership of distribution.

We have sat here now for two, three or four years since Wallis dropped this report on us and we have watched life offices buying up distribution. The old tied agency force are still there; they are just called something else. They are usually called AMP financial planners or something like that, but they are still here. There is one company, which I will not name, which has a deliberate policy of going around this country, buying up small- to medium-sized dealerships. They take them to a 51 per cent ownership, but they own distribution. Nowhere is there going to be disclosure that a brokerage that has representatives scattered all around Australia—and I hope I am not insulting anybody—is 51 per cent owned by a life office. If we are going to have disclosure, let us have fair dinkum disclosure.

Mr Ross—In making what I suspect is a genuine attempt to give consumers information that will help them to make a decision, you run the risk of throwing the baby out with the bathwater. You can see something is wrong but you do not quite know what the solution is, and so you come up with a lot of solutions.

Take a look at some of the banks. For example, the Commonwealth Bank for a lot of years had a life insurance company but it was not really in the life insurance business. So how did that bank get into the life insurance business? With billion dollars of profit they bought Colonial—$10 billion, I understand it was. But Colonial had already purchased Prudential and Prudential had already purchased Aetna. Colonial had also purchased Legal and General and had purchased Scottish Amicable. In one fell swoop, because it has a lot of money, Commonwealth Bank was able to take out of the market 10 or 12 insurance companies at one hit.

I have an office in Toowoomba and I go with my adviser out to Roma. As you go through villages on the way to Roma, you can see places that used to have a bank but that do not have a bank now; they are not going to have an insurance adviser either. Do you think the Commonwealth Bank is going to send an adviser out to Roma to see a guy who wants an income protection policy or a claim handled? It is not going to do that. With a great deal of thought, I quoted in my submission a comment from the Bible. That is, there arose in Egypt a pharo who did not know Joseph. Of course, you would have to read the story of Joseph and the fat cattle and the thin cattle and the fat years of wheat and the thin years of wheat to understand what he did for the Egyptians. But a new guy comes along and he does not know all of that, and I think that is what is happening today.

I have a lot of admiration for the Consumers Association and I read the magazine—although I do not quite know why they seem to know what is best about everything! And I am quite amazed but I have to congratulate Catherine, because I look in the mirror and see my age and I look across at Catherine and try to estimate her age, and she is the senior policy officer. It took me bloody ages to become the senior anything in my life. I was well into my forties before I became the senior manager of a huge financial conglomerate in the United Kingdom. So, congratulations, Catherine—it must be your ability, or your looks, that has got you to such a fine position.

I respect some of the work that the Consumers Association does, but I also get disturbed if I feel that it is dishonest. In this case, I have to say there is a lack of experience. I have had a lot to do with Peter Kell; we have had a lot of discussions together. I think these people do not go out into the country, they do not see what is happening to the country, but they criticise when they see that country customers cannot get banking services. How are they going to get life insurance services? There are big conglomerates—such as National Australia Bank; they have bought MLC—and if you go through them you will see that one bank after another, with huge amounts of money, are able to take the smaller players. Colonial was not a small player, but a bank can take them right off the planet because they have so much profit. Of course, it is in the interest of the shareholder that the bank does that. Earlier this evening Catherine said that, if commission cannot be justified, perhaps it is better that the consumers go to salaried people. Those salaried people will be the bank's salaried people, and once the bank's salaried people have the market you will not be able to get insurance advice.

Another thing I note is that a lot of associations seem to quote that they are non-profit associations. I notice that in superannuation a lot of funds say they are non-profit associations. I have dealt with so many claims from people who are members of industry funds because they have not got somebody to speak to. Sunsuper is a big fund in Queensland. We give advice to employers as to how to get their employees to select the best level of cover if they want to use the Sunsuper scheme. We do not get paid commission from Sunsuper—we do not even charge a fee to the employer because the employer is already dissatisfied with having to put nine per cent

into super. We had a person who had a total and permanent disability claim with Sunsuper denied. Nobody went to see him. It took us about a year and a half to get the insurance company to acknowledge and pay the claim, and we did not even get paid for that. We did not ask for pay. The guy was a client of ours in some other area.

My fear is that commission disclosure has become an ideological thing. It has nothing to do with what is in the best interests of consumers. It does not take into account what happens to Australian families, to widows and kids if dad dies or becomes disabled. Noel Whitakker, in his book *More Money Made Simple*, said that if you take 100 15-year-olds and put the clock forward 50 years, 38 of them will be dead. They do not all die when they are 15, 16 or 17—they just die throughout the 50 years and they very often leave widows and children.

Most industry funds do not give advice on the level of cover. There will be some sort of token amount, some clause that says, 'If you are a member, you will get X number of dollars of insurance,' but it is usually insufficient. So commission agents do a huge job. But we are not a not-for-profit organisation. It as if there were some criticism of profit, as if it were a dirty word, when, without profit, the $180 billion that this federal government needs for revenue could not exist. The non-profit organisations do not make a contribution to the economy of Australia. We do it in a lot of ways: first, by paying tax on the commission we earn after we have paid our expenses and, second, by making sure that our clients are not a drain on the community. I made a comment earlier and now I am going to withdraw it unreservedly because I now feel I may have offended Catherine. I am sorry for the comment I made, Catherine.

Mr HUNT—The purpose of the legislation is to balance the protection of consumers with a reasonable impost on business. There is a very strong argument here about the impost on business. What particularly interests me, though, is that, as I see it, three arguments have been put forward. They say that it not only imposes an unreasonable impost on the advisers but also works negatively on consumers. I want to test the three arguments that I have drawn from the collective presentation to see if my understanding is accurate and if anything is missing.

The first argument is that at the point of giving advice to and negotiating with possible clients there is likely to be a loss of independence. This point was made by Mr Menkens. The reason is that there will be greater pressure for tied product sales, given that a number of the independent advisers will be forced out under what you claim will be the new financing structures. So the effect of that will be a move towards either more salaried advisers or people who are directly linked to major corporations.

The second argument, as I understand it, is that on an ongoing basis, after the initial acquisition of the client, there will be a loss of incentive to effectively review and manage the protection of the client. The reason is that the bulk of the income for the adviser will come in the tail rather than up front. That was the argument presented by Mr Brown.

The third argument, which we have just heard from Mr Ross—and I want to see if my understanding is correct—is that significant sections of the consumer population will be denied access to face-to-face advisers. This will be most notably in country areas where there will be neither independent small firms nor independent sole advisers and, because of the links to banks and major finance corporations, nor will there be access to advice in that area because of the retreat of the banks from certain country areas.

Mr Brown—I will add to that, Mr Hunt. Bank advisers are forbidden to act in claims. They are not allowed to get involved in a claim. I just want to clarify something else. I have been reading about my friends at Westpac and the limited range of advice they can give. Westpac says, ‘Our financial advisers can only recommend Westpac products.’ These are the people who sell life insurance under the Westpac banner.

Mr HUNT—That is very interesting. Are there any consumer protection arguments, over and above the three that I mentioned, which you wish to advance?

Mr Yates—I would like to make a comment on the issue that Bill Brown has brought up about the differentiation between a bank product and a qualified adviser who is a life insurance broker. In discussing a product with a person, we would normally go through the whole needs analysis and discuss all those things with them. In so doing we would then put together a portfolio of eight or 10 different companies that we deal with. We might look at a comparator which is drawn up by industry and at other issues and go through them. Finally, given that person’s occupation, attitude, what they require and a raft of those issues, we would come up with a recommendation. With Westpac—and I know this is true—on threat of instant dismissal, the advisers are never allowed to discuss any product but the Westpac product. They receive no servicing commission to go on and see the client the next year and the next year. They get no incentive and no servicing commission. They are actively encouraged not to go back and see the person again once they are sold, but rather to find new people next year to go on with. If the other people drop off, that is bad luck. The view is that 1 January next year is a new year and that they should keep on going.

Their disclosure process revolves around the fact that they get 35 per cent commission and many of the soft options, like a company car, a free telephone and a free office, and other issues are often clouded over, moved aside and lost. How do I know all this? My brother works for them, and I know very well what my brother does. He knows and he tells me. That is the way it is. We look after a generation of clients on an ongoing basis, which is our brief because it is our promise to pay when there is a claim—that is part of our brief. That is the difference between employees being able to offer, regardless, one size fits all and that is it. Now, if anyone believes that at all then, as Tom Collins says, they believe in fairies at the bottom of the garden.

CHAIRMAN—We are going to have to wrap this up fairly soon if we are going to get this finished at a reasonable hour tonight, because we still have to hear from ASIC and then have all of you coming back for your final responses. Can you please keep your comments fairly succinct?

Mr Enever—To answer Mr Hunt’s question—although I am putting a question—where is the benefit to the consumer in knowing what the commission is on a risk product when that commission has no bearing on the end result of a claim payout? Why would the consumer want to know that when it has nothing to do with the end result?

CHAIRMAN—The argument is whether the level of commission affects the advice as to which product to take—whether there is bias inherent in variations in commission.

Mr Enever—Listening tonight I have come to the understanding that there is quite a big range of commissions, especially in the life insurance and the financial planning side of things. My aspect from general insurance is that commission is static: household is 20 per cent and

motor vehicle is 10 per cent if you are lucky. It is governed by the insurance companies; it is non-negotiable. We cannot increase the commission. We cannot say, ‘We’ll whack a bit more onto the client.’ It is a commission that is set by the insurance company. In the fire and general side of things, we have no control over the amount of commission other than what the percentage of the premium is.

Mr George—From a consumer’s viewpoint, we believe that there certainly would be a negative with full commission disclosure in the area of fire and general insurance. We can see that the full disclosure of our 14 per cent average brokerage that we receive on the turnover of our premium pool, of which some 60 to 70 per cent is in back office costs, would serve no purpose to the consumer. Of our 18 branches, 12 are in regional and rural areas through out Australia. You only need to knock off, in that 14 per cent, maybe one per cent and those offices may become those unviable and we will have to look at withdrawing our services from those areas.

Mr Foster—Senator Chapman, you made the comment earlier about the FSA in England, where one of the reasons they now have no disclosure on risk products in the future is the complexities. Robin Yates just brought up a good complexity where one organisation discloses the net, yet we as professional advisers have to disclose the gross. How do you combat that complexity?

Mr Morgan—I will help Mr Hunt with his thinking—and once again with Mr George, that the general industry does exist. Currently the large brokers in our industry—and I am not knocking them for taking advantage—are buying up the small brokers and the agents. The reason is that this legislation is becoming far too complex for a lot of older people and the result is that there are going to be fewer people to help people in country areas. I will name one: OAMPS, which is quite a well-known company. Every time you pick up the papers they have just bought someone else. Obviously, like the banks, they will rationalise. If they buy five brokerages or agencies in a country area that will be down to one very quickly and the smaller business further away is just not going to get service. So I ask the consumers: who is going to advise and assist the elderly or other people in the remote areas? Are they going to be forced to go on the Net? Are we going to have pensioners trained to use the Net who have no clue about it now? The effects are happening now. There are businesses being taken over because it is just not going to be viable and I think the consumer will be the long-term loser under this legislation.

Mr Murphy—Mr Hunt, in response to you—I made some notes earlier and, because of the way the forum has gone, have not been able to express them—if there is an exit from the industry, and Dr Dixon says there could be if there is a change in the structure of the remuneration and trying to capitalise a business, I think what will happen is there will be a vacuum for middle Australia. Middle Australia are intimidated by the financial planner brand, as they think it is above them. They are fed up with the banks and their lack of service. They do not relate to stockbrokers. Not many of them have accountants. And they do not receive face-to-face contact with industry fund people, as we have found from the earlier submission from the gentleman from the FPA. If all advisers are employees—as they could be under this act—I do not think they are going to go and do the hard yards and provide the catalyst to expose the need and offer the solution when it comes to insurance. We believe in financial advice for all Australians not just those who can afford it. This may be perception but is in fact reality. We represent a client-focussed association, skilled in underwriting and claims management, and that

will disappear off the face of the Earth if you persist with this idea of commission disclosure up-front.

CHAIRMAN—Thank you for your contribution to the roundtable. It has been very valuable from our perspective. We look forward to the wrap-up towards the end of the evening, after we have heard from ASIC.

[7.53 p.m.]

ADAMS, Mr Mark, Director, Regulatory Policy, Australian Securities and Investments Commission

JOHNSTON, Mr Ian, Executive Director, Financial Services Regulation, Australian Securities and Investments Commission

McALISTER, Ms Pamela, Director, Legal and Technical Operations, Financial Services Regulation, Australian Securities and Investments Commission

MAHER, Mr Dave, Analyst, Consumer Protection Unit, Financial System Division, Department of the Treasury

RAY, Mr Nigel, General Manager, Financial System Division, Department of the Treasury

ROSSER, Mr Mike, Manager, Consumer Protection Unit, Financial System Division, Department of the Treasury

CHAIRMAN—Welcome. I will start by asking both ASIC representatives and Treasury representatives for their reaction to the decision by the Financial Services Authority in the United Kingdom, after some years of having commission disclosure on risk products, to reverse that decision and move to a situation of nondisclosure.

Mr Johnston—Our understanding is that it is not a decision at this stage. They have a consultation paper out and they have asked for comments and have put forward some positions in their consultation paper in the same way that ASIC does with its proposals. It is my understanding that they have yet to make a determination as to which way they will go but their proposal is as stated in the paper. I do want to make some opening comments, and I think that Mr Ray may also want to do so.

CHAIRMAN—Yes, you may.

Mr Johnston—It might be best if Treasury precedes ASIC—as is the proper way of things!

Mr Ray—I am conscious that we did not make a submission to this inquiry. In large part, it was because this issue has been around for about 10 years and since the Trade Practices Commission, the Senate select committee and the ALRC reported on it back in the early 1990s we thought that the government's position was quite clear. The Financial Services Reform Act commenced on 11 March last year, as you know, and we are about halfway through the transitional period. It introduced a harmonised regime for the licensing and conduct of providers of financial services and disclosure in relation to financial services and products. It replaced a patchwork of industry based regulations that applied previously, where essentially similar financial products were offered and regulated differently depending on the nature of the provider. The legislation—as you know, Senator, better than most—was subject to lengthy and wide-ranging public consultation and it has been reviewed by this committee on three occasions, I think.

The issues that have been canvassed in the submissions to the committee from various parties opposing commission disclosure were raised very early in the development of the then CLERP 6 proposals and through the passage of the FSR legislation itself. The issues are well understood by the government and the government has considered very carefully the issues that have been raised directly with it and through submissions to the PJC on previous occasions. Indeed, as a result of those submissions, the government amended the legislation in a number of ways as it went through the Senate. That position is reflected in the current law.

In terms of disclosure of commissions on risk products, I think it is worth emphasising that disclosure of commissions and other benefits is a key component of the regime, especially where consumers are being provided with advice recommending that they acquire a particular product or they undertake a particular financial strategy. The disclosure requirements in the act recognise that if consumers are to rely on such advice it is appropriate that they be aware of any potential bias or influence on the advice provided to them. The government is not of the view that it is necessarily a bias; the question is whether there is any potential for bias. The disclosure requirements aim to provide consumers with information which is relevant to, and of potential value in, reaching a decision on the nature of that advice.

Disclosure in the act occurs at three stages. I think you are all familiar with the financial services guide, the statement of advice and the PDS. The two stages that I want to dwell on for a moment are the PDS stage, that is, at the point of sale, and the statement of advice stage, that is, at the point when advice is given. The purposes of disclosure at those two stages are different. At the point of sale stage—in the product disclosure statement—the legislation recognises that what is important is the cost to the consumer of the product being acquired. Therefore, only commissions that affect the cost or lower the return need to be disclosed at that stage. However, at the advice stage, when the statement of advice is given, disclosure is directed at informing the client of any potential conflicts of interest or influences that may impact on the advice they are receiving, advice that should be tailored to their specific circumstances. The government's view is that the amount of commission paid to the adviser, to the extent that it could reasonably be expected to be capable of influencing the advice provided, is a relevant factor that the consumer should be made aware of.

Unlike disclosure at the point of sale, therefore, where advice or recommendations are provided, it is irrelevant whether the payment of commission will affect the cost of the product or the return to the investor. What is important is whether there is any potential to have influenced the nature of the advice. I think I will leave it there as a statement of the policy.

Mr Johnston—I have a couple of brief comments. Much of the evidence presented over the past hour or so seems to be around the fact that levels of commission are expected to drop for advisers as a result of disclosure of commission. There is also evidence about perhaps a different pattern of distribution in the industry—for example, we heard that the average age of advisers is increasing—and there may well be rationalisation and so a different pattern of distribution. That seemed to take up much of the argument and the evidence that was given.

It is not something that you would expect ASIC as a regulator to have a view on. Those things might well be important and those things might well happen, and they are all relevant things for policy makers to take into account in formulating government policy, but I do not really think they are things on which the regulator should opine or that you would expect us to opine on. We would be more concerned about what the impact is on consumers and how the law will actually

work. It is our job to uphold the law; it is our job to apply it. So we are happy to take any questions on that but perhaps we should not offer any opinion on the other issues.

CHAIRMAN—In that context, what if the changing pattern of distribution fostered by the commission disclosure is detrimental to consumers and their interests, as has been argued by the some of the representatives tonight—in the sense that they will not get the level of service that was previously provided and they will not have someone arguing their case before the insurance company when they have a claim.

Mr Johnston—I am not sure that I accept the premise. Regarding the disclosure of commissions, which is what this hearing is about, there seems to be an assumption made that consumers will either stop buying the product or drive down the level of commission as a result of the commission being disclosed. I am not sure that it is a meritorious argument to say that, if we disclose to consumers what our commission is, they will stop buying from us. I do not think that is meritorious and I am not sure that it necessarily follows that that would be the case, so I do not accept the premise. I would imagine that the product manufacturers will still want to have a way of distributing their product, so I am not sure that the actual level of sales in the industry would drop either. As to whether it means the same level of service would not be provided, of course we would want consumers to receive an appropriate level of service. I am not sure why it is argued that people would stop buying insurance from me, if I were to disclose my commission. And I am not sure why the commission would necessarily drop as a result of that disclosure. If the premise is not necessarily right, I do not think that service levels would necessarily change.

Senator MURRAY—I do not mind who answers my question or set of questions. Apart from the half hour or so when I was required in the Senate to manage a bill, I have listened to both sets of witnesses with interest. It seems to me that there is an area of concern which probably needs greater exploration than has occurred to date both in our previous report and perhaps sufficiently here. Using the language of an economist, disclosure is almost characterised as a public good. It has a value and worth of itself. As a society and a democracy, in which the issues of transparency, accountability and openness are virtues, disclosure falls into that virtuous package. If you move on from there and you look at one side of the coin, which is the return generated by the industry as it is presently structured and whether those returns will change—and the participants in the profitable returns may alter, diminish or grow—our society says that is a market function and is part of the dynamism and the death or destruction of some participants to the benefit of new participants. But that proposition has to be tested.

What has been put before us by the second set of witnesses is that the market consequences of disclosure may, on balance, provide more detriment than the benefit of the public good. So you are back into a classic cost-benefit argument. What concerns me is if the policy is predicated just on the virtue of the public good and, secondly, predicated on the 'potential', which was the word used, for bias. It seems to me that, surrounding the issue of disclosure of commissions on risk products is an unspoken—and I have not heard it spoken by Treasury in the past or present, or by anybody else—statement that a significant enough group of persons who take commissions will take the highest commissions, regardless of the product which best suits the customer. Because the customer does not know it, they are being fleeced, effectively. That lies behind it, because behind disclosure is the view that, if you did not disclose, people are going to take the highest commission.

There are people like that and there are people who are not like that. The people we have had before us today would say that they certainly would not operate like that. The question is: has that proposition been tested? Perhaps you would know, Mr Johnston, through your operations whether anyone has gone out there and tested what a customer has been sold and what the alternatives were, on a representative sample, and whether a sufficiently large number of people were fleeced. In other words, were they sold the wrong product because it maximised the return to the seller?

CHAIRMAN—In a sense, you are asking, ‘If it ain’t broke, why fix it?’ Is it broke?

Senator MURRAY—No, I want to know, because we have to service the consumers. It is our job, ultimately. Citizens, voters, consumers—that is our job. I want to know if the present system results in the fleecing of consumers and if anyone has been able to find that out for a fact.

Mr Ray—Your question is very large.

Senator MURRAY—Yes, excuse it, but I had to give you the framework. I hope you did not mind that.

Mr Ray—I might start, but Mr Johnston, because of his role as the regulator, is probably better placed to answer the last part of your question. I might go backwards in your question. There is absolutely no assumption on the part of the Treasury or the government that anyone decides to sell a product because it has the highest commission attaching to it. That is not the underlying rationale of this provision.

Senator MURRAY—But you would be certain that a percentage of people would do that. There is a percentage of politicians, gravediggers and Treasury officials who will not do the right thing; the majority will. There must be a percentage who do do it.

Mr Ray—I think it is not question of whether or not that is the right thing. It may well be that, in a given case, the product with the highest commission is the best product for the individual consumer. I think there might well be submissions, at least to an earlier inquiry, that make that very point. I wanted, though, to go back to your earlier point about disclosure as a public good. I am not sure that, as an economist, I can agree. The reason is that, fundamental to the operation of markets is that the market for information works. Technically, in order for an equilibrium to exist, consumers have to make informed decisions. So a more fundamental objective of disclosure is so that the market can work. It is not a question of being public good; it is a question of being a private good as well.

Mr Johnston—With respect to the more specific part of the question, we have done a lot of work across the industry, but I am not just talking about the risk part of the industry. I am going wider than that in looking at the quality of advice that is provided. Yes, there is strong evidence that product pushing takes place where commission is highest. We have recently completed two or three pieces of work that would bear out that as a hypothesis. The shadow shopping exercise that was referred to earlier certainly saw a lot of evidence of that, but I would add the rider that that was not looking so much at the risk market.

But, in regard to the principle of whether or not people will have a tendency to push a product that pays a higher commission rather than one that pays a lower commission, we have done quite a bit of work that indicates that that happens frequently, and we have removed some people from the industry where that has happened. As to how great the incidence is as a percentage of the market, it would be impossible to say.

Senator MURRAY—At the heart of my proposition is the fact that we have to come down to a judgment. It is something we have to do as politicians, and Treasury have to do as policy-makers. If the industry is not clean, then we have to have disclosure. If it is clean, then we debate whether disclosure is anyway a public good and produces the circumstances that lead to more perfect competition, which is based on more information and advice, to use the economists' language. As a committee, we have not been given evidence. We have been given anecdote and personal experience and so on—which has a value and I do not discount the value—and we have the judgment of very capable people from representative associations across the industry, but I have not heard evidence either in the previous inquiries or now that the industry is not clean. That is why I have used the language I have and have tried to assess it on that basis. My bias is to disclosure, not necessarily in every circumstance but because of the character of our democracy and our system. Transparency is a good thing.

Mr Johnston—I would add a couple of comments. We certainly have a lot of evidence that indicates that product pushing takes place when commissions are higher. I have made that point before. One piece of work that we have recently completed was looking at an area that I know is of interest to you, Senator—the tax driven area of securities. We have just completed a major piece of work there where we looked at a number of responsible entities and a large number of advisers and interviewed 300 or so clients. We found a very high incidence there of high-commission products being pushed inappropriately to investors.

CHAIRMAN—Was this in relation to risk products or investment products?

Mr Johnston—That was in the securities market dealing with tax driven product. The risk market is a newer area for us to regulate, frankly, and so we do not have as much experience over time of behaviour in that industry as we do in the securities market.

Senator MURRAY—The point I made somewhat crudely in my remark about politicians, gravediggers and Treasury officials was that I take the view that a percentage of humanity are crooks. It does not matter what profession they are in or what they do, they are going to rip you off. But it is a very small percentage and we know pretty well statistically what it is. It is when you move away from that known or expected small percentage and you get large numbers of people behaving in a way which is contrary to the interests of citizens or consumers that we need to bring people like Mr Johnston and his agency into play to regulate it. That is the issue we are faced with. You are faced with a lack of evidence, Treasury is faced with a lack of evidence, and so are we.

Mr Johnston—When we were talking about disclosure of commissions, the chairman asked whether service levels might drop as a result of it. I would have thought that good service levels are provided by agents and brokers. We have no evidence that good levels of service are not provided by them and I would support the contention that they do a good job. I would have thought, though, that disclosing to the client the commission that they are to receive should be a part of the demonstration of the service that they provide for that reward that they receive. And

because they do a good job I would have thought it would have been much easier for them to justify the commission that is paid to them.

Senator MURRAY—The difficulty you have with that proposition—and I agree with you; I accept that as a proposition—is the argument of those who oppose it who say that the unintended consequence of that will be market failure in areas which matter. If I understood their argument correctly, that means in the service of relatively unsophisticated consumers—looking after, as they described it, middle Australia, and particularly regional Australia, where you do not have the same access to the same people. It is the market area which I am grappling with.

Mr Ray—That assumes that the mere disclosure of the commission means that the consumer will not purchase the product.

Senator MURRAY—Yes, it does. I recognise your query and the implicit criticism, but you heard what they said. I am reflecting back to you that view.

Mr HUNT—To take Senator Murray's questioning a step further: to be fair, I do not think that the allegation is that disclosure of commission will mean that the product is not purchased. As I understood it, all the points which were made said that there would be a change in the nature of commission, which would militate against the smaller and more independent providers because of the capital costs involved with the change in the nature of that provision—that they would have to bear more capital in acquiring customers. In essence, the allegation that they are making is that by changing the disclosure there would be a change from the balance of payment from up-front commission to trailing commission and that that is what would discriminate against independent and smaller advisers.

CHAIRMAN—And also more standardisation of commissions.

Mr HUNT—That is correct.

CHAIRMAN—Driving them down.

Mr HUNT—There should be a significant body of evidence available to test that proposition from the experience in the United Kingdom. This may be one of the reasons why it is being reconsidered in the United Kingdom. What evidence do we have about the allegation made by those who oppose disclosure, that disclosure has led to a change in the nature of commission in the United Kingdom?

Mr Johnston—I do not have evidence of that.

Mr HUNT—Why is it being rethought in the United Kingdom?

Mr Johnston—We need to look at the fact that the United Kingdom is coming from a very different regulatory environment. I would not necessarily say the market environment is much different, but it is a different regulatory environment. They do not have the type of legislation that we have with the Financial Services Reform Act. The FSA are now acquiring this part of the jurisdiction and, if you like, bolting this law onto their existing law. From a regulatory point

of view, they are looking at different considerations. We are at the starting point. The starting point of the Financial Services Reform Act is that we have the same rules going right across the financial services sector. The FSA are coming from a position that is way behind that. Mr Adams might be able to shed more light on that.

Mr Adams—To confirm what Mr Johnston has said, it is my understanding that what is happening in the UK is that the regulation of general insurance and non-investment life products is now coming within the statutory regime of the FSA, where once it was not under a statutory regime. So this paper which is referred to is part of a series of proposal papers that they are putting out about how they are thinking about their approach to this new regime. So it is not a case of reviewing what has already been in place; it is a case of thinking about what to put in place under the statutory regime.

CHAIRMAN—Are you saying that they have never had commission disclosure on risk products?

Mr Adams—I am saying that at present they have codes which provide for conduct. As a matter of statute and underpinning, that is what is being introduced to start from 2004.

Mr Johnston—Our starting point is quite different because we have had presented to us, as the regulator—and, as I say, it is for the policy makers to determine the policy that gives rise to the legislation—one act, the Financial Services Reform Act, that is supposed to have common principles going across the sector. Our operational policy is developed based on that premise: we treat the various sectors equally, with the same law applying to them.

Mr HUNT—If there is no evidence at this stage of the likely impact—which we can draw from other jurisdictions—of an increase in disclosure on the balance of commission, which is the heart of why they say there will be negative public consequences, what is your response to the statement by those opposed to disclosure that it will lead to a change in the balance of commission, which in turn will lead to the other consequences?

Mr Johnston—I think I said before that I am not sure that I accept the premise that the pattern will change all that much. There is just no evidence of that.

CHAIRMAN—Can I draw you out a bit more on the UK situation? They have also had experience in the not too distant past, particularly on the investment side of the industry, of the misselling of endowment policies and so on. And yet it seems they are still—certainly, in their intention—heading towards a non-disclosure regime in that risk area of the industry, despite the fact that in a different sector of the industry there are concerns similar to ours. Could you explore that a bit or comment on that?

Mr Adams—I might make a couple of comments just to expand on what Mr Johnston said earlier; that is, about considering the context of the UK regime—and I do not claim to be entirely an expert on that. However, their legislative regime has a series of other provisions that we do not have as part of our context which include rules against unfair inducements and excessive charges. They are seen as being part of the support on which they balance the question of disclosure. I bring those to the attention of the committee because I think, when looking at what is proposed in the UK, one has to look at the context in which they are working, and it is at least slightly different to the context we are working in.

Senator MURRAY—Are there enforceable sanctions for those rules?

Mr Adams—My understanding of FSA rules is that they have the force of law and can be pursued by third party rights.

Mr Ray—I might make a couple of comments. It is very difficult to take a particular element of another jurisdiction's regulatory framework and ask why it is the way it is without looking at the whole. To summarise our joint answers to Senator Murray's earlier question, ASIC has found evidence that there are issues in the industry, in the broad—not necessarily on risk products, because the experience with risk products is relatively new. I think it is fair to say that there have been some issues with risk products which have become public as well. So there have been some cases, although isolated, I would hope. The broader issue is that there are strong arguments about the way the economy works in favour of disclosure. It is very hard to argue against consumers being informed.

CHAIRMAN—One of the issues that has been raised is the practical utility of disclosure, as required in the financial services guide and the statement of advice, given that the financial services guide only requires the specification of a range of commissions received on the range of products offered by the provider and the statement of advice only requires commission disclosure on the recommended product. In that context, it does not really give comparability of commissions.

Mr Ray—Those are minimum requirements. It would be open to an adviser to provide information on what the commission might have been on comparable products.

CHAIRMAN—It is certainly open to them—but it would be open to them to give advice on commissions even if they were not any regulatory requirement.

Mr Ray—Correct. It is a minimum requirement—that is what we are saying.

Mr Johnston—That is what the law requires, so it is hard for us to talk about whether it goes far enough. It is a practice in various parts of the industry to exceed minimum disclosure requirements, and I think we had evidence earlier tonight that some advisers regularly prepare a suite of products that are worthy of consideration but perhaps with a recommendation as to the most suitable product.

CHAIRMAN—As there are no further questions, thank you very much to the representatives of ASIC and the Treasury for your session with us. We will now have a wrap-up. Perhaps Mr Johnson and Mr Ray could stay to be part of that, and perhaps we could have at the table some representatives from both those who are perceived to be against disclosure and those who are for it. The others can sit behind in case there is a need to refer back to you. Perhaps you can work out among yourselves who you want at the table and who you want behind.

Senator MURRAY—I must just apologise. I did not realise that it had gone later than the booking.

CHAIRMAN—I would ask that some representatives from the first group we had at the table earlier this evening give their response to the issues that have been raised subsequent to their appearance before us—and try to keep it reasonably succinct and brief.

Mr Hristodoulidis—There are two parts to my summation. Firstly, we have had three or four hours discussion now and it seems that a hypothesis has developed, particularly from Mr Hunt, that the issue of risk commission disclosure will lead to a change in market structure. I would like to challenge that hypothesis, put on the table a bit more evidence and then move on to my summation. The issue of banks and life companies buying up distribution is not a new phenomenon. It is happening now under the current regime and it was happening before the Financial Services Reform Act. So I do not think that disclosure of risk commission is going to lead to that outcome—it is already happening; it is a market dynamic.

The other issue, in terms of that hypothesis, is that it will drive out small business. The FPA, which represents about 80 per cent of the adviser market, has a very strong small business membership. If you break down our membership—and we are talking about 80 per cent of the industry—75 to 80 per cent are small, 10 to about 15 per cent are medium sized and the large end of town, if you like to call them that, really only represent five to 10 per cent of our membership. The growth in our membership has been at about 10 per cent per annum for the last five to six years and that is consistent with the growth of small, medium and large. No particular sector has been disadvantaged in terms of the opportunities available to it. I would also like to put on the table my view on the hypothesis that the disclosure of risk commission on its own will lead to changes in market dynamics. The change in market dynamics is occurring; however, within that, there are opportunities for any size player if they structure themselves in an appropriate manner.

Moving on from that, I like to go back to the point that the FPA does not survey its members and to make a few comments about that. I thank Mr Menkens for mentioning that he is a member of the FPA. As a member, he would know that when you first sign up to the FPA you sign up to the code of ethics and rules of professional conduct, which quite clearly require that you will fully disclose all your commissions regardless of the financial product. Our rules of professional conduct go beyond the Financial Services Reform Act in that, if you are advising or dealing in real estate property and you receive any commission from that, you must disclose that as well. By being a member of the FPA you implicitly sign up to those rules, so you are adhering to the disclosure principles.

The second point I would like to make about our membership, as I said earlier, is that it represents 80 per cent of the market. I think the views that were put at this table for or against disclosure really represent only a minority of the industry. The development of our submission goes through fairly robust discussion with a number of our members. We have member advisory committees which are very robust and are made up of all different sizes, so the views represented in our submission are the views of not just the technocrats within the FPA but the membership of the FPA.

In summing up, I want to make a few quick comments. It is evident from the discussions we have had today that there is variability in risk commission products in terms of the commissions that are received. If we go back to the principles of the Financial Services Reform Act, as Mr Ray said, if there is potential for bias it needs to be disclosed. If there is variability in commissions and, as Senator Murray said, there is a potential for bias, you need to disclose it.

We believe that non-disclosure perpetuates a climate of suspicion about the adviser's motives and puts at risk a relationship between an adviser and the client that is based on trust. Professional risk protection advice is very valuable to a client, so why hide the value by

implying that the advice is free? There is no evidence that disclosure of risk commission has harmed the small business financial adviser. It would be unlikely that a client would walk away from expert risk advice given by a dedicated adviser or deny that adviser a fair remuneration. In conclusion, disclosure of risk commission at the FSG and statement of advice level would allow the consumer to make a fair comparison between the price of the product, its features, its benefits and any potential bias towards each particular product.

Ms Brown—The ICAA represents 38,000 chartered accountants practising in Australia and overseas. Of this number, a significant proportion are actually in public practice and small business. The ICAA is one of Australia's peak professional bodies and our members represent many of Australia's significant business and finance professionals. Such members act as advisers and key decision makers in all areas of superannuation and financial planning industries. The ICAA's policy position is that all financial institutions should have to disclose all fees and commissions earned from any financial products, and that includes risk insurance products.

I would like to use a phrase that Senator Brandis used. Disclosure, from our point of view, is desirable and you might ask why that is. In order to protect consumers and uphold high professional standards and ethics, the ICAA ensures that, where an authorised representative takes commissions, the ICAA does provide for full and open disclosure. The best practice by our members has been to expose various levels of commissions. This, as my colleague Mr Tony Negline, mentioned earlier in the debate, is reflected in the ICAA's code of professional conduct. For those of you who are not aware of that code, in statement F6 of that code, which is on professional fees, it actually states that, where the type of service provided by a member in public practice is in the form of advice which, if acted upon, would result in a commission being earned from a third party, the client must be informed in writing of the fact that commission will be received, the amount or basis and the terms of the commission. The advice given must be independent, objective and in the best interests of the client.

Tonight we have also heard questions raised in relation to consumer interest and product advice. The ICAA's view is that receiving information such as disclosure of commissions for these products will not harm the consumer. In some circumstances, as was raised by other members on the forepanel, this information may give a consumer cause to reconsider or to amend a course of action. The ICAA has a long history of favouring as much disclosure as possible. That has been obvious in the reforms enacted over the last two decades. In short, we believe that more information is better than less, because it actually empowers the decision maker. Finally, the ICAA wants to see best practice used in financial planning in the industry in the interests of consumers. Obviously, from our perspective, this means full disclosure.

CHAIRMAN—Although you support the disclosure regime in relation to this aspect of the legislation, I think in part we could say that the argument put by those opposing disclosure is that the 'one size fits all' intent of the legislation is not appropriate to their particular industry sector. That cause has also been argued by the Institute of Chartered Accountants in relation to their requirement for licensing under this legislation. That view has also been reflected by the committee, I might add, in our recommendations. Do you accept that there are areas of exception where the 'one size fits all' concept may not be appropriate?

Ms Brown—I guess the question the committee has been asking is in relation to risk products. In relation to that, the ICAA's position is that all financial institutions should have to

disclose all fees and commissions earned from any financial product, and that includes risk products.

CHAIRMAN—I was asking in a more general sense.

Mr Hristodoulidis—The issue that the Association of Chartered Accountants and CPA Australia are debating is what is an accounting function as opposed to a financial product. The legislation quite clearly states that risk commission is a financial product. So I do not think we are comparing similar cases.

Mr Murphy—Mr Chairman, it is that issue that I think you so well teased out earlier—yes, risk insurance is a financial product in their terminology, but I think there is a very distinct difference between an investment product and a risk insurance product.

Mr Hristodoulidis—Not by the legislation standard.

Mr Murphy—I am not talking about legislation, because we know in which direction the legislation was driven.

Ms Wolthuizen—I will start by making some general comments and perhaps going back to why it is we have this particular regulatory model. We are dealing with a booming industry of financial services—a particularly complex market—where responsibility is increasingly being shifted onto consumers to negotiate their way through all that complexity and make decisions based on the information that they are given. Our chosen regulatory model for that is not one which advocates restriction on fee levels. It is not one which proscribes particular forms of remuneration. Instead it sets out a framework for disclosure of all those factors to a consumer to promote, as it says, confident decision making. In presupposing this, it sets out a whole range of factors such as adviser qualifications, cost, the potential influences or biases that might influence the recommendations or advice provided and features of products and a stipulation that they be appropriate to the needs of the client. It is not a regulatory model that has ASIC or any other regulator combing through plans to assess whether the appropriateness test has been met. That test is left to the consumer.

Unlike superannuation, a grudge product in the sense that Australians do not like saving, we as a society have not mandated risk insurance. We leave the decision as to whether that product is appropriate to the needs of consumers up to the consumer. There has been a flavour to a lot of the arguments presented today that, if commission amounts are disclosed, consumers will shy away from purchasing these products and that that is to the detriment of consumers and the community as a whole. It is our very strong contention that, if the brokers and agents who sell these products cannot convince consumers that they are worth the commissions paid or that the appropriateness test has been met, it is entirely understandable that consumers might be reluctant, and that is ultimately their decision. Until we decide that insurance of this nature is such a public good that we mandate it in much the same way as we have mandated superannuation, consumers still have that choice. The same information disclosure and transparency principles as apply to other financial products must apply to this product.

We also need to remember, when we look at potential reasons for having such a regulatory model and reasons for disclosure, that commissions are paid for a reason. We have this remuneration structure in place for a particular purpose—to incentify sales. We do not

necessarily need to look at evidence of misselling, although we find that across financial services. We do not necessarily need to bring to the table widespread surveys showing up case after case of misselling of other financial products to justify the need for disclosure. At the end of the day we have a remuneration structure in place with a particular purpose and it is entirely appropriate that that remuneration be disclosed to consumers so that they can make an informed and confident decision about whether they want to walk away from the product or purchase it. With this comes the need for a framework of protection and uniformity consistent with consumer expectations; that is a key purpose of this act. If we are going to have consumers making that choice, it is very difficult to educate them about what their rights need to be and what they should expect from financial providers and licensees. If we go carving out particular areas of financial services, that will only compound that difficulty.

Advocates of a carve-out have argued on the one hand that commissions are irrelevant to decisions consumers make and on the other hand that they are absolutely critical to the decisions that consumers make when it comes to whether or not they purchase a particular product. We have heard on the one hand that they can facilitate equity of access to particular forms of financial advice and products. We have heard on the other hand that consumers do not care. I think that, when it comes down to it, it is up to the consumer, and it will be individual consumers who come down one way or the other as to whether or not they are influenced by the quantum of commission that is disclosed to them.

All of the impassioned arguments that have been made by advocates of a carve-out are in a sense irrelevant to the question of disclosure to consumers. They should not be making those arguments here; they should be making them to their clients when trying to justify why they are paid in the way that they are and why they are paid as much as they are for recommending particular products. But the argument seems to suggest that the basic case for a carve-out in this instance boils down to: we cannot make the case so do not force us to. In our view, we would be extremely disappointed if that argument were to hold sway and if an exemption were indeed granted. I believe that would send a message that this sector deserves protection simply by virtue of obscuring and withholding information that is clearly material to a decision that consumers are going to be making as to whether or not they purchase products in this area. I believe that all the claims that have been made about what material and what information are relevant to consumers are arguments that should be put directly to consumers. If we grant an exemption those arguments will not be made.

CHAIRMAN—Mr Hanks and Mr Bruining, do you wish to briefly add anything?

Mr Bruining—I will clarify the example I used of the commission and the premium for the two types of life insurance. It was not to get into a debate about conditions of release in superannuation; it was simply to point out the premium level differing between one product and another product—it was not simply about superannuation—and the fact that we had a 105 per cent commission being paid and a doubling of the premium, and I think that is relevant to this discussion. The other thing I would point out is that when my clients come to see me and when clients go to see a financial adviser they do so because they do not understand the complexities of the financial products that are in the market. They are seeking professional advice, much like I go to see my doctor to receive professional medical advice. I think it behoves those people giving that advice to take a line from doctors' Hippocratic oath—'do no harm'—and to have a similar approach to the advice they give those clients. If, as part of that, there is total and complete transparency as to what fees and benefits you are deriving from it, then so be it. If

through that process you cannot justify the work that you are doing—if you cannot become accountable for the commission that you are going to receive—then perhaps you need to change your business model or the sort of work that you do.

Those who have chosen to join the Financial Planning Association and subscribe to the code of ethics and rules of proficient conduct, as Con said before, have been disclosing commission on risk products since 1994, as have I. It has not affected their business and it has not compromised them. In fact, as Con said, our membership is growing even stronger as we speak. So I would suggest being transparent is a part of moving to being a true profession. I would suggest that we need to look to the larger group of financial service providers, rather than to a smaller group who perhaps need to look at their business model and adjust it for the current conditions.

Mr Hanks—I would like to raise a side issue. This is in relation to back office costs—and it is an area of particular concern to NIBA—where commission is paid by an insurance company for functions that are performed by insurance brokers and others on behalf of the insurance company. More and more insurance companies are outsourcing various activities of their business. In some cases they outsource it almost entirely and they only carry the risk while the functions, the underwriting and the claims payments are actually done by somebody else. In those sorts of situations we believe that the commissions in relation to those things should not be disclosed, because these are functions being performed by the underwriter. The underwriters themselves would not need to disclose the costs. If they are performed by somebody else on behalf of the underwriter, then, for comparability sake, they should not be. Joe Hockey, when he introduced the draft of the FSRA legislation on 11 February, summed it up when he said:

This approach recognises that where commission includes payment for back office services, that portion of commission does not need to be disclosed.

However, in recent statements from ASIC, including their submission to you, it is not clear how ASIC will administer the provisions. Pauline Vamos of ASIC recently indicated to NIBA that ASIC's intention is that realistic back office costs should be excluded. NIBA has offered to work with ASIC to ensure that only the legitimate costs involved in the provision of such service are excluded. From NIBA's point of view, we would like confirmation that these back office costs would be excluded from the commission.

CHAIRMAN—Thank you. Within the group opposed to disclosure we have those who are involved principally in the life insurance sector and those involved in the general insurance sector. We will deal with the general insurance sector first.

Mr George—In respect of the general service sector, the fees we receive for our services are not limited to sales commissions but are for the management, sale and administration of insurance products. Sometimes these are products we have developed together with the insurers. We believe the question of commission needs to be clearly extracted from such transactions. Sections 950D and 950E of the Financial Services Reform Act fail to adequately address the problem of what is purely a commission and a fee paid by underwriters to brokers and what is for either background administration or backroom services, as we have just heard from NIBA.

CHAIRMAN—Is it a simple matter to actually calculate the difference?

Mr George—I think it is something that NIBA and the government authority will have to work out, and strike a percentage. I spoke earlier of a figure of about 30 per cent being a realistic amount that would not be allocated to back office costs; probably 70 per cent would be. We believe that if the legislation continues as it is, it is going to hurt those people that it sets out to protect and there is going to be a reduction of services, particularly in the rural and regional areas that are really marginal, from a profit point of view, for organisations such as ours.

Mr Morgan—I agree. It seems that the poor old general insurance industry is the innocent little baby here: we are hearing about all these terrible high interest rates and problems, but there have not been too many problems over the years so we are probably being dragged in here unwillingly, kicking and screaming. The IAAA agrees with commission disclosure on investment based products but not on risk. All insurers have expense ratios. For the direct insurer there is the expense of maintaining and operating call centres; for the intermediary using insurer there is the commission expense. It appears a bit illogical that the direct insurer is not required to disclose expense ratios but the intermediary using insurer must disclose expenditure via the intermediary commission disclosure forms. The amount of commission is non-negotiable, basically, in general insurance. As I said before, it can range from five per cent up to, if you are very lucky, 25 per cent. I do not know of too many trips or other fringe benefits being given away—except perhaps getting an ulcer at an earlier age. The intermediary really has no control over the amount of commission paid.

As I said, I do not see that there have been any significant problems on the general insurance side, but, once again, we are being dragged in on the basis of one rule fits all. I would like, if I may, to ask the FPA something. I notice that they keep saying that they do not have any problem with this. Just out of curiosity, I would like to know what percentage of the FPA business is risk business.

Mr Hristodoulidis—That is a good question. The FPA takes the stance that financial planning is a process and a service. Within that process and service there are specialists who are either investment advisers, risk insurance advisers or superannuation advisers, or they do the whole gamut of those services. We do not survey our members in terms of identifying exactly what they do. What we provide them with is training on how to go about providing financial planning advice without focusing on the end product. Whether you do risk commission, investment or superannuation you still need to focus on your clients' needs and do a needs analysis of your clients.

Dr Dixon—As far as I am concerned, there are a number of issues at play here. One is the push that has been going on for a number of years to bring all aspects of the financial services and insurance industry under one umbrella. The vast bulk of advisers in the industry today are financial planners and investment planning people and the majority of their skills lie in that area. Many of them are under the auspices of the Financial Planning Association, which is a very powerful group that has been a big voice leading the charge in imposing what it believes on all aspects of the industry. However, our sector began from a different point of view altogether. For example, I have never been involved—and neither have many of my colleagues—in the investment side of things. We do not want to be involved in the investment side of things. Our focus is on protecting families and businesses against premature death and disability. It is a specialised area of business. From a business structure point of view it is totally different from an investment planning operation.

Quite frankly, I resent the fact that these people from the FPA, and others, are trying to tell us how to run our specialised business. They have no right to do that. They are not in our business, they do not know about our business, and they do not know how to operate our business. They do not know about dealing with specialised matters such as underwriting special risks or taking care of claims, or about the service we provide. Our customers look to us to provide that service. The financial planning business, from what I have seen, is very technology oriented; the people in it tend to be technicians rather than 'people' people. Our customers, as far as the protection of their family and business needs is concerned, are looking to have a very close personal relationship with somebody they can trust completely. That is part of the value that we bring to bear on the situation.

That is the broad picture. With regard to the effects of risk commission disclosure, I think we could summarise that in two areas. One is the effect on us as small business people. All my colleagues and I run businesses. We have employees and we provide ongoing services. Most of us have been in the business for many years. As I said at the meeting I went to last week, it is quite clear that the life companies expect—and all my colleagues expect—that the nature of the cash flow will change dramatically. It will go from a situation where the cash flow is sufficient to fund putting business on the books and to provide the capital to develop a business that can provide these services, to a situation where the business will not have sufficient cash flow to do that and where somebody will have to provide the capital.

The life companies are already making it clear that they are not in a position to provide that capital. In fact, the particular insurance company that convened that meeting commented that there was no way they could go back to their bank owner and say, 'The cost of making this transition, if we're going to support our advisers, will be of the order of $150 million. The bank won't buy it. Tough luck, boys—you're either going to have find the dough yourselves to stay in business or you go out of business.' That is going to happen to a percentage of my colleagues. The strongest ones, the ones who have large amounts of capital or are seen by the institutions as having sufficient value, will probably do very well. They will probably take over a lot of the businesses that fail. But the net result will be that a lot of the small businesses, which are providing the services now, will not be around.

As far as the effect on the consumer is concerned, we provide specialist services in this area. As one of my colleagues has said, a big part of our market is middle Australia. However, as we have seen in the recent survey that has taken place, the financial planners do not want to know about that market. We have not got a problem with shonky dealings. As far as the risk side of the business is concerned, the complaint rate, as I understand it, is something like 0.001 per cent. We are not financial planners who are ripping people off. So the effect on the consumer—the people that require our services, the mass market—is that the level of service is not going to be available because the businesses that are able to provide that specialist service will not be there any longer. In the meantime the financial planners—who are on the nose as far as funds management goes, because they have all performed so badly—are now wanting to move into the risk business. We will see some—if you do not mind my expression—half-arsed risk insurance advice from people that are brand-new and have never dealt in this area before. I can tell you that they are going to make some horrible mistakes and have their arses sued off.

CHAIRMAN—Do you have anything to add, Mr Ross?

Mr Ross—From a life insurance point of view, I was interested in what my fellow countryman—he succeeded in hiding his accent very well, whereas I do not even try—had to say. One of our fellow countryman once said:

O wad some Pow'r the giftie gie us

To see oursels as others see us!

I refer of course to Robbie Burns. Many of you may never have heard of him, but that is okay. I listened to some of the comments because I am concerned about what I perceive to be almost disinterest on the part of ASIC in the consequences of what they do. I do not mean to be blasphemous but I will refer to another person who once said, 'Forgive them, Father; they know not what they do.' I am quite sure that, when he said that, those who sought to have him hanged probably had a good motive from their point of view. In fact, for the rest of us who believe, it was just as well that they did carry that out, because at least we have got a mediator who may argue for us in another place. But our consumers and customers need somebody to argue for them, and I do not think it is the ACA who argues for them; I think it is us. So I am here as an independent person arguing for my clients.

Earlier, Mr Chair, you asked Ian Johnston whether there would be a change in the distribution system, to which I think the response was—although I do not have it word for word, because I just scribbled it down—that ASIC did not have a view and they felt ASIC did not need a view. The responsibility really belonged to the regulators, and ASIC had one role and it was the same role—to quote my words now and not Ian's—as a policeman. You give someone a breathalyser, the guy is over or under and your arrest him. You have no particular view of the law; you just enforce it. That is fine, except that ASIC seem to be taking a position that they do have a view on disclosure of commission and that they support it. I find that a bit contradictory.

I did also notice, Ian—I do not mean to attack you, because that really goes against the grain when we come from the same country, but I have no choice—that when you were asked whether commission would reduce you said a number of times that you were not sure. You said, 'I am not sure if I accept the premise,' or 'I am not sure if commission would drop.' I think that is the danger in the whole thing. When the Challenger spacecraft took off recently some tiles flew off and accidentally damaged a wing. The people responsible for the lives of others were not sure if the damage was so great that the lives of the crew would be in jeopardy. As it turned out, that was a big mistake—or so it appears.

We could be back here five years from now arguing about what went wrong, as they are doing in England, because a lot is going to go wrong. I looked up the word 'sure' in the English dictionary. I do not have an English dictionary in my pocket, although I have four cans of beans—I had not expected to have to prove the meaning of the word 'sure'. On page 1,162 of the *Concise Oxford Dictionary*, new edition, it says that 'sure' means to be convinced with satisfactory knowledge or free from any doubt. I feel a person has to be convinced and free from any doubt that the consequences will be damaging to customers. If there is some doubt—and I think Ian has some doubt, because a number of times he said he is not sure—we should do nothing until we are sure that the disclosure of commission will not damage clients, and certainly country clients. I have referred before to the fact that my manager in Toowoomba has to go 300 miles to see a client. He is not going to go there for an argument on whether the customer understands what happens to the commission.

I also noted that the Consumers Association said, through their representative here, that if we could not convince the customer face to face on the value of the commission we receive then our problem would be up to the customer. I can promise you that I could sit down with you, sell you a life insurance policy and convince you.

Ms Wolthuizen—I sincerely doubt that.

Mr Ross—I agree that you will doubt it, but give me the opportunity. Having said that, you might not accept the sale because of the commission, and many clients are not as educated as you are—they are not even biased. They do not already have a predetermined position, and some people in this room have, including me. So we do have a predetermined position. We did not say that all our clients would not buy life insurance; we said some of them would not buy life insurance. If 10 per cent of them stopped buying life insurance, our businesses would have serious financial problems, so I am concerned about that. I am also concerned that, if 10 per cent do not buy, it will be the 10 per cent of people who do not understand businesses. If you come face to face with a business client, he sells something else—he is in business. We see his profit and loss sheets, we know the kind of money he makes, and I am happy to give him a copy of mine if he asks for them. In fact, I think I will reach the stage where I will be giving him a copy whether he asks for them or not—it will be part of my presentation as to why I have to disclose commission. But there is a cost involved with all of that and, unfortunately, it is the customer who will have to bear it.

CHAIRMAN—Could I get you to sum up, because we are running very much behind time.

Mr Ross—Summing that up, I am concerned because there does not seem to have been enough research done as to what the effect would be on country clients if commissions were driven down. I think they will get no adviser to service them. They already have no banks; they will end up with no advisers. I must be certain that my clients will not be harmed. To tell you the God's honest truth, if I thought my clients would benefit from the disclosure of commission, I would be at that table fighting for it.

I will make one last comment about the FPA. I have been a member since it was formed. I am a certified financial planner. I have spoken to you, Con. Most of my colleagues who sell life insurance do not disclose their commission, and I have told you that. I have done surveys of fellow members of the FPA in Brisbane and they have real problems in knowing how to do it. I do not think the FPA can enforce its own rules. An easy way to enforce it is to have the government pass a law that the government will enforce it, and that then takes the whole pressure off the FPA. I will not send you some plans, because I keep them in confidence, but I have plans in my office from colleagues who are CFPs and who have not disclosed their commission.

CHAIRMAN—It would be good if you could keep it very succinct, Mr Foster.

Mr Foster—We are all looking for statistics on the market, and in our presentation we stated some statistics on misrepresentation for life advisers. The code of practice was introduced in 1995. At that time, through the Financial Insurance Complaints Service, there were 1,260 complaints of misrepresentation.

In the latest report, which I attached to our submission, there were 618 complaints in the year 2000 of which complaints in terms of life risk, term, trauma and income protection amounted to 10. There were 10 complaints on misrepresentation. The majority of the complaints—one-third of the 618 complaints—were to do with denial of claim. Nearly one-third of the complaints were to do with customer services by life offices. Misrepresentation by advisers is another issue. My other concern is about the complexities of the level playing field we brought up. I get the feeling that in the UK market it became too hard to disclose and they have taken the other act because people were not getting the service in terms of supplying risk or income protection with those products, and the issue of uniformity is also not clear.

Ian, I would like to ask you a question. Going back a year ago, I think ASIC were expecting 7,500 and licences over a period of two years, whether they be individual or corporate licences or whatever. How many licences have been approved to date?

Mr Johnston—I cannot tell you how many have been approved. I can tell you the number of applicants so far, which is about 800.

Mr Foster—And how many have been approved?

Mr Johnston—I do not know how many have been approved. I would be guessing.

Mr Foster—My information says that 260 have been approved, which just shows that—

Mr Johnston—It is certainly not that.

Mr Foster—It is a lot higher?

Mr Johnston—Yes.

Mr Foster—My point is that it suits the big end of town but not the small end of town in small business.

Mr Johnston—Most of the licences that have come through so far have been from small business and have been new applicants.

Mr Foster—So the big end of town is still to come?

Mr Johnston—Yes.

Mr Hristodoulidis—If it is the small to medium members that have applied for licences and not the large dealers they are not going to be that damaged.

Mr Foster—Our basis was stand-alone risk products. I heard Catherine talk about the survey today and also, in their submission, the survey by the ACA and ASIC. Not once in that report, whether it was on the *Four Corners* show or in the written report, was a risk adviser actually damaged. In fact, I disagree with Con, because most financial planners create wealth but very few sell risk to protect it. Robert is right. I run a dealer group of 300 people. For most advisers working under the agents and brokers act disclosure of risk from a financial planning point of

view is not part of the financial plan and they have separate businesses to do it. So you have a severe problem. You should look at your membership, survey the people and get their opinion.

In conclusion, I would like to thank you for the opportunity, Senator Chapman. The government, whether it be Liberal, Labor or Democrat, has always supported free enterprise and small business and I would hate to see a decision made which would affect not only middle Australia but the major cities in terms of providing protection to the consumer.

CHAIRMAN—Does anyone else want to make a brief comment?

Mr Menkens—The sincerity of some of the people who are pro disclosure for clients is to be applauded. The lack of honesty by some of the others who are also pro disclosure is to be challenged. I say this with a real fear of what has occurred and what is going to occur. I am a member of the FPA because my big end of town dealer says that I must join the FPA because they are a principal supporter. Therefore, to get a proper authority under that particular regime all my staff must join the FPA as well and there are seven in my office.

This is a problem. We are getting bad statistics—'lies' is the old way it is put—in that you can make anything up out of anything else. Of the membership of the FPA who would disclose honestly, I would suggest that the percentage who actually do risk or the percentage of your members who are actually advisers is warped from what you say. The percentage who actually do risk would be far less. So we are getting something that is being promoted by the big end of town. I would like you to disclose how much you have received from the big institutions and the big fund managers by way of sponsorship and premiums et cetera for them to be principal members.

Tell the public what is going on here. This is what we need to know. As I have said, I challenge your sincerity; I do not challenge the sincerity of anybody else who is trying to look after the clients. I would like to say to those people that, at the moment, no argument has been put that can unambiguously or even probably improve the lot of the clients in this industry. Until that occurs, I believe we should leave things as they are and have a far wider inquiry. Also in terms of that, you should make sure those people asking the questions understand what the outcomes should be.

Mr Hristodoulidis—I would like to respond to the questions that were raised about the Financial Planning Association. Firstly, the cost of membership of the Financial Planning Association is available on the Internet and on the application form. Secondly, any moneys, sponsorships or any other subscriptions the FPA receives are available in its annual report. We are accountable to our members and it is all freely available. I would also like to challenge Mr Menkens' views about our membership. We maintain a database of our membership and can back up every statistic that we roll out in this hearing and in any other place. I would like to challenge Mr Menkens to prove and bring forward the data he has that is contrary to what our membership data tells us.

Mr Murphy—We have been told by the FPA that we are a very small organisation and we are proud of that and we are all practitioners. I am also a member of their esteemed group because, as Leo has said, in order to hold a proper authority it is mandated. So, it is really a press-gang membership. I think Ian Johnston was probably quite right: they are not experienced to regulate. Having said that I reckon we should leave it alone for a while. The argument has

been put for and against and I am glad that we have had the opportunity to be in this forum. We feel very strongly about a position and non-disclosure of commission is a stand we would like to go forward with, because the impact on the consumer would be detrimental if the situation was changed. So, we sit with the status quo.

Mr Vanderwolf—I am part of a practice and I am a risk writer. I have been in the industry for 22 years as a specialist risk writer. I am in partnership with a financial planner. My partner refuses to write insurance business because it is too difficult to write and there is no profit margin in it as far as he can see. We have it as a service to our clients. Clients my age or younger have no real interest in financial planning, in terms of big lump sums of money that they need to invest, but they do need specialist advice as to how to best cater for their families and any other liabilities that may arise on the way through their lives.

Over the years, I have dealt with a number of claims on behalf of young clients of mine and without my advice and intervention their families could well have been destitute. The profitability of my side of the business is always at risk because of the amount of time that we have to put in to manage our clients' business. As we have heard before, we consider it the thin end of the wedge. Once disclosure of commission on risk products comes in, the large insurance offices will see that as an excuse to drive commissions downwards. On that basis, I would strongly consider whether I would continue to provide risk advice. I am a qualified financial planner but if commission is driven down I will have to completely reassess my position. As a result, I may turn my back on the risk side of the business which will inevitably leave clients of our practice very vulnerable.

Mr Yates—I would like to respond to one of the earlier speakers, Kristen Brown, regarding the Institute of Chartered Accountants. I deal with a couple of partnerships of quite reasonable size. They ask me to see their clients to talk about life risk business, succession planning, estate planning and all sorts of issues simply because they do not want to tackle it. It is all too hard and too complicated and they are very happy to let someone else do it.

Ms Brown—In answer to that, every member of the Institute of Chartered Accountants adheres to our professional code of conduct and they must always disclose any commissions and that includes—

Mr Yates—I am not saying that they do not disclose them but they do not then do the business; I do. So that solves the problem.

Mr HUNT—I wish to make a comment followed by a request. My comment is that, as a starting point, as a member of the committee I view disclosure generally to be a public good. In this particular case, I have no sympathy for the argument that protection of the consumer from the direct effects of disclosure should carry any weight. It is for consumers to make their own decisions. In part, however, this argument turns on—and this is something I, and perhaps others, need more evidence on—the notion that disclosure will lead to market-distorting effects which, in the end, will have a negative effect on the consumer. I would respectfully ask whether there is any supplementary information which people wish to submit in terms of an allegation of market-distorting effects and the answer to that claim. That will help me in my judgment.

Mr Murphy—I am very pleased that we have had to come back here again today, because a lot of people thought the door was shut on this issue. I am very grateful to this committee for

maintaining an open door on this. With that comment from Mr Hunt, I think we have achieved something—if we can get further information in order that the correct decision, rather than a decision, can be made.

CHAIRMAN—Do Treasury or ASIC want to make a further response?

Mr Johnston—I might make a couple of quick comments. This is an interesting place to be tonight! In relation to the one size fits all comment that has been made a few times now, ASIC's regulation of the industry recognises the differences that apply across the sector. For example, in our policy statement 146, which deals with training and competency of representatives and people offering retail advice, the standard of training and competency is lower for those selling risk products than for those selling investment products. In the licensing system, we have made it clear that when people apply for a license the things taken into account most are the nature, scale and complexity of their business. Therefore, the small business does not need to provide nearly as much evidence to us as does a large business in terms of its capacity; rather, the evidence that it provides is appropriate to the size and scale of its business.

So we do make a distinction on how we regulate the industry between the various sectors and also on size. We have deliberately made sure that the licensing guides that we have issued—particularly the guide that we prepared for small business coming through the door to obtain an ASIC licence—make it possible for those people to come through without having to pay for specialist advice in putting together their application.

The only other thing I would say is that ASIC has no problem with people being paid by commissions. The legislation allows that. Any disinterest that I expressed before went to the fact that we will apply the law however it is framed. If the law provides that commissions need to be disclosed that is what we will uphold. If the law does not provide for commissions to be disclosed that is also the position that we will uphold. But our preferred position is that we think commission should be disclosed. Back at the time when the bill was being debated a few years ago we made that clear, because we just do not accept the argument that consumers are better off by not being told about something.

So we certainly do not operate from a disinterested point of view as far as consumers are concerned. We are trying, though, to make sure that how we regulate industry and how we licence them is reasonable for them. We are very interested in their behaviour, and the sorts of actions that we have taken—for example, with misselling of risk products into Aboriginal groups over the past couple of years—show that we have a keen interest in this part of the market.

Mr Menkens—What sort of product were they?

Mr Johnston—Risk products.

Mr Menkens—They were savings plans, Sir. Do not mislead people, please.

Mr Johnston—That is all, thanks.

Mr Ray—Chairman—

CHAIRMAN—Before you comment, Mr Ray, I want to ask Mr Johnston something. Mr Johnston—and you might take this on notice—the issue raised by Mr Hanks and also referred to by Mr George about the back office costs, on which, according to my information, the government's intent was—

Mr Johnston—I think Mr Ray was just about to talk about that.

CHAIRMAN—Mr Ray, as I understand it, the government's intent was that there would not be a requirement for disclosure of back office costs that were a component of commission, but, as I understand it, there is nothing in the legislation to exclude those back office expenses. Also, in a general sense—and perhaps this was highlighted earlier by Mr Ross's example of the beans—

Mr Ray—I missed the beans, Mr Chairman; I was in another committee.

Mr Murphy—He is not going to do it again!

CHAIRMAN—One of the arguments here tonight is that risk products provide a predetermined or fixed outcome—they are purchased and subject to some trigger event occurring—whereas investment products provide a sort of indeterminate outcome. They are different in nature and are more of the nature of a commodity or a product—like beans, a refrigerator or whatever—on which we do not require commission disclosure. We do not require the fellow in the store who sells you a refrigerator to disclose his commission. Why is this particular product different?

Mr Ray—I might answer the second question first. I had jotted that down as an issue I might raise. The financial system serves various functions. One is to allocate savings for investment and another is diversifying risk across the economy, and that is a very important function. We have seen in a number of other contexts over the past 12 months a lot of issues concerning insurance markets in Australia for that very reason. Risk insurance is a very important element of that second function, diversifying risk, and that is why the government has defined risk insurance as a financial product.

There is a distinction between investment and risk products in the legislation, though. It is not expressed on the surface of the legislation. That is the point I tried to make in my earlier remarks—that at the point of sale disclosure is directed at ensuring that the consumer understands how much the product is going to cost him or her. At the point of sale, if the commission or any other remuneration does not affect the price or return to the consumer, then it does not need to be disclosed. I think ASIC would agree that in general, on risk products, that is accepted.

The disclosure that we are talking about here is at the point of advice. Again, the legislation is neutral. It says that, at the point of advice, commission needs to be disclosed if it is reasonably expected to influence the nature of that advice, and that is a factual question in each and every case. That brings me to the back office costs. The intent of the legislation is that, where a back office cost could not reasonably be expected to influence the advice, it does not need to be disclosed—and that is on the surface of the law.

I will make one or two other brief comments. The provisions are neutral as to industry structure. There is nothing about these provisions that is directed at any particular industry structure. It is difficult to understand why merely disclosing commission is going to affect that, because licensees are still going to want to distribute product and need a distribution system, and consumers are still going to demand product. Back in the early 1990s financial advisers expressed similar concerns, and there is little evidence that the financial advice industry did not grow at quite a pace throughout the 1990s. The provisions are also neutral as to the mode of remuneration, which is a concern that has been raised previously and in several of the submissions to this inquiry. The last point that I would make goes to Mr Hunt's question and is that, from an economist's point of view, a well-informed consumer is clearly better off than an ill-informed consumer.

Mr Ross—I appreciate that it is late, and I thank you for bringing that to our attention earlier. I have watched parliament sometimes argue till two o'clock in the morning, especially on 30 June because it is a cut-off time for other things. I am 60 years of age. I do not really give a monkey's, frankly, because I will be out of this business soon. I have two heart valves that leak and I am waiting for heart valve transplants. So in a lot of ways I think I have issues greater than disclosure. But I have 2,500 clients. Some of them live 500 kilometres away—in fact, tonight I am going to stay with one, and I will address their issues tomorrow, because they are here in Canberra. I did not sell to them when they were in Canberra; they were on the Gold Coast then.

It seems to me that we have played the game and we have argued. When the ISC was the regulator we argued on this. A code of practice was developed, and commission disclosure was discussed then. For all the same reasons that it has been thrown out three times by this committee, it was thrown out then. The government counts life insurance as a financial product because of a push by a lot of others to only have one regulator. The consequences of one regulator require you to fit life insurance in somewhere. So, if it is not going to be under ASIC, who is it going to be under? That is the whole problem. The Corporations Law dictates that life insurance is a financial product and that it is the same as every other financial product. But it is not the same. That is the first real mistake.

I appreciate that ASIC may not have a particular concern about commissions as our remuneration. But I can tell you this: the ACA does have a concern. They are opposed to commissions full stop. This is just the start. I read an article on this every day in the press. Today in the *Sydney Morning Herald* there is an article on the 'Money' page in which commissions per se are constantly criticised. People do not seem to understand that commissions are just a form of remuneration by the customer. Life companies, or their fund managers, do not pay me; it is the customer who pays me.

I will talk as a financial planner. When I ask a client to sign on an application form that the fund manager will pay me two per cent or whatever, and we spell out the dollars in our financial plan, it is not the fund manager who is paying me two per cent; it is the customer. He could put his signature on a cheque, write '$2,000' on it and let me draw the money from his bank account. But it is not his bank that is paying me $2,000; it is him. He writes 'two per cent' on an application form and lets the fund manager pay me. But it is not the fund manager who is paying me; it is him.

Mr HUNT—Thank you, Mr Ross. We have the argument.

Mr Ross—Accept that this is my business. I have a son in my business whom I hope will still be there in 10 years—as, I am quite sure, you want to be in your jobs in 10 years. To me, the game seems almost over. It is almost as though we are playing extra time. We now have an opportunity, and if we do not get this right this time the final whistle will go and it will be up. I feel that, if I have to sit here all night—and I appreciate, Gregory, that you may not want to do that, as some of your colleagues have not wanted to sit and listen to this whole argument, which one of my colleagues quite rightly got pissed off with, as I did—

CHAIRMAN—I will address that a minute, Mr Ross. We did have a fixed time for this hearing and we are now an hour and a half over it. I think I have been very generous in allowing presentation of the arguments.

Mr Ross—I certainly appreciate that, too. But when it becomes your business with hundreds of thousands of dollars invested in it, you do have a business interest.

CHAIRMAN—I understand that, Mr Ross.

Mr Ross—You want to pursue it until you feel you have exhausted the argument. If, finally, commissions have to be disclosed, our guys generally are law-abiding people and they will do it. My business will survive because I have some good guys in it, but many of my colleagues' businesses will not. Many members of your electorates who vote for you will not have an adviser, either. That is a big concern to me.

CHAIRMAN—Thank you very much, Mr Ross. I think everyone who has participated this evening. I believe that this format—a roundtable—is a very useful way for committees to operate and glean evidence from conflicting parties where there is a conflict of views. I think it is a healthy way for us to assess issues. Mr Murphy and you, Mr Ross, made reference to the absence of some of the committee members from the hearing. I think that, at various stages of the hearing tonight—this committee is a committee of 10—all but two of the members were present. But, as is always the way in the parliament, there are a number of conflicting activities going on. There were activities in the chamber. I know, for instance, that Senator Murray had to depart to speak and I think that Mr Hunt, too, was absent to speak in the chamber at one stage. So I think we just have to accept that that is the way the parliament operates. But, certainly, most of the members have had some exposure to the evidence tonight. All members will have input to and consideration of the report we will produce. Again, thank you, everyone. I declare the hearing closed.

Committee adjourned at 9.30 p.m.