Parliamentary Joint Committee
on Corporations and Financial Services

---

# Inquiry into the disclosure of commissions on risk products

August 2003

© Commonwealth of Australia 2003

ISBN 0 642 71287 5

Printed by the Senate Printing Unit, Parliament House, Canberra.

# MEMBERS OF THE COMMITTEE

Senator Grant Chapman, **Chairman**
Senator Penny Wong, **Deputy Chair**

Senator George Brandis
Senator Stephen Conroy
Senator Andrew Murray
Mr Anthony Byrne MP
Mr Steven Ciobo MP
Mr Alan Griffin MP
Mr Gregory Hunt MP
Mr Stewart McArthur MP

**Secretariat**
Dr Kathleen Dermody, Secretary
Ms Bronwyn Meredith, Principal Research Officer
Dr Frank Donnan, Principal Research Officer
Ms Cheryl Hardiman, Executive Assistant
Ms Angela Lancsar, Executive Assistant

Suite SG.64
Parliament House
Canberra ACT 2600
T: 61 2 6277 3581
F: 61 2 6277 5719
E: corporations.joint@aph.gov.au
W: www.aph.gov.au/senate/committee/corporations_ctte

# DUTIES OF THE COMMITTEE

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the duties of the Committee as follows:

The Parliamentary Committee's duties are:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

# TABLE OF CONTENTS


**MEMBERS OF THE COMMITTEE** **iii**

**DUTIES OF THE COMMITTEE** **v**

**ACRONYMS AND ABBREVIATIONS** **ix**

Witnesses ix

Legislation ix

Other abbreviations ix

**RECOMMENDATIONS** **xi**

**CHAPTER 1** **1**

**BACKGROUND TO THE INQUIRY** **1**

**CHAPTER 2** **3**

**DISCLOSURE REQUIREMENTS FOR RISK INSURANCE PRODUCTS** **3**

What are risk insurance products? 3

Up-front disclosure requirements under the FSR Act 4

Financial services guide (FSG) 5

Statement of advice (SOA) 6

Product disclosure statement (PDS) 8

**CHAPTER 3** **11**

**COMMISSION AND BIAS** **11**

Why disclosure? 11

Testing the presumption 13

The Committee's views 21

**CHAPTER 4** **23**

**DISCLOSURE: WILL IT HELP CONSUMERS?** **23**

Introduction 23

Consumers' attitudes and the need for disclosure 23

Will disclosure mislead and confuse consumers? 25

The Committee's views 27

**CHAPTER 5** **33**

**SALARIED VERSUS COMMISSIONED ADVISERS** **33**
Competition issues 33
The Committee's views 37

**CHAPTER 6** **43**
**SMALL BUSINESS ISSUES** **43**
Introduction 43
Disclosure and the move to lower commissions 43
Evidence refuting risk advisers' claims 54
Assessing the evidence 56
Summary of the Committee's position 58

**ALP MEMBERS MINORITY REPORT** **61**

**SENATOR ANDREW MURRAY: AUSTRALIAN DEMOCRATS** **65**
**SUPPLEMENTARY REMARKS** **65**

**APPENDIX 1** **69**
**SUBMISSIONS RECEIVED AND ADDITIONAL INFORMATION** **69**

**APPENDIX 2** **73**
**WITNESSES AT HEARINGS** **73**

# Acronyms and abbreviations

## Witnesses

| | |
|---|---|
| ACA | Australian Consumers' Association |
| ACI | Australian Compliance Institute |
| AFA | Association of Financial Advisers |
| ARA | Authorised Representatives' Association |
| ASIC | Australian Securities & Investments Commission |
| CSA | Corporate Superannuation Association Inc |
| FPA | Financial Planning Association of Australia Ltd |
| IAAA | Insurance Advisers Association of Australia |
| ICAA | The Institute of Chartered Accountants In Australia |
| IFSA | Investment & Financial Services Association Ltd |
| LAAG | Life Advisers Action Group |
| MGA | MGA Insurance Brokers Pty Ltd |
| NIBA | National Insurance Brokers Association of Australia |
| Treasury | Department of the Treasury |

## Legislation

| | |
|---|---|
| FSR Act | *Financial Services Reform Act 2001* |
| the Act | *Corporations Act 2001* |

## Other abbreviations

| | |
|---|---|
| commission disclosure | This refers to the disclosure of the quantum of commission (such as up-front commissions, level or trail commissions) as required in the Financial Services Guide, the Statement of Advice and, where the commission may affect the return on the financial product, the Product Disclosure Statement. |
| commissioned adviser | This is a risk adviser who is remunerated by commission and is to be contrasted with references in |

| | |
|---|---|
| | this report to a salaried adviser. (See below for the meaning of 'salaried adviser' in this report.) |
| FSA | Financial Services Authority, United Kingdom |
| FSG | Financial Services Guide |
| PDS | Product Disclosure Statement |
| risk advisers | This refers to the agents, brokers and their industry groups who gave evidence to the inquiry either opposing commission disclosure or seeking modification of the requirements. Agents and brokers who are not licensees under the *Corporations Act 2001* can apply to become authorised representatives of a licensee. |
| risk insurance businesses | These are businesses operated by risk advisers. |
| salaried advisers | In this report, salaried advisers are advisers who are remunerated by salary or salary and commission (and/or other benefits). |
| SOA | Statement of Advice |

# Recommendations

**Recommendation 1**

**The Committee recommends that the Department of the Treasury and ASIC:**

- **investigate claims that there could be disclosure abuses on packaged products where commission disclosure requirements vary on the products involved; and**
- **where the potential for such abuses is confirmed, should take the appropriate action to close off this potential.**

**Recommendation 2**

**The Committee recommends that the disclosure provisions for the Financial Services Guide and the Statement of Advice—at the very least—should provide an exemption for the commission component paid in respect of back-office functions performed on behalf of the product issuer or provider.**

**Recommendation 3**

**The Committee recommends that the Government amend the *Corporations Act 2001* so that licensees and authorised representatives are required to disclose in the Financial Services Guide the nature of their remuneration (i.e. whether salary, commission, etc.) but are exempted from the requirement to disclose details (i.e. quantum) of commissions on risk insurance products in the Financial Services Guide and Statement of Advice. The present remuneration disclosure requirements for Product Disclosure Statements should be retained.**

**Recommendation 4**

**The Committee recommends that the Government review and report on the extent and likely effect of consolidation and restructuring in the financial sector to determine its effect on the delivery of risk insurance services in metropolitan and regional Australia. The review should place emphasis on:**

- **whether there is sufficient competition in the industry to promote outcomes that are beneficial for consumers in terms of:**
  - **the quality of risk insurance advice (taking into account issues of adviser independence and expertise);**
  - **availability of face-to-face risk insurance advice;**
  - **product diversity;**

**– services including claims handling; and**

**– price;**

- **the role and viability of small risk insurance businesses; and**
- **whether increasing numbers of ‘tied’ advisers or the increasing use of direct selling are adversely affecting the quality and independence of advice available to consumers.**

**The report should formulate a remedial program to correct any identified areas of market failure.**

# Chapter 1

## Background to the inquiry

1.1 The Committee has conducted three inquiries into financial services reform legislation made under the sixth stage of the Government's Corporate Law Economic Reform Program (CLERP 6).

1.2 The first inquiry in 2000 involved the exposure draft for the Financial Services Reform Bill.[1] The second inquiry in the following year involved the Financial Services Reform Bill 2001.[2] More recently, the Committee inquired into regulations and policy statements made under the *Financial Services Reform Act 2001* (FSR Act). This inquiry culminated in the tabling of the Committee's *Report on the Regulations and ASIC Policy Statements made under the Financial Services Reform Act 2001* on 23 October 2002.

1.3 As the formulation and then implementation of the CLERP 6 legislation progressed, the Committee heard increasing debate on the advantages and disadvantages of commission disclosure for risk insurance products.

1.4 The Committee's view, expressed in its 2000 and 2001 reports, was that there should be no requirement for disclosure of commission on risk insurance products because:

- there was no consumer demand for such disclosure and it served no purpose;
- cost and service were the principal concerns of consumers; and
- disclosure would adversely affect the viability of small risk insurance businesses remunerated by commission.[3]

1.5 The Labor Members' minority reports in 2000 and 2001 expressed clear opposition to any commission disclosure exemption for risk products.[4] In their supplementary report in 2001, the Democrats supported full disclosure and stated they

---

1 *Report on the Draft Financial Services Reform Bill*, 14 August 2000.

2 *Report on the Financial Services Reform Bill 2001,* 16 August 2001.

3 *Report on the Draft Financial Services Reform Bill*, 14 August 2000, Chapter 5, paragraph 5.8; *Report on the Financial Services Reform Bill 2001,* 16 August 2001, Chapter 6, paragraphs 6.24-6.26.

4 *Report on the Draft Financial Services Reform Bill*, 14 August 2000, *Minority Report*, pp. 32-3. *Report on the Financial Services Reform Bill 2001,* 16 August 2001, *Labor Members Minority Report*, p. 107.

would 'almost invariably err on the side of disclosing, unless that is likely to cause too great an administrative burden, or is unnecessary'.[5]

1.6 In its third report in 2002, the Committee did not depart from its earlier conclusion. The Committee also supported the qualification regarding commission disclosure in the Product Disclosure Statement and recommended that this be retained.[6]

1.7 On 22 August 2001, during the passage of the FSR Bill, the Senate adopted a motion proposed by Senator Andrew Murray that the requirement in the Bill that commissions on risk products be fully disclosed be referred to the Committee for inquiry and report on or before 1 October 2003. Federal elections, however, intervened and the reference lapsed.

1.8 On 14 November 2002, after the commencement of the 40th Parliament, the Committee resolved to inquire into and report on the requirements for disclosure of commission on risk insurance products. The Committee agreed that such an inquiry would provide the opportunity to conduct a more wide-ranging examination of relevant issues.

1.9 The Committee advertised nationally on 22 and 27 November 2002 inviting submissions from interested parties. Written submissions totalled 50. Three supplementary submissions were also received. A list of these submissions is in Appendix 1 to this report.

1.10 Public hearings were held in Canberra on 5 March 2003 and in Adelaide on 12 March 2003. A list of witnesses who appeared before the Committee is in Appendix 2.

1.11 All submissions and the Hansard of the Committee's hearing are tabled with this report. The Hansard of the hearing is available at the Parliamentary website, http://www.aph.gov.au/hansard/joint/commttee/j-corps-fs.htm.

1.12 The Committee thanks those who made submissions or who appeared as witnesses.

---

5 *Report on the Financial Services Reform Bill 2001,* 16 August 2001, *Australian Democrats Supplementary Report*, pp. 119-20.

6 Under paragraph 1013D(1)(e) of the *Corporations Act 2001*, commission need only be disclosed in the Product Disclosure Statement if it may or will affect the amount of the return generated by the financial product involved. Consequently, for risk insurance products where the policy or insurance payment is not affected by the commission paid, it is generally accepted that disclosure of commission will not be required.

# Chapter 2

## Disclosure requirements for risk insurance products

### What are risk insurance products?

2.1 Risk insurance involves the provision of an insured with an agreed financial benefit upon the occurrence of an insured event. With a risk insurance policy, there is no surrender value, and payment of a benefit is not linked to a specified date or dates.[1]

2.2 Before going into more detail about these products, it must be remembered that the up-front disclosure provisions, which are the subject of this inquiry, apply where a person deals in financial products or gives financial advice to a retail as opposed to a wholesale client. [2]

2.3 Generally, a retail client is:

a) an individual who does not exceed certain net worth or gross income specifications[3] and is not a 'professional investor';[4] or

b) a small business[5] purchasing the product for use in connection with that business.

2.4 This definition applies in the case of life risk insurance and would therefore include a dealing in or advising on the following kinds of products:

- total and permanent disability;
- income protection;

---

1 The *Corporations Act 2001* defines 'risk insurance product' in sections 761A and 764A. These provisions would generally cover life risk insurance and general insurance. For a working definition of 'risk policy', see the *Code of Practice for advising, selling and complaints handling in the life insurance industry*, ISC Circular to life insurance companies and life brokers, Consumer Issues No. G.II.1, August 1995.

2 Section 761G defines 'retail client' and 'wholesale client'. Basically, if an insurance product is not acquired by a retail client, it is taken to have been acquired by a person as a wholesale client.

3 Corporations Regulation 7.1.28 sets minimum net worth and gross income thresholds of $2.5 million and $250,000 respectively. (Under subsection 761G(7), the gross income must be for each of the last two financial years.)

4 'Professional investor' is defined in section 9. Briefly, the person or entity, because of their licensee status, trustee status or business activities, does not qualify as a person who would need the protection of the disclosure provisions.

5 Subsection 761G(12) defines 'small business' as a business employing less than 100 people if it manufactures goods, or otherwise a business employing less than 20 people.

- term life; and
- trauma insurance.

2.5 For general insurance products, the definition of retail client is different and turns on the type of client and the products involved. For these types of products, a retail client is:

a) an individual; or

b) a small business purchasing the product for use in connection with that business,

who or that purchases:

i) motor vehicle insurance;

ii) home building insurance;

iii) home contents insurance;

iv) sickness and accidence insurance;

v) consumer credit insurance;

vi) travel insurance;

vii) personal and domestic property insurance; or

viii) a prescribed general insurance product.[6]

2.6 The above are general insurance risk products. Up-front commission disclosure requirements for these products as well as the life risk products cited above, come within the terms of reference of this inquiry.

## Up-front disclosure requirements under the FSR Act

2.7 The disclosure requirements introduced by the *Financial Services Reform Act 2001* (FSR Act) build on the framework set by the *Financial System Inquiry* (Wallis Inquiry)[7] and are intended to promote 'informed decision-making by the consumers of financial products' by enabling them to 'compare product characteristics, costs and expected rates of return'.[8] These objectives are achieved through specified disclosures by financial services providers in three documents:

---

6 Subsection 761G(5).

7 *Financial System Inquiry Final Report*, March 1997.

8 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 4, paragraph 2.6.

- the Financial Services Guide (FSG)—this is intended to provide consumers with information about the types of services being offered by a financial services provider;[9]
- the Statement of Advice (SOA)—this is intended to ensure that consumers 'receive information necessary to make informed decisions whether to act on the advice';[10] and
- the Product Disclosure Statement (PDS)—this is the point-of-sale document which is intended to provide consumers 'with sufficient information to make informed decisions in relation to the acquisition of financial products, including the ability to compare a range of products'.[11]

2.8 The three disclosure documents are examined in more detail below.

## Financial services guide (FSG)

2.9 A FSG must generally be given to a retail client before financial services are provided to the client.[12] The FSG is intended to enable a consumer to make an informed decision about whether to obtain financial services offered by a particular financial services provider. Among other things, the Act specifies that the FSG must contain information about:

- the kinds of financial services offered and the kinds of financial products to which the services relate; and
- the person for whom the provider acts in the provision of the services.

2.10 Because of their relevance to the issues raised in this inquiry, the requirements relating to disclosure of commissions in the FSG are quoted from the legislation. For financial services licensees, paragraph 942B(2)(e) requires disclosure of:

> …information about the remuneration (including commission) or other benefits that any of the following is to receive in respect of, or that is attributable to, the provision of any of the authorised services:
>
> (i) the providing entity;
>
> (ii) a related body corporate of the providing entity;
>
> (iii) a director or employee of the providing entity or a related body corporate;

---

9 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 109, paragraph 12.6.

10 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 117, paragraph 12.50.

11 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, p. 137, paragraph 14.28.

12 Section 941D. Exceptions are made in time-critical cases. Also, there are some circumstances in which a FSG is not required (section 941C).

(iv) an associate of any of the above;

(v) any other person in relation to whom the regulations require the information to be provided…[13]

2.11 The regulations[14] provide more detailed guidance on how disclosure of 'remuneration, commission or other benefits' is to be effected, namely:

- The amount of remuneration, commission or other benefits must be stated or, if not known at the time the FSG is given, a description of the means of calculation or provision must be included. In the latter case, the FSG should give a range of amounts. The regulation gives the example: 'Commission is paid at rates between X% and Y%'.
- Where personal advice is given, the FSG must include a statement that the quantum of commission and the timing and means by which commission is to be payable will be disclosed in the SOA.

2.12 ASIC's PS 175 *Licensing: Financial product advisers—Conduct and disclosure*, says with regard to remuneration disclosure in the FSG that:

> Ranges, rates, comparisons, simple tables and formulae should normally be included in the FSG to ensure that the information is presented in a clear, concise and effective manner. Normally, worked dollar examples should be included in the FSG (where actual amounts cannot be ascertained at the time the FSG is provided).[15]

2.13 The requirement to provide a FSG does not distinguish between risk products and other financial products.

## Statement of advice (SOA)

2.14 Financial services providers must give retail clients a SOA when they provide personal advice.[16] The SOA can either be the means by which advice is provided or a separate record of the advice.[17] Except in specified time-critical cases, the SOA, as a record of the advice, must be given as soon as practicable after the advice is provided and before provision of any service arising from the advice.

---

13 Section 942C specifies FSG requirements for authorised representatives. While based on section 942B, the section includes additional requirements for information about the authorised representative's employer (if applicable) and the authorising licensee.

14 Corporations Regulations 7.7.04 (FSG given by a licensee) and 7.7.07 (FSG given by an authorised representative).

15 Page 15, paragraph 175.39. (PS 175 was released on 26 June 2003.)

16 Section 944A. Financial product advice is 'personal advice' if the adviser has considered one or more of the person's objectives, financial situation and needs, or if a reasonable person might have expected the adviser to have considered one or more of those matters: subsection 766B(3).

17 Subsection 946A(2).

2.15 The Explanatory Memorandum for the Financial Services Reform Bill 2001 says:

> The content requirements [of the SOA] are intended to ensure that consumers receive information necessary to make informed decisions about whether to act on the advice, while at the same time allowing industry some flexibility in determining the level of information that should be included.
>
> …the level of detail of information is that which a person would reasonably require for the purpose of making a decision whether to act on the advice provided.[18]

2.16 The express emphasis in the SOA regarding commission disclosure is on the capacity of commission to influence the advice given. Specifically, the requirement is for the disclosure of:

> …information about any remuneration (including commission) or other benefits…that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice…[19]

2.17 Corporations Regulations 7.7.11 and 7.7.12 applicable to financial services licensees and authorised representatives respectively, require commission to be stated as an amount with details of when and how the commission is payable. If the total amount cannot be identified at the time the SOA is provided, the method of calculation of the commission should be specified and include, where appropriate, percentages or worked dollar examples.

2.18 ASIC's PS 175 *Licensing: Financial product advisers—Conduct and disclosure,* indicates that disclosure of 'remuneration, commission and other benefits' specified in the legislation 'includes…all upfront commissions, trailing commissions and "soft" dollar commissions or benefits'. ASIC takes the view that 'even where the providing entity…receive[s] the same level of commission for all the financial products it recommends, the commission received should normally be disclosed in the SOA'. This is because ASIC considers the receipt of commission—regardless of its quantum—could reasonably be expected to influence or to be capable of influencing a recommendation that the client purchase a financial product.[20]

2.19 As with the FSG, the requirement to provide a SOA does not distinguish between risk products and other financial products.

---

18 Page 117, paragraphs 12.50-12.51.

19 Paragraphs 947B(2)(d) and 947C(2)(e). Section 947C specifies SOA requirements for authorised representatives. As with the FSG provisions discussed above, SOA requirements for authorised representatives are based on those for licensees in section 947B but include additional requirements for information about the authorised representative's employer (if applicable) and the authorising licensee.

20 Page 43, paragraphs 175.138-175.139.

## Product disclosure statement (PDS)

2.20 Generally, a PDS must be given to a retail client at or before:

- giving financial product advice; or
- entering into a binding agreement to sell or issue a financial product.[21]

2.21 The rationale for the PDS is stated in the Explanatory Memorandum:

> The broad objective of point of sale disclosure obligations is to provide consumers with sufficient information to make informed decisions in relation to the acquisition of financial products, including the ability to compare a range of products.[22]

2.22 A provider must include in a PDS 'such of the following information as a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product'.[23] The provision lists various categories of information which includes areas such as:

- significant benefits and risks of the product;
- the cost of the product and when amounts are payable;
- if payments are made into a common fund, the fees, expenses or charges that will be deducted;
- other significant characteristics of the product;
- dispute resolution arrangements; and
- taxation implications.[24]

2.23 In addition, if the financial product 'will or may generate a return', the PDS must contain information about 'any commission, or other similar payments, that will or may impact on the amount of such a return'.[25] The purpose of this requirement is to help the client to assess what the likely return will be on the product.

---

21 Sections 1012A, 1012B and 1012C.

22 Page 137, paragraph 14.28.

23 Section 1013D.

24 Section 1013D. In the event that the main contents requirements omit information that could be pertinent to a retail client when deciding whether to purchase a product or not, section 1013E provides a 'catch-all' provision that says the PDS must contain 'any other information that might reasonably be expected to have a material influence on the decision of a reasonable person, as a retail client, whether to acquire the product'.

25 Paragraph 1013D(1)(e).

2.24 Where the product is not an investment product but is instead a risk insurance product,[26] there is no requirement to disclose commission or similar payments in the PDS:

> For the most part, when a consumer purchases a risk insurance product they pay a premium in order to insure against a future risk. If and when that future risk eventuates, the consumer will receive the amount for which they were insured…the payment of the commission will not affect the amount paid if the event occurs.[27]

26 Paragraphs 764A(1)(d), (e) and (f) provide three definitions of insurance products that are regarded as financial products. They include life policies and sinking fund policies within the meaning of the *Life Insurance Act 1995* and general insurance that is not reinsurance, health insurance or Commonwealth, State or Northern Territory insurance.

27 Financial Services Reform Bill 2001, Explanatory Memorandum, Parliament of the Commonwealth of Australia, House of Representatives, page 148, paragraph 14.95.

# Chapter 3

## Commission and bias

### Why disclosure?

3.1 It has long been recognised that consumers have a right to be fully informed about impending purchases to ensure they are able to make the most appropriate choices for their needs. It is also recognised that measures to achieve these objectives must strike a balance with the interests of the providers of these goods and services to ensure optimum market performance.

3.2 According to the *Financial System Inquiry* (Wallis Inquiry), being fully informed included having 'information about fees, commissions…and the remuneration paid to [one's respective] financial advisers…[to] determine whether a recommendation is skewed in favour of a particular product'. Disclosure of remuneration was advocated 'at a minimum' in relation to products from which commissions were deducted.[1]

3.3 The *Financial Services Reform Act 2001* (FSR Act), consistent with the Wallis Inquiry's recommendations, developed an up-front disclosure regime that was intended to alleviate information asymmetries between providers and consumers. However, the FSR Act went further than the Wallis Inquiry's minimum disclosure requirements. As noted in the previous chapter, remuneration disclosures are required in the Financial Services Guide (FSG) and Statement of Advice (SOA) on investment and non-investment products.

3.4 When introducing what is now the FSR Act into Parliament, the then Minister for Financial Services and Regulation, the Hon. Joe Hockey MP, stated in relation to the disclosure provisions that:

> The financial service provider disclosure obligations contained in the bill will ensure that retail clients receive sufficient information to make informed decisions about whether to take up a financial service and whether to act on the advice they receive.
>
> In particular, advisers will be required to disclose information on any conflicts of interest, including commissions, that might reasonably be expected to influence the advice provided. Additional requirements will apply where advice recommends the replacement of one financial product with another.
>
> …

---

1 *Financial System Inquiry Final Report,* March 1997, pp. 262-3.

> The bill's approach to financial product disclosure is intended to ensure that retail clients receive sufficient information to make informed choices in relation to the acquisition of financial products and that this information is provided in a concise and readily understandable format that facilitates comparisons between financial products.[2]

3.5 For the FSG, the content requirement for commission disclosure refers to 'information about the remuneration (including commission) or other benefits that [any of certain listed parties] is to receive in respect of, or that is attributable to, the provision of any of the authorised services'.[3] While on its face the provision does not mention remuneration that might be capable of 'influencing' the advice given, it is arguable that remuneration disclosures are intended to alert consumers to this possibility.

3.6 Indeed, this seems to have been the inference drawn by witnesses at the current inquiry.[4]

3.7 It is clear that commission disclosure in the SOA is intended to protect the consumer against the possibility that a financial services adviser, acting out of self-interest, may give biased advice. In so doing, the presumption is that the consumer will be disadvantaged by such advice and will suffer detriment. As discussed in an earlier chapter, the main content requirements of the legislation require disclosure of 'any remuneration (including commission) or other benefits that [any of certain listed parties] is to receive that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice'.[5]

3.8 Before looking into the commission/bias issue, the Committee wishes to point out that much of the evidence to this inquiry did not specify whether objections were to disclosure in all or some of the three disclosure documents, namely, the FSG, SOA and Product Disclosure Statement (PDS).

3.9 As commission for risk insurance products does not have to be disclosed in the PDS,[6] this report concentrates on commission disclosure in the FSG and SOA unless this would be inappropriate.[7]

---

2 Second Reading Speech, 5 April 2001, *House Hansard*, pp. 26523-4.

3 Paragraphs 942B(2)(e) and 942C(2)(f).

4 See, for example, the comments of Mr Con Hristodoulidis, FPA, *Committee Hansard*, 5 March 2003, p. 12.

5 Paragraphs 947B(2)(d) and 947C(2)(e).

6 Paragraph 1013D(1)(e). If the financial product will or may generate a return, commission and other benefits need only be disclosed in the PDS if they will or may affect the return.

7 Arguments that a disclosure exemption will create scope for abuse with packaged investment products having a risk component will be taken to include references to the PDS.

## Testing the presumption

3.10 Given the consumer-protection rationale of the legislation, the Committee's approach to the debate regarding commission disclosure will be influenced by its findings regarding the presence or otherwise of commission-driven bias in the risk insurance industry.

3.11 The disclosure provisions discussed in this inquiry are based on the premise that because remuneration structures can militate against an adviser's impartiality, clients should be alerted to this possibility. As the Australian Consumers' Association said in its submission:

> Commissions may influence agents to recommend products that are more expensive for consumers than other products; products that are less appropriate for consumers than other products; or products that are inappropriate. Commission disclosure gives consumers improved tools with which to consider the quality and impartiality of advice provided by agents.[8]

3.12 The Committee believes it is important to see whether this premise has any basis in fact. Is there, for example, sufficient evidence of commission-driven bias among risk insurance advisers to warrant the disclosure of commission in the FSG and SOA?

3.13 Although research commissioned by the then Trade Practices Commission (TPC) in 1992 found evidence of commission-driven mis-selling in the life investment market, the Committee is unaware of any recent studies into the relationship between remuneration structures and bias in the risk insurance industry.[9]

3.14 The Committee notes that the Financial Services Authority in the United Kingdom recently commissioned an independent study[10] to determine whether financial advisers[11] in the packaged investments market displayed commission bias.

3.15 The need for such a study was explained thus:

> Do financial advisers display 'commission bias', recommending the products or providers that pay them the largest commissions? Does this damage the interests of buyers of packaged investment products? While

---

8 *Submission* 48.

9 The findings of the TPC's research program were published in *Life insurance and superannuation*, December 1992.

10 *Polarisation: research into the effect of commission based remuneration on advice*, Charles River Associates Ltd, published by the Financial Services Authority in January 2002. A copy of the report is available at http://www.fsa.gov.uk/pubs/other/pol_res1.pdf.

11 Under the UK's polarisation regime, there are IFAs or independent financial advisers and tied advisers. IFAs act as agents for customers and can advise on products across a range of providers. Tied advisers, on the other hand, can only advise on the products of one provider. The study looked at both categories of advisers.

> everyone knows individual cases or has their own hunches, previous research has been inconclusive on whether there is bias, and economic theory is ambiguous about whether bias would necessarily be harmful.[12]

3.16 The findings of the study were that, apart from bias displayed with some products, there was no evidence of 'significant bias in the advice given in the remainder of the market for investment products' and 'for the most part the advice market is working reasonably well, and…adviser recommendations are not dominated by self-interest'.[13]

3.17 The Committee acknowledges that the findings cannot be applied to the Australian risk insurance market. However, they do suggest—and this is important for the purposes of this inquiry—that bias is not necessarily an inevitable by-product of commission. It was with this in mind that the Committee reviewed the evidence.

## *Evidence from witnesses*

3.18 Numerous and varied assumptions were made during the inquiry about the link between commission, self-interest and consumer detriment. No concrete evidence was produced, however, to prove or disprove such a connection in the risk insurance industry. Evidence addressing this issue tended to be anecdotal.

3.19 One adviser appeared somewhat affronted by the suggestion that advisers might be motivated more by commission levels than by legitimate professional concerns, and asked:

> As a life broker representative with the availability of many products to consider, do you think that I sit here and work out which products are going to pay me the most dollars?[14]

3.20 Other advisers considered that their use of research software to help with product selection countered any possibility of bias.[15]

3.21 One adviser sought proof that commission disclosure was necessary and asserted that:

---

12 FSA study, p. v.

13 Page vi, FSA study. The study was well designed and used two complementary approaches. The first involved a statistical economic analysis of changes in commission rates for certain products to see if there was any correlation with changes in the sales volumes for these products. This analysis was intended to throw some light on provider bias. (Provider bias' was defined as recommending products paying the highest commission.) The second involved a mystery shopping exercise in which approaches were made to 250 advisers. The purpose of this exercise was to see if there was a relationship between commission and product bias. ('Product bias' was defined as recommending, within a particular product type, the provider paying the highest commission.)

14 *Submission* 11.

15 *Submission* 20 and 22.

> …the regulators can't point to any industry statistics which support the need for such disclosure, i.e. there is no great body of evidence pointing to the fact that advisers have been misrepresenting risk products to the public.[16]

3.22 The Life Advisers Action Group (LAAG) questioned why commission disclosure was considered so important when industry statistics showed a decline in consumer complaints against life insurance advisers. Referring to statistics compiled for 2000 by the Financial Industry Complaints Service Limited,[17] the LAAG claimed that there had been:

- a drop in life insurance complaints from 1,260 in 1994 to 618 in 2000;
- a drop in complaints involving misrepresentation from 38 per cent in 1996 to 11 per cent in 2000;
- a total of only 10 stand-alone risk insurance complaints representing 1.6 per cent of total complaints, the remaining 30 per cent being attributable to life company services; and
- (using their own calculations) a complaint ratio for misrepresentation in 2000 of 0.001 per cent of all policies in force.[18]

3.23 Of the evidence endorsing commission disclosure, it was generally taken as a given that bias was inevitable where remuneration was in the form of commission and/or other benefits.

3.24 For example, Mr Nick Bruining, Member, FPA, commented that commissions 'certainly cloud the sorts of products that are recommended to clients'.[19] The Institute of Chartered Accountants in Australia (ICAA) considered that, without a disclosure requirement:

> …there is scope for unscrupulous market participants to fail the reasonable person tests of independence, objectivity and in the client's best interests.[20]

3.25 In answer to arguments that commission or profit margins did not have to be disclosed, for example, by car salesmen, supermarkets and so on, Mr Bruining observed that:

> …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'—

---

16 *Submission* 12.

17 *Annual Review 2000*, Financial Industry Complaints Service Limited.

18 *Submission* 6.

19 *Committee Hansard*, 5 March 2003, p. 5.

20 *Submission* 38.

> 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.[21]

3.26 Recognising that commission-driven bias may not be universal, the Committee asked the Department of the Treasury (Treasury) and the Australian Securities & Investments Commission (ASIC) whether the presumption relating to commission and adviser bias in the risk insurance industry had been tested.[22]

3.27 Mr Nigel Ray, Treasury, suggested that ASIC might be better placed to answer the question because of its role as regulator. He did comment, however, that:

> 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 [the disclosure provisions regarding commission in the SOA].[23]

3.28 Mr Ian Johnston, ASIC, said the regulator's experience was that 'there is strong evidence that product pushing takes place where commission is highest' and that this happened 'frequently'. Among other things, he based these observations on ASIC's ongoing surveillance work, the joint ASIC/ACA shadow-shopping survey of the quality of financial planning advice,[24] and a survey of advisers in the securities market. He indicated that ASIC's experience of behaviour in the risk insurance industry was not as extensive as in other financial markets given that it had only recently come within ASIC's area of responsibility. Because of this, ASIC could not point to any specific findings that established a correlation between commissions and mis-selling of risk insurance products.[25]

3.29 Other witnesses were not convinced that there was a need for empirical research or surveys to prove a connection between commission and bias. Ms Catherine Wolthuizen, ACA, thought the need for such research was irrelevant given that the obvious purpose of commissions was to 'incentify sales'. She said:

---

21 *Committee Hansard,* 5 March 2003, p. 58.

22 *Committee Hansard,* 5 March 2003, p. 47.

23 *Committee Hansard,* 5 March 2003, p. 47. (It appears to the Committee that the underlying rationale for the SOA is to protect consumers against mis-selling of a product because the adviser will receive commission—whether it be the highest on offer or a lower amount.)

24 Details of the shadow-shopping survey were published by ASIC in *Survey on the quality of financial planning advice, ASIC research report* (ASIC report) February 2003 and by the ACA in *Financial planners put to the test*, February 2003.

25 *Committee Hansard*, 5 March 2003, p. 48. ASIC took up responsibility for regulation of conduct and disclosure issues in the insurance industry on 1 July 1998.

> We…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 mis-selling, 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 mis-selling 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.[26]

3.30 In a joint submission, the FPA, IFSA and ACI expressed a similar view that the obvious purpose behind the use of commission structures and the payment of other benefits was to 'incentify sales'. They argued that these were 'clearly intended to influence the promotion of one product over another' and '[w]hile the end benefit could be the same the recommendation could be influenced by commission structure and incentives'.[27]

3.31 Mr Con Hristodoulidis, FPA, added at the hearing that:

> …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. 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.[28]

## *Studies and surveys*

3.32 The Committee also looked at other sources to see if they pointed to the potential for commission-driven bias among risk advisers.

### TPC report, 1992

3.33 In 1992, the Trade Practices Commission (TPC) published the results of 'empirical research into consumers' experiences with life insurance and superannuation agents' in *Life insurance and superannuation*. The findings of this

---

26 *Committee Hansard*, 5 March 2003, p. 55.

27 *Submission* 45, pp. 4-5.

28 *Committee Hansard*, 5 March 2003, p. 14.

research were the catalyst for the introduction of fee and commission disclosure for life investment products.

3.34 Although the selling practices of life risk products were not included in the research, the report made some useful observations about the potential dangers of commission-based selling. The TPC looked at 'the availability to consumers of impartial advice in relation to life insurance…and personal superannuation services' and commented that:

> The TPC is concerned that life insurance agents may not be seen as providing impartial advice because they…have a direct financial interest in the sales transaction which may influence their advice…[29]

3.35 In addition, the TPC thought that commission militated against 'needs based' selling. It noted that, although there was vigorous competition on the supply side of the life insurance market, consumers continued to receive poor value for money. It attributed this market failure to the fact that consumers did not have enough information to enable them to 'choose rationally' between the products on offer and commented that 'there would be benefits for competition and consumers in requiring agents to disclose their commission payments'.[30]

3.36 A recommendation was consequently made that intermediaries should be required to make up-front oral and written disclosure of commission and other benefits to clients:

> [to make] consumers more aware of, and vigilant against, the potential for 'commission bias' in the advice they receive…[31]

3.37 The TPC's reference to 'commission bias' was arguably well grounded. Independent research and analysis into consumer purchases and discontinuances of investment life insurance products indicated that:

> There appeared to be a strong relationship between the quality of [a consumer's] purchase decision and being 'told' about commission arrangements. Those who were told about commission arrangements made an 'excellent' decision three times more often than those who recorded 'didn't mention'. They also made half the number of poor decisions. While it does not follow that there is a direct causal relationship involved it does

---

29 *Life insurance and superannuation*, December 1992, TPC, p. xii. The TPC's findings were endorsed in 1993 by the Senate Select Committee on Superannuation (SSCS) following its inquiry into long-term savings and superannuation products sold by life insurance agents. The SSCS concluded in its report, *Super—Fees, Charges and Commission*, that commission should be disclosed to enable consumers 'to make independent and informed judgements about the motives of the agent selling the product and the cost of the financial advice prior to sale'.

30 TPC report, p. xiv.

31 TPC report, p. xiv.

> suggest the role of information disclosure is in some way significant in the process of making the investment decision…[32]

3.38 In addition, the marketing and distribution practices in the industry revealed a remuneration structure for agents that provided 'very substantial rewards for new business sales' and thus the potential to 'encourage inappropriate sales and selling practices'.[33]

3.39 These findings are somewhat tempered by the fact that the research did not cover risk insurance products. In the passage below, the TPC explains why.

> The TPC's research **did not** cover the full range of products distributed through the life industry's agency system as there was general consensus that the products consumers have most problems with are the savings and investment products. Because of the nature of risk products such as term life and disability insurance, the purchase transaction is more straightforward, with comparison shopping, mainly focusing on price, being possible. The fact that these products do not have an investment component and thus no surrender value, eliminates the major cause of consumer detriment and dissatisfaction with life company products.[34]

3.40 It is interesting that the TPC attributed the major cause of consumer detriment and consumer dissatisfaction to life investment products because of their investment component. The complaints statistics published by the Financial Industry Complaints Service over the past three years, for example, indicate that this is still the case with life investment products generating the majority of complaints for mis-selling.[35]

## Office of Fair Trading (United Kingdom) report, 1997

3.41 In 1997, the Office of Fair Trading in the United Kingdom commissioned an independent study of the relevant academic and applied literature to look at the relationship between information asymmetries and consumer detriment.[36]

3.42 Of particular interest to the Committee was the study's identification of specific indicators of markets where informational problems were most likely to occur and to result in consumer detriment. Of the six identified indicators, the following four are present in risk insurance markets:

---

32 TPC report, pp. 98-9. This conclusion was based on consumer survey data collected the Roy Morgan Research Centre (RMRC) and the independent analysis of that data by Mr Daryl Dixon, financial adviser and author. Note that the surveys concerned life office investment products and not risk insurance products.

33 TPC report, p. xiv.

34 TPC report, pp. 25-26.

35 See FICS Annual Review for 2001, 2000 and 1999.

36 *Consumer Detriment under Conditions of Imperfect Information*, prepared for the Office of Fair Trading by London Economics, August 1997, research paper 11.

- price dispersion for seemingly similar products;
- commissioned advisers;
- complex products; and
- infrequent purchase.[37]

3.43 On the subject of commissions in particular, the study commented that they could 'force a divergence between the incentives of sales people and consumers' which could result in mis-selling or overpricing. In addition, it observed that:

> [Commissions] paid by upstream firms to sales people or advisers, to encourage the sale of a specific product or service, are likely to be most damaging.[38]

## ASIC Final Report, National Life Insurance Disability Campaign, 2001

3.44 From May to September 2000, ASIC conducted an investigation into the sale of disability insurance by tied and multi-agents. In its *Final Report, National Life Insurance Disability Campaign*, ASIC commented that there were significant shortcomings in life companies' and agents' conduct, advisory and sales practices for disability insurance products.[39]

3.45 ASIC's survey did not set out to make findings about the relationship between bias and remuneration structures. However, ASIC's comments that 'most life companies paid agents by commission under structures that did not reward them for advising clients—even on a limited basis' are consistent with those made in the TPC report.[40]

3.46 In contrast perhaps to the TPC's observations that the purchase transaction for disability products was relatively straightforward, ASIC described disability insurance policies as 'typically difficult to understand' with a substantial variation in coverage between products. The implication was that with such complex products, it would be desirable if remuneration could be structured to improve the quality of advice.

---

37 *Consumer Detriment under Conditions of Imperfect Information*, prepared for the Office of Fair Trading by London Economics, August 1997, research paper 11, pp. 102-110.

38 *Consumer Detriment under Conditions of Imperfect Information*, prepared for the Office of Fair Trading by London Economics, August 1997, research paper 11, p. 106.

39 *Final Report, National Life Insurance Disability Campaign*, February 2001, ASIC, p. 6. The report was provided as Attachment 1 to ASIC's *supplementary submission* 34A.

40 *Final Report, National Life Insurance Disability Campaign*, February 2001, ASIC, pp. 6-7.

### Financial Services Authority study, 2002 (FSA study)[41]

3.47 As noted earlier, the FSA study's findings are significant for this inquiry because they show that it is not necessarily correct to assume there will always be a connection between commission and bias that causes detriment to consumers.

### ASIC/ACA shadow-shopping survey, February 2003

3.48 The ASIC/ACA shadow-shopping survey[42] into the quality of financial planning, raises interesting issues about remuneration structures, bias and consumer detriment.

3.49 The survey found that 'significantly worse' financial plans were produced by financial planners remunerated by commission only.[43] ASIC commented in this regard that:

> A common observation by several judges was that clients' interests did not appear to be the sole factor in the plan strategy or product selection. They characterised this practice as '*commission-driven product selling, not impartial advice.*'[44]

3.50 Although this study has identified instances of commission-driven bias in the financial planning industry, its results do not apply directly to risk advisers. Furthermore, the survey was neither intended nor designed to produce concrete evidence of a relationship between commission and bias, and concentrated on financial planners—not risk advisers.

## The Committee's views

3.51 The Committee would have been helped greatly by better targeted quantitative and qualitative evidence to establish or disprove the presumption underlying the commission disclosure requirements as they apply to risk insurance advisers.

3.52 For the Committee, the commission/bias issue was not clear cut and, in the absence of compelling evidence either way, a decision was made to defer to the interests of consumers.

---

41 *Polarisation: research into the effect of commission based remuneration on advice*, Charles River Associates Ltd, published by the Financial Services Authority in January 2002. A copy of the report is available at http://www.fsa.gov.uk/pubs/other/pol_res1.pdf.

42 *Survey on the quality of financial planning advice, ASIC research report*, February 2003 and the ACA in *Financial planners put to the test*, February 2003.

43 ASIC report, p. 6.

44 ASIC report, p. 33.

# Chapter 4

## Disclosure: Will it help consumers?

### Introduction

4.1 Risk advisers opposed to commission disclosure argued that consumers were not interested in disclosure, that disclosure would be counter-productive and misleading, and that it would not always be possible to ensure the accuracy of such disclosures. Furthermore, it was claimed that as commission did not affect the end benefit to the consumer, there was consequently no reason for disclosure.

4.2 Apart from dismissing these claims as unfounded, those advocating the retention of the status quo advanced the following arguments:[1]

- Commissions and benefits affected the costs of the products involved and, as such, were relevant to consumers' decisions whether to purchase these products.
- Allowing an exemption for risk products would create opportunities to hide real commissions on investment products sold as a package with risk products.[2]
- Commission disclosure was essential to maintain the regulatory harmony intended by the *Financial Services Reform Act 2001* (FSR Act).

4.3 Risk advisers' claims about the more immediate practical issues ensuing from the disclosure requirement are examined in this chapter.

### Consumers' attitudes and the need for disclosure

4.4 The Committee heard from several risk advisers that consumers' interests, when purchasing risk insurance products, were in 'the ability of the company to pay in the event of a claim, its attitude to paying claims, the suitability of the contract, and then, assuming the first three criteria [were] met, costs'.[3] They were not interested in knowing what commissions their advisers were paid.[4]

4.5 Mr Robert Ross explained why he had come to this conclusion:

---

1 These included financial planning practitioners, the Australian Consumers' Association (ACA), the Institute of Chartered Accountants in Australia (ICAA), the Financial Planning Association of Australia Limited (FPA), the Investment & Financial Services Association Ltd (IFSA) and the Australian Compliance Institute (ACI).

2 *Submissions* 5 and 45.

3 *Submission* 33. See also *submission* 19.

4 See, for example, *submissions* 9, 10, 11, 14, 28, 33, 46 and 47. See also comments by Mr Brian Enever, Insurance Advisers Association of Australia, *Committee Hansard*, 5 March 2003, p. 31.

> My adviser services guide, which I give to every client, says, ‘Remuneration: we will be paid (a) a commission, (b) a fee charged to 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.[5]

4.6 Similarly, Mr Bill Brown told the Committee:

> I have a disclosure [statement] like [Mr Ross] has, and I say to my clients that those products have a rate of commission within five per cent of each other…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.[6]

4.7 However, for some witnesses, the presence or absence of consumer demand for commission disclosure was irrelevant.

4.8 According to the Institute of Chartered Accountants in Australia (ICAA), for instance, consumers would not be harmed by disclosure whether or not there was a demand. Furthermore, the ICAA considered that a consumer armed with information about commission could be prompted to ‘reconsider or amend a course of action’.[7]

4.9 Mr Ian Johnston said that ASIC was not opposed to ‘people being paid by commissions’ but did not accept ‘the argument that consumers are better off by not being told about something’.[8]

4.10 The Corporate Superannuation Association Inc (CSA) disagreed with claims that because commissions for risk products did not affect the end benefit they should not have to be disclosed. The CSA argued that:

> …commissions form part of the cost structure for an insurance product and that even if not recovered directly at the time of the sale of the policy, such costs ultimately affect premium levels…consumers should be made aware of this aspect of any product they are evaluating.[9]

4.11 Similarly, in their joint submission, the FPA, IFSA and ACI said that ‘[other benefits such as overseas conventions and volume bonuses] are logically factored in

---

5 *Committee Hansard*, 5 March 2003, p. 25.

6 *Committee Hansard*, 5 March 2003, p. 25.

7 *Submission* 38, p. 1.

8 *Committee Hansard*, 5 March 2003, p. 46.

9 *Submission* 5.

by the product manufacturer to the price of the product' and were, along with commission structure, 'major factors in the cost of the premium'.

4.12 Mr Michael Rabbitt similarly argued that:

> …the amount of commission to an adviser is clearly a cost to the insurer and the insured. The amount of commission and other benefits to advisers, such as extravagant overseas trips, must add to the cost of premiums…
>
> In some cases, initial commissions are in excess of 100%; ongoing commissions are in the region of 30% pa. I believe many clients would be shocked by this high number.[10]

4.13 Opponents of disclosure challenged this view and claimed that product costs would remain the same regardless of whether product distribution was through agents, brokers or directly through salaried advisers.[11]

## Will disclosure mislead and confuse consumers?

4.14 In addition to the claims already discussed, concerns were raised that disclosure would confuse rather than inform consumers[12] or be 'complex, difficult to explain and ultimately misleading'.[13]

4.15 The Committee heard that accurate disclosure of remuneration was not always possible because of the manner in which commissions and other benefits were calculated. Advisers said they did not always know at the time disclosure was required what their remuneration would be.

4.16 Mr Ken Wybrow, Authorised Representative and Director of AAA Shares & Investments Pty Ltd, thought this could lead to outcomes that would not be 'helpful' to consumers and, in fact, be 'farcical'. He cited the following as an example of what remuneration disclosure could amount to in the Financial Services Guide:

> The licensee may receive commissions and fees ranging from 0% to 100% of the amount lodged or paid as a premium and may pay the adviser from 0% to 100% of that amount.[14]

4.17 The Mawson Group of Australia Limited expressed a similar view.[15]

---

10 *Submission* 4.

11 See, for example, the comments in *submission* 36.

12 *Submission* 1.

13 *Submission* 46.

14 *Submission* 14.

15 *Submission* 39.

4.18 More generally, it was argued that it was difficult to disclose commissions in such a way as to be meaningful to consumers and assist them in product selection. The AFA gave the following example published in *Money Management*:

> With the type of product finalised and the price fixed at say a first year annual premium of $3000, you may get one of at least four different answers [regarding commission] from:
>
> Adviser A who likes up-front commission, is a big producer with a number of staff and may answer by saying their business earns 110 per cent new business commission or $3300 in the first year and 10 per cent or $300 in the second year in trails if the policy is in force;
>
> Adviser B likes to know what their business income will be next month and is another big producer with staff, so based on a different commission schedule, the answer might be that their business earns 50 per cent or $1500 in the first year plus 30 per cent a year in renewals, that is, $900 in the first year;
>
> Adviser C is a one-man band who likes to work alone so the production and commission rate is lower and the answer may be that their business earns 67 per cent, that is $2000 plus 10 per cent or $300 in the first year;
>
> Adviser D is the employee of a bank, who receives a salary, but gets 5 per cent as an incentive and may answer saying $150 only in the first year.
>
> Now with the product, price and quality of advice the same, who are you going to buy from?[16]

4.19 Mr Brown argued that disclosure could be counter-productive and mislead consumers into making inappropriate product choices. He said that consumers might select products associated with lower premiums and commission levels believing them to represent better value when, in fact, they might be inappropriate for the client's needs. He referred to the hypothetical case study in his submission about a client seeking income protection insurance who is presented with nine options—some suitable, some unsuitable—and all with different premiums and different commissions:

> …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 [commission disclosure] distracts and confuses clients. [17]

---

16 *Submission* 32, pp. 3-4, taken from AFA's letter published in *Money Management*, 28 November 2002, p. 12.

17 *Committee Hansard*, 5 March 2003, p. 17 and *submission* 46.

4.20 Another concern raised by Mr Brown was that difficulties in accurately disclosing production bonuses which varied 'from life office to life office, and may (yet again) be varied by the life office in a product year' might expose advisers to penalties for non-compliance.[18]

## The Committee's views

### *Consumer indifference*

4.21 Although risk advisers at the hearing and in submissions asserted unhesitatingly that their clients were not interested in knowing what their remuneration was, the Committee is nevertheless unsure of how representative the experiences of these advisers are.

4.22 Furthermore, the Committee is concerned by the results of two studies, one in Australia initiated by the ANZ Banking Group which showed that adult consumers had a low level of financial literacy,[19] and the other in the United Kingdom that showed consumers had very little understanding of different remuneration structures of financial advisers.[20]

4.23 These studies suggest the need for better consumer education in financial matters. The Committee strongly supports measures designed to ensure that consumers are fully informed of matters that are relevant to their assessment of financial product recommendations. The mere fact that, for various reasons, some consumers might not be interested in remuneration disclosure is not a sufficient justification for overturning a measure designed to protect consumers' interests.

4.24 In light of this—and absent other factors—the Committee accepts in principle the views expressed by the ICAA that disclosure will not do the consumer any harm[21] and those of ASIC that 'consumers are [not] better off by not being told about something'.[22]

### *Commissions and product costs*

4.25 The next question for the Committee's consideration is whether risk insurance commissions should be disclosed because they affect product costs. This was an argument raised in favour of commission disclosure.

---

18 *Submission* 46.

19 ANZ Media Release: *ANZ releases Australia's first financial literacy survey*, 2 May 2003.

20 Financial Services Authority (United Kingdom), *Polarisation: Consumer Research, Report of research studies carried out by IFF Research Ltd, ORC International Ltd and NOP Research*, January 2002, pp. 31-2.

21 *Submission* 38.

22 Mr Ian Johnston, *Committee Hansard*, 5 March 2003, p. 46.

4.26 The Committee agrees that consumers should know how much they will pay for particular products and what the benefit or return on them will be. The Committee also agrees that consumers should be informed if remuneration is deducted from the return on an investment product.

4.27 However, many factors affect product costs and are not required to be disclosed. The Committee therefore questions how remuneration disclosure for risk insurance products will empower consumers in relation to product costs.

4.28 Indeed, the Committee acknowledges the comments made by risk advisers that there are no requirements for commission disclosure on many commodities, products or services sold to the public. In this regard, risk advisers referred to cars, furniture, white goods or electrical products and asked why risk insurance products should be regarded differently when the end benefit was known to the consumer.[23]

4.29 They emphasised the point that the client purchases a known level of cover at a known price—that the client's premium and end benefit remain the same regardless of the commission paid. Thus customers are well placed to compare a range of products on both costs and end product. This arrangement is very different from products that have an investment component.[24] Suggars & Associates represented the views of most risk advisers in submitting:

> In the case of life insurance, it is a product that people buy and keep as long as their need is there. The cost of the product i.e. the premium charged, is there for all to see. It is my job to find the most competitive product that provides all the features that are required including the one of major importance—how quickly the benefits will be paid, without fuss, in the event of a claim. It is a bit like buying a car, a computer or an appliance—will it do the job required and satisfy the need, be reliable and be at an affordable price. No one expects the store or salesperson to tell the client how much they make or earn as a commission on the sale or what the company's gross profit is on sale and neither should it be on risk insurance.[25]

4.30 The Committee believes that the principal consumer-oriented objective of insurance regulation should be that, if and when consumers make a claim the insurer and the insurance adviser will still be in business to assist them with claims.

4.31 Commission disclosure will not achieve this objective and, indeed, may work against it by forcing commissioned advisers out of the market and deny consumers the benefits of the claims handling services presently offered by these advisers.

---

23 See, for example, s*ubmissions* 6, 11, 13, 17, 20, 21, 23, 24, 25, 27 28, 32, 33, 36, 37, 41, 44 and 47.

24 See for example, R & J Holt Consultants Pty Ltd, *submission* 20, p. 1 and Peter Rae, *submission* 22, p. 2.

25 *Submission* 28, p. 1

4.32 Unless there is evidence to show that product costs are inflated as a result of distribution through agents and brokers, the Committee accepts risk advisers' claims that product costs will remain the same regardless of the distribution channel used.

4.33 Moreover, commission disclosure in the FSG and SOA appears to have more to do with alerting the consumer to the prospect of commission bias than of helping consumers to work out how remuneration expenses would affect product costs.

4.34 However, in the Committee's view, it is open to an adviser to explain to a client, for instance, why a more expensive product paying a higher commission is more suited to the client's needs or why a cheaper product might be more appropriate.[26]

## *Investment and risk insurance packages*

4.35 Several witnesses claimed that a disclosure exemption for risk products created scope for abuse when disclosure involved risk products packaged with investment products. The Committee agrees that if such products are on the market, there is potential for the loading up of commission on the risk product component to avoid disclosure of the actual commission on the investment component thereby artificially inflating the investment return. It appears that this may not have been adequately addressed in the legislation, in ASIC's Policy Statement 168: *Disclosure: Product Disclosure Statements (and disclosure obligations)* or ASIC's Policy Statement 175: *Licensing: Financial product advisers—Conduct and disclosure*.

**Recommendation 1**

**The Committee recommends that the Department of the Treasury and ASIC:**

- **investigate claims that there could be disclosure abuses on packaged products where commission disclosure requirements vary on the products involved; and**
- **where the potential for such abuses is confirmed, should take the appropriate action to close off this potential.**

4.36 With regard to concerns that the timing for disclosure militates against its accuracy, again, the Committee does not believe this alone constitutes a sufficient reason for dispensing with disclosure.

4.37 In any event, the relevant regulations[27] and ASIC's PS 175 *Licensing: Financial product advisers—Conduct and disclosure*, accepts that actual dollar

---

26 The Financial Services Authority in the United Kingdom proposed in *CP160—Insurance selling and administration: The FSA's high-level approach to regulation*, December 2002, that commission on non-investment life insurance not be disclosed. One of the drawbacks of disclosure cited in the proposal paper on page 74 was '**customer confusion—**...if the premium for two policies is the same but commission varies, it is not necessarily the right choice for a customer to choose the policy that pays the lowest commission'.

27 Corporations Regulations 7.7.04 and 7.7.04 (FSG) and 7.7.11 and 7.7.12 (SOA).

amounts of commission may not be known at the time disclosure is required in the FSG or SOA. ASIC suggests that where actual dollar amounts cannot be provided in the SOA, this information should be provided when available, for example:

- in periodic client communications;
- through a telephone or internet facility;
- in other communications required under the Act (such as a periodic statement or transaction confirmation).[28]

## *Regulatory harmony*

4.38 One of the objectives of the FSR Act is to provide a harmonised licensing, disclosure and conduct framework for all financial services providers and to establish a consistent and comparable disclosure regime. The intention behind this is to facilitate flexibility and efficiency for businesses while, at the same time, maintaining an acceptable level of consumer protection.

4.39 As discussed earlier in this chapter, an objection raised against the creation of a disclosure exemption for risk insurance products, was that it would interfere with practical benefits that ensued from regulatory consistency. Mr Neil Whelan, Member, Financial Planning Association and Chief Executive Officer, Australasian Association of AMP Advisers, illustrated the everyday practicalities involved:

> 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.[29]

4.40 Similarly, Mr Richard Gilbert, IFSA, commented on the desirability of maintaining uniformity in regulation:

> 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…we will have more debate on whether these things should be in or out than on whether people should be investing in these products.[30]

4.41 The Committee agrees that uniformity in disclosure is desirable if it promotes comparability of products and simplifies administrative procedures for product

---

28 Page 19, paragraph PS 175.53 (FSG) and p. 45, paragraph PS 175.145.

29 *Committee Hansard*, 5 March 2003, p. 12.

30 *Committee Hansard*, 5 March 2003, p. 7.

providers. If uniformity does not facilitate these objectives, then its utility will come into question. This issue is discussed in the following chapter.

4.42 In summary, the Committee agrees with the view that consumers should have before them the information necessary to make informed decisions about contemplated financial product purchases. The Committee accepts that disclosure is an important means of equipping consumers with such information. The issue before the Committee is whether disclosure of commission on risk products will achieve these consumer-protection objectives. This matter is taken up in the following chapters.

# Chapter 5

## Salaried versus commissioned advisers

### Competition issues

5.1 Risk advisers were concerned that commission disclosure would 'upset the level playing field' in their industry and provide salaried advisers with an unfair competitive advantage. They feared that consumers would think salaried advisers receiving no commission or a lower commission than risk advisers offered a more independent, impartial service. It was also thought they would associate salaried advisers with a cheaper product and service.

5.2 Furthermore, some advisers claimed that disclosure anomalies would advantage 'the big end of town' such as banks marketing their own risk products through salaried advisers.[1] Mr Bill Brown, proposed that consumers, in relation to salaried advisers employed by a bank:

> …will on one hand believe they are meeting someone from a bank who they believe is not performance orientated, while the self-employed adviser will be forced to disclose commission in gross terms without allowances for the cost of his services and running his business.[2]

5.3 The problem for risk advisers is that commissions factor in a number of expenses other than 'salary' which salaried advisers' disclosures do not contain. Mr John George, MGA, commented in this regard that the 'fees we receive for our services are not limited to sales commissions but are for the management, sale and administration of insurance products'.[3]

5.4 Mr Murray Morgan, Insurance Advisers Association of Australia Inc (IAAA), explained the practical ramifications of the differences between commission and salary structures when it came to disclosure:

> 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

---

1 *Submissions* 16, 33 and 39.

2 *Submission* 46.

3 *Committee Hansard*, 5 March 2003, p. 59.

> ratios but the intermediary using insurer must disclose expenditure via the intermediary commission disclosure forms.[4]

5.5 Mr Barrie Moyle also commented in this regard that:

> How could a level playing field be created with the salaried advisers who may have say a 5% incentive scheme but enjoy all of the benefits of salary, super, workcover, holidays [and] maybe private use of a motor vehicle?[5]

5.6 Risk advisers claimed that consumers would not understand the factors that went into running a risk insurance business and would therefore assume commissions were inflated.

5.7 They commented, for example, on the impact of cross-subsidisation on commission quantum and indicated this as another expense that consumers would not take into account when comparing disclosures. The Committee heard that not all consultations resulted in sales—'It is a numbers game'[6]—and regardless of the outcome, some of these consultations could involve significant expense for the adviser, particularly in regional areas. Mr Robert Ross referred to Toowoomba-based advisers travelling 300 kilometres to visit clients and an adviser in Perth going to Broome for a consultation who, if he sold a policy, would get 'the same commission as though somebody had walked in off the street in Canberra and bought a policy'.[7]

5.8 For Mr Russell Collins, Association of Financial Advisers (AFA), consumers were not aware of the work entailed in preparing policies and the long lead times between the submission and acceptance of policies. There was also the possibility that commissions could be clawed back by insurers if policies lapsed within a certain time.[8] All of these added to the cost of doing business but would not be taken into account by consumers when comparisons were being made.

5.9 A consumer looking at remuneration disclosures, for example, would not be comparing 'apples with apples' and might assume the salaried adviser—because of the lower commission disclosed—represented better value for money.

5.10 The inclusion of back-office expenses in commissions was a particular concern.

---

4 *Committee Hansard*, 5 March 2003, p. 57.

5 *Submission* 9.

6 Mr Leo Menkens, ARA, *Committee Hansard*, 5 March 2003, p. 23.

7 *Committee Hansard*, 5 March 2003, p. 25.

8 *Submission* 25.

## *Back-office expenses*

5.11 A number of risk advisers argued that the competitive advantage enjoyed by salaried advisers as a result of commission disclosure, was heightened by the fact that commissions might also be inflated by a reimbursement component paid to advisers for back-office functions performed on behalf of insurers.

5.12 Mr George, MGA, described back-office functions as entailing:

> …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.[9]

5.13 He commented that insurers had been outsourcing their services to intermediaries since the early 1980s because of 'shortages of qualified personnel and an unwillingness to provide direct customer service'. He added that, with the downturn in local and global insurance markets from around the time of September 11 and HIH's collapse, insurers were 'pushing more and more…back-room services towards the intermediary' in a bid to cut costs further. According to his estimate, back-office functions accounted for about 70 per cent of the work outsourced to advisers.[10]

5.14 Mr George estimated that advisers working for MGA would only receive between 20 to 25 per cent of commissions, the remainder being more in the nature of a 'fee for service' for back-office functions performed. He questioned why the total commission should be disclosed in such cases[11] and commented that the legislation failed to make a distinction between back-office costs and commission for disclosure purposes.[12]

5.15 Similar concerns were raised by Mr John Hanks, National Insurance Brokers Association of Australia (NIBA), who argued that a requirement to disclose back-office payments as part of commission placed commissioned advisers 'at a distinct disadvantage compared to insurance companies that sell directly to the public'.[13] He too referred to a growing trend by insurers to outsource their functions and added that in some cases outsourcing was so extensive that an insurer might 'only carry the risk while the functions, the underwriting and the claims payments' were done by others.[14]

---

9 *Committee Hansard*, 5 March 2003, p. 30.

10 *Committee Hansard*, 5 March 2003, p. 30.

11 *Committee Hansard*, 5 March 2003, p. 30.

12 *Committee Hansard*, 5 March 2003, p. 57.

13 *Submission* 18.

14 *Committee Hansard*, 5 March 2003, pp. 56-7.

5.16 He proposed that, for the purposes of facilitating equitable comparisons, payment for these outsourced functions included in commissions should not have to be disclosed. He referred to a statement made by the then Minister for Financial Services and Regulation, the Hon. Joe Hockey, MP, when introducing the draft FSR legislation in February 2000 that 'where commission includes payment for back-office services, that portion of commission does not need to be disclosed'. [15]

5.17 Mr Hanks said there was some uncertainty about the approach ASIC intended to take towards back-office costs and sought 'confirmation that these back-office costs would be excluded from the commission'.[16]

5.18 NIBA referred in its submission to the following excerpt from the Department of the Treasury's consultation document, *Financial Services Reform Bill, Commentary on the draft provisions*, which said in relation to back-office expenses and disclosure in the Statement of Advice that:

> A.13 Where financial service providers and product issuers enter into an arrangement that the service provider will perform 'back-office' functions on behalf of the issuer and the payment for performing those functions is included in the commission paid in respect of individual products, then this component of the commission does not need to be disclosed.
>
> The basis for this is that this component of commission represents payment by a product issuer to a financial service provider for the performance of services that would otherwise be performed by the product issuer, for example, underwriting. These services could not be said to influence the giving of advice where the payment for the service equals the cost of performing the service.[17]

5.19 NIBA was concerned that the following passage in ASIC's policy proposal paper, *Licensing Financial product advisers—Conduct and disclosure*, appeared not to recognise the intention expressed by 'the Parliament and the Government'.

> We consider that any benefit received by a providing entity (or any associated person), other than commission rebated in full and hourly fees paid by the client, in relation to personal advice might reasonably be expected to be capable of influencing the advice.[18]

---

15 *Committee Hansard*, 5 March 2003, pp. 56-7.

16 *Committee Hansard*, 5 March 2003, pp. 56-7.

17 *Financial Services Reform Bill, Commentary on the draft provisions*, Department of the Treasury, February 2000, p. 203.

18 *Submission* 18. The quotation is taken from ASIC's disclosure proposals for the Statement of Advice, paragraph D3 on p. 49 and paragraph 11 on p. 55. The policy proposal paper was the precursor to ASIC's PS 175 *Licensing: Financial product advisers—Conduct and disclosure*, released on 26 June 2003. ASIC's policy statement makes specific reference in paragraph PS 175.141 to back-office payments and disclosures in the SOA which indicates it has not

5.20 At the hearing, the Committee asked witnesses who supported the disclosure requirements to comment on risk advisers' claims that consumers could be misled into favouring a salaried over a commissioned adviser simply because the salaried adviser received less or no commission.[19]

5.21 Although Mr Tony Negline, the Institute of Chartered Accountants in Australia (ICAA), agreed that market distortions between salaried and commissioned advisers could result from current disclosure requirements, he nevertheless considered that remuneration should be disclosed.[20]

5.22 Ms Catherine Wolthuizen, ACA, saw no cause for concern if a client avoided products associated with high commissions. She commented that this could have positive effects on price levels for consumers:

> 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…[The ACA accepts] 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.[21]

5.23 Similarly, Mr Nick Bruining, Financial Planning Association of Australia Limited (FPA), considered that disclosure was a good thing because it placed an onus on advisers to justify their commission levels. In this regard, he said:

> 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.[22]

## The Committee's views

5.24 The Committee agrees that consumers should have access to information that will empower them to avoid overpriced products or negotiate a better deal. However, the evidence advocating the desirability of commission disclosure to enable consumers to do this, seems to assume that commissions are unjustifiably high when no evidence was provided to establish this. In this regard, the Committee questions

---

departed from its earlier position expressed in the proposal paper. This is discussed more fully later in this chapter.

19 *Committee Hansard*, 5 March 2003, p. 9.

20 *Committee Hansard*, 5 March 2003, p. 18.

21 *Committee Hansard*, 5 March 2003, p. 11.

22 *Committee Hansard*, 5 March 2003, p. 12.

why risk product manufacturers would use agents and brokers to distribute their products if this was not cost effective or was more expensive than distribution through salaried advisers.

5.25 The evidence also assumes that remuneration disclosures in the FSG and SOA promote comparability. The Committee does not agree and asks how a consumer can make a meaningful comparison between two SOAs, one from Adviser A and one from Adviser B, which disclose:

- Adviser A's salary range plus perhaps a 'net' commission; and
- Adviser B's gross commission which might include 'salary', office overheads, a cross-subsidisation component, a claims handling component and back-office expenses.

5.26 In addition, the SOA requires disclosure of commission in relation to the specific product recommended by the adviser. This, in itself, will not help the consumer determine the existence of bias although the legislative provision requiring disclosure of relationships of influence might. NIBA said in its submission that:

> 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.[23]

5.27 On the efficacy of commission disclosure generally, Mr Don Stratford also commented:

> How can disclosure of a commission be of any help to a consumer as it does not provide information on the relevant cost structures of competing products?[24]

5.28 The Committee notes these comments and believes that, without proper comparability, remuneration disclosures will do little to help consumers detect bias.

5.29 Moreover, the Committee considers that the requirement to disclose back-office costs in commission will only serve to heighten consumers' misconceptions that salaried advisers offer a cheaper, more independent service. The following comments illustrate how misleading remuneration disclosure can be:

---

23 *Submission* 18.

24 *Submission* 11. See also *submissions* 24, 28, 32 and 33.

> ..two banks…recently purchased life offices and now sell those life office risk products in their bank offices. That same product, with an identical premium, will have two differing levels of commission disclosed, depending on the status of the adviser.[25]

5.30 The Committee considers it is unhelpful to consumers to create such an impression for the following reasons:

- nothing in the evidence established that products purchased through salaried advisers are cheaper;
- nothing in the evidence established that salaried advisers offered a better service at a lower cost;
- although the Committee heard that commission disclosures will ultimately lead to lower costs for consumers, the Committee is not necessarily convinced that cheaper distribution—whether through salaried or commissioned advisers—will translate into lower costs or better service for consumers; and
- the Committee heard no evidence to establish that salaried advisers are any more likely to give impartial advice than commissioned advisers.

5.31 While the Committee has some sympathy for the view that advisers should be able to explain the differences between their remuneration and that of a salaried adviser, it does not agree that advisers should have to explain away overheads and particularly back-office costs.

5.32 For one, back-office costs are not salary and should not be compared with salary. Second, salaried advisers do not have to disclose their employers' administrative or other running expenses and there is no reason why commissioned advisers should have to do so. Third, the Committee does not see how this anomaly helps consumers and cannot support a requirement that will do nothing for consumers but present salaried advisers with a competitive edge based on consumers' misconceptions rather than legitimate competitive forces.

5.33 The Financial Services Authority (FSA) in the United Kingdom recently released a policy proposal paper, *CP160—Insurance selling and administration: The FSA's high-level approach to regulation*, in which it proposed that commission only be disclosed if clients requested such information. Of particular interest to the Committee, however, is the following 'drawback' of commission disclosure cited in the paper:

> [C]alculation costs for firms—the costs involved in calculating accurate commission figures for disclosure could be substantial. Furthermore, to ensure a level playing field, we would need to consider requiring insurers

25 *Submission* 46.

> selling directly to disclose a 'commission equivalent' and this would also require detailed rules.[26]

5.34 It is clear from this that the FSA recognises the difficulties involved in ensuring accurate and comparable disclosures between commissioned advisers and direct sellers.

## *Legislative requirements and back-office costs*

5.35 It appears that the legislation makes no express exemption for back-office costs. In the FSG, for example, remuneration can be excluded if it is not received in respect of or is not attributable to any of the authorised services.[27] In the SOA, remuneration can be excluded if its receipt cannot reasonably be expected to be or have been capable of influencing the providing entity in providing the advice.[28]

5.36 When asked at the hearing whether the legislation required disclosure of back-office costs, Mr Nigel Ray, Treasury, answered that:

> 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.[29]

5.37 The Committee has difficulty with this explanation because it merely re-states the legislation which, in relation to its application to back-office costs, is vague by any measure and susceptible to a range of interpretations.

5.38 ASIC's PS 175 *Licensing: Financial product advisers—Conduct and disclosure* does not mention back-office costs specifically in its discussion of disclosure requirements for the FSG. However, ASIC says nothing to suggest that back-office costs do not have to be disclosed in the FSG.

5.39 In its coverage of disclosure requirements for the SOA, ASIC's PS 175 says:

> We expect that back office payments will normally need to be disclosed, particularly where they are not provided under an arm's length agreement between the issuer and the providing entity. A providing entity that forms the view that a back office payment does not need to be disclosed in the

---

26 *CP160—Insurance selling and administration: The FSA's high-level approach to regulation*, Financial Services Authority, UK, December 2002, pp. 74-5.

27 Paragraphs 942B(2)(e) and 942C(2)(f).

28 Paragraphs 947B(2)(d) and 947C(2)(e).

29 *Committee Hansard*, 5 March 2003, p. 68.

> SOA should maintain records to enable it to demonstrate why it has formed that view. We consider that these records should show, for each back office payment not disclosed in the SOA:
>
> (a) who made the payment;
>
> (b) who received the payment;
>
> (c) the date of the payment; and
>
> (d) the amount of the payment.[30]

5.40 The Committee believes that the inclusion of costs other than a risk adviser's net 'salary' in commission does not provide consumers with the information needed to draw accurate conclusions or make fair comparisons as intended by the FSG or SOA. At the very minimum, the Committee believes that the legislation should exempt payments included in commissions for back-office functions from the commission disclosure requirements.

5.41 Indeed, the following statement in Treasury's consultation document on the draft provisions for the *Financial Services Reform Act 2001* clearly indicates that it was the Government's intention to exempt back-office costs from up-front disclosure requirements in the legislation:

> Where the service provider will perform 'back-office' functions on behalf of the issuer and the payment for performing those functions is included in the commission paid in respect of individual products, then this component of the commission does not need to be disclosed…[because back-office functions] could not be said to influence the giving of advice where the payment for the service equals the cost of performing the service.[31]

5.42 The Committee acknowledges that there is the potential for abuse with the artificial loading up of these costs to disguise from consumers the real commission received.[32] However, the Committee does not believe this presents an insurmountable problem and notes NIBA's comments that they have been discussing with ASIC, the ways in which this can be overcome.

**Recommendation 2**

**The Committee recommends that the disclosure provisions for the Financial Services Guide and the Statement of Advice—at the very least—should provide an exemption for the commission component paid in respect of back-office functions performed on behalf of the product issuer or provider.**

---

30 Page 41, paragraph PS 175.130. (Also see p. 43, paragraph PS 175.141.)

31 *Financial Services Reform Bill, Commentary on the draft provisions*, Department of the Treasury, February 2000, p. 203.

32 This point was made in the joint submission made by the FPA, IFSA and ACI, *submission* 45, the Corporate Superannuation Association Inc's *submission* 5 and the ICAA's *submission* 38.

# Chapter 6

## Small business issues

### Introduction

6.1 In the previous chapter, the Committee considered risk advisers' claims that commission disclosure was unnecessary for the protection of consumers and would unfairly advantage salaried advisers. In this chapter, the report looks at the possible broader ramifications that disclosure of commission on risk products might have on small risk insurance businesses.

6.2 One concern was that disclosure would pave the way for the introduction of level commissions. The result of this, it was claimed, would be:

- the demise of many smaller businesses, particularly in country areas; and
- the loss of the client-focused services offered by these businesses.

6.3 Comments were also made that the loss of these businesses would merely consolidate the position of large institutions which were increasingly buying up market share but individually offered limited product choices to consumers.

6.4 All in all, these changes would ultimately work to the detriment of consumers who, paradoxically, the disclosure provisions were meant to protect.

6.5 In the following section, the Committee examines the claims that disclosure of commission on risk products would force commissions down to a commercially unsustainable level for small risk insurance businesses.

### Disclosure and the move to lower commissions

6.6 Risk advisers' claims regarding the closure of many small risk insurance businesses rested on the premise that commission disclosure would drive commissions down or pave the way for the introduction of level commissions.

6.7 Mr Ross Vanderwolf, Authorised Representatives' Association (ARA), suggested that 'the large insurance offices will see [commission disclosure] as an excuse to drive commissions downwards' but there was no explanation of why disclosure would give these offices 'an excuse' to reduce commissions.[1] For Mr Bill Brown, the life offices would introduce level commissions 'because the pressure for continuous product development in a highly competitive marketplace will be less under a level commission regime'.[2]

---

1 *Committee Hansard*, 5 March 2003, p. 66.

2 Additional information, 25 March 2003.

6.8 Certainly, it appears from Mr Michael Rice's comments below that the introduction of fee and commission disclosure requirements for investment products was accompanied by a move to level commissions:

> [upon] the introduction of full fee and commission disclosure on investment products in Australia…the industry tilted its remuneration structure away from up-front to trail commissions and it placed a greater emphasis on servicing clients rather than selling products.[3]

6.9 The Committee presumes that one reason for the introduction of level commissions could be insurers' or advisers' expectations that, if disclosure is to become a reality, level commissions would be more acceptable to consumers than up-front commissions. This would be all the more so if, as research suggests, consumers have little understanding of remuneration structures and generally low levels of financial literacy.

6.10 Disclosure might also provide insurers with more leverage to negotiate a move to lower or level commissions. Mr Brown suggested this:

> Life offices will take advantage of the perceived (by them) inability of life risk advisers to justify up-front commissions to introduce level commissions.[4]

6.11 In light of these points and market dynamics in the insurance industry at present, the Committee accepts that disclosure of commissions is likely to result in commission structures moving from up-front to level commissions or, alternatively, will be reduced.

6.12 Although very little was forthcoming to explain why disclosure would prompt the introduction of level commissions, there was extensive argument about their predicted impact, especially on small risk insurance businesses.

## *Impact on small business*

6.13 The Committee heard that small businesses presently reliant on higher up-front commissions would not have the cash resources to make the transition to lower or level commission structures and would consequently close down. At the hearing, Dr Phil Dixon explained why the substitution of higher up-front commissions with level commissions would threaten the viability of smaller operations:

> 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

3 Mr Michael Rice, Rice Walker Actuaries, *Asset Magazine*, *Disclosure disharmony*, April 2003.

4 *Submission* 46.

> 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.[5]

6.14 He indicated that at a recent meeting with other risk specialists, the general consensus was that the '$10 up-front, 50c ongoing [commission] model would change to something like $2.50 up-front and $2.50 ongoing' which meant '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'. He said life companies had already indicated to advisers that they would not be providing capital to keep smaller operators afloat to allow them time to adjust to lower commission structures. The result of this, he predicted, would be further consolidation in the industry and a return to 'those days when the large institutions had a stranglehold on the market place' and consumers had only limited product choice.[6]

6.15 Dr Dixon's evidence suggested that the move to level commissions would result in a substantial drop in income ('perhaps to one-third of their current level'[7]) for an adviser presently remunerated by up-front commissions. According to evidence provided by Mr Brown, an adviser choosing a level commission structure for life risk products presently offered by one company would receive 66 per cent of net annual premium in the first year compared with 95 per cent if commission were on an up-front basis.[8] For small businesses structured around up-front commissions, a move to level commissions representing the drop in the first year's income indicated by Dr Dixon's or Mr Brown's figures could have a significant impact.

6.16 Even if it transpires that these figures are overstated, evidence from other advisers indicates that even relatively small decreases in commission levels could have serious consequences for small businesses.

6.17 The Committee accepts that level commissions will not necessarily translate into a loss for advisers in the mid to longer term.[9] However, as Dr Dixon made clear, the problem for small businesses is not level commissions per se. It is how they will cope in the short term with the pressures generated by shortfalls in cash flow caused by the substitution of up-front with level commissions.

---

5 *Committee Hansard,* 5 March 2003, pp. 33-4. See also *submission* 46, Part C, p. 10.

6 *Committee Hansard,* 5 March 2003, pp. 33-4.

7 *Submission* 8.

8 *Submission* 46.

9 *Supplementary submission* 46B, see comparative table, *Calculation of commissions—up-front versus ongoing*, which suggests that level commissions can exceed up-front commissions in the longer term.

6.18 The Committee notes that the cost of putting new business on the books is high, particularly for non-standard risks, and refers to Mr Negline's comments that:

> 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.[10]

6.19 Mr Ross said in relation to the high costs of writing new business that:

> …sometimes [advisers] would drive 300 kilometres to see a client and not make a sale…What [the consumer] may not realise is that for every sale the adviser may have made two submissions, and one bought and one did not.[11]

6.20 Several country-based advisers referred to their own practices to illustrate how they expected disclosure requirements would affect the viability of country businesses.

6.21 Wilburtins McDonald General Insurance Brokers (Wilburtins) described itself as 'a medium-sized General Insurance Brokerage' employing two financial planners and offering financial planning services including advice on life insurance, income protection, trauma insurance, total and permanent disability insurance and superannuation.

6.22 Commission disclosure requirements, Wilburtins claimed, would result in the 'immediate reduction of $150,000 from the bottom line of [its business]…reducing it to marginal profitability at best and resulting in the loss of at least one job.' The outcome for many small businesses, Wilburtins said, would be a rapid and dramatic downturn in their profitability. Direct market insurers would gain ascendancy and consumers would no longer have access to much needed product advice provided by small business advisers.[12]

6.23 In this regard, the Committee notes the statement of Mr John George, MGA that it would not take much of a reduction in commissions to affect his group's profitability. He predicted that a 1 per cent drop in commission could result in the withdrawal of his business's general risk insurance business from country areas.[13] He

---

10 *Committee Hansard*, 5 March 2003, p. 19.

11 *Committee Hansard*, 5 March 2003, p. 22.

12 *Submission* 3.

13 *Committee Hansard*, 5 March 2003, pp. 44-5.

suggested that services would have to be withdrawn from country areas as a survival measure:

> 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 throughout Australia. You only need to knock off, in that 14 per cent, maybe one per cent and those offices may become…unviable and we will have to look at withdrawing our services from those areas.[14]

6.24 The Committee also notes Mr Ross's calculations that his regionally-based life risk insurance practice would become commercially unviable if commissions were to drop by 10 per cent. He said about his own practice that:

> [it] 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.[15]

6.25 In these circumstances, the Committee notes the evidence that small businesses currently relying on up-front commissions could experience quite serious cash flow shortfalls upon the introduction of level commissions and be forced out of business. The following comments by the Financial Services Authority (FSA) when considering possible changes to the remuneration structures for advisers on packaged investments clearly bear out risk advisers' claims regarding the adverse consequences of level commissions:

> …any rapid move away from the present system of initial commission, or from commission altogether, could have a significant impact on the sector. For example, a move to end initial commission in favour of level commission would mismatch the timing of [independent advisers'] income to their expenditure and while the overall amount of commission over time could be the same, a funding gap could emerge. A fee-based approach would match income and expenditure timing but might not generate, at least initially, the same revenue as commission, given what we have found out about consumer attitudes to paying fees. This too could open up a funding gap requiring financing.[16]

6.26 In looking specifically at the option to switch to up-front fees, risk advisers noted some drawbacks. For decades, consumers have not had to pay fees for risk insurance advice—probably because they view the advice as incidental to the product purchased. Moreover, the needs and motivations (and possibly demographics) of

---

14 *Committee Hansard*, 5 March 2003, pp. 44-5.

15 *Committee Hansard*, 5 March 2003, p. 22.

16 *Consultation Paper, Reforming Polarisation: Making the market work for consumers*, Financial Services Authority, January 2002, p. 42.

people visiting small risk insurance practices are different from those who visit financial planners. A person visiting a financial planner is seeking advice and is more attuned to paying for that advice. A person visiting a risk adviser is in the market for a product and expects advice on product selection to be free. Until consumers' attitudes change, risk advisers will have an uphill battle charging consumers for advice.

6.27 There is also the question of how much advisers would need to charge and how much consumers would be prepared to pay. Evidence from risk advisers suggests that more complex advisory work can entail many hours of research, policy preparation and liaison with the insurer. According to Mr Negline's estimates, a consumer could be charged between $1,200 and $2,500 for policy work.[17] The Committee suspects that consumers would baulk at paying such relatively high fees. Even the FSA commented, in relation to consumers' perceptions of the work entailed in advising on packaged investments that:

> [Most] assumed that the work needed to give advice and the time taken to complete the background research is minimal. Most assumed advisers used best advice lists and panels of providers, that providers supply the documentation and information and computer programs, and 'back-room' boys completed the process. Advice was perceived as standardised rather than bespoke or proactive.[18]

6.28 The FSA's comments in relation to research findings on consumers' willingness to pay for advice bear this out:

> …while the research also showed some greater willingness on the part of consumers to pay a fee for advice, if only of a modest amount, there must be doubts about whether that willingness would translate to the real world. A group of consumers may well reach sensible conclusions about the merits of consumers in general paying a fee for advice, but it could well be a different matter when it came to those individual consumers themselves being asked to write a cheque.[19]

6.29 It might be, as several risk advisers suggested, that only the top end of the market will be able to pay the fees needed for quality advice and service.

## *Impact on the risk insurance market and consumers' interests*

6.30 For many advisers, the predicted adverse effects of commission disclosure on the viability of smaller operations would filter through to consumers especially in country areas. It was claimed that the increasing concentration of market share and distribution in the hands of fewer and fewer players in the insurance industry would

---

17 *Committee Hansard*, 5 March 2003, p. 19.

18 *Polarisation: Consumer Research, Report of research studies carried out by IFF Research Ltd; ORC International Ltd; NOP Research*, Financial Services Authority, January 2002, p. 33.

19 *Consultation Paper 121, Reforming Polarisation: Making the market work for consumers*, Financial Services Authority, January 2002, p. 39.

compound these adverse effects. In this regard, the Committee heard from Mr Murray Morgan, Insurance Advisers Association of Australia Inc (IAAA), who described this development and how he thought it would affect smaller businesses and consumers in country areas:

> Currently the large brokers in our industry…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.[20]

6.31 Mr Ross referred to the entry of banks into the insurance market and the Commonwealth Bank's activities in particular. With the acquisition of so many insurers by the banking sector, he asked how consumers in country areas would fare, given the banks' history of withdrawal of services in these areas. He said:

> 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?
>
> …
>
> How are [people in country areas] 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

20 *Committee Hansard*, 5 March 2003, p. 39.

> 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.[21]

6.32 Although much of the evidence to the Committee indicated the problem would be pronounced in country areas, the following comments by Mr Ross suggest the potential for a more widespread incidence because of the increasing dominance of institutionally-based distributors Australia wide which, because they also own the manufacturers of risk products, set commission levels. Mr Ross said that of the top 12 distributors of financial products:

> …only one was not totally owned or partly owned by an institution, a life company or a bank. [And between] them, they own 41 distribution groups.[22]

6.33 He commented further that:

> This dominance by the institutions (because they also own the manufacturers of risk products) has potential to severely damage non-institutional competitors because they, as manufacturers, set the commission levels.[23]

## Loss of expertise and independence in advisory services

6.34 Advisers said that, unlike salaried advisers engaged in direct selling for life companies, they offered consumers independent advice. They argued that commission disclosure, in reducing their numbers, would work against consumers' interests by depriving consumers of access to this independent advice. Mr Ross said in this regard that:

> …[the ACA] 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.[24]

6.35 Similarly, Mr Leo Menkins, ARA, argued that the risk insurance industry would see a movement away from distribution by multi-agents to a situation 'where the majority of advisers [would] be under some form of constraint to sell the product of their particular institution-owned dealer group'.[25] He claimed that this loss of independence would impose limitations on the extent to which advisers could pursue claims on behalf of clients:

---

21 *Committee Hansard*, 5 March 2003, p. 37.

22 *Supplementary submission* 47A. Mr Ross's calculations were based on a list of the top 50 distributors of financial products published in *Money Management*, 13 March 2003, pp. 16-17.

23 *Supplementary submission* 47A.

24 *Committee Hansard*, 5 March 2003, p. 37.

25 *Committee Hansard*, 5 March 2003, p. 35.

> …can you imagine [the product manufacturer] funding the dealer to assist my client to fight the manufacturer to get a claim?[26]

6.36 It was also claimed that the exodus from the industry of commissioned advisers would be accompanied by a loss of risk insurance experience and specialist knowledge. This again would be to the detriment of consumers, particularly those with special needs who did not meet standard risk thresholds.[27]

6.37 The Committee heard evidence that financial planners, because their background was more investment-oriented, would not have the expertise to fill the gap left by the exodus of risk advisers from the market place. Dr Dixon said, for example, that 'investment/financial planning is a totally different business from risk insurance underwriting' and cautioned against what he saw as a trend towards encouraging investment-only advisers to 'start dabbling' in risk insurance.[28] The result, he said, would be 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.[29]

6.38 Certainly, the suggestion was made at the hearing that direct sellers tended to rely on small businesses to handle the more complex cases. In this regard, Mr David Squire, National Insurance Brokers Association of Australia (NIBA), commented that:

> …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.[30]

## Loss of access to risk insurance advice

6.39 Several advisers predicted that downward pressure on commission levels would see many risk advisers concentrating on the more certain end of the risk insurance market and abandoning consumers seeking insurance for non-standard risk. For example, Dr Dixon said that the 'heavy up-front cost in placing risk business' and the 20 per cent of non-standard risk placements that were declined but nevertheless consumed advisers' time and other resources, justified current commission levels. He estimated that commission disclosure requirements would lead to a drop in commission by as much as two-thirds of their current levels. This, he said, would mean that risk advisers:

---

26 *Committee Hansard*, 5 March 2003, p. 36.

27 See, for example, *submission* 17 (ARA).

28 *Committee Hansard*, 5 March 2003, p. 58-9.

29 *Committee Hansard,* 5 March 2003, p. 32.

30 *Committee Hansard*, 5 March 2003, p. 20.

- would only have the resources to deal with the top 20 per cent of the market; and
- would no longer provide specialist services for non-standard risks because of the very high up-front costs involved.[31]

6.40 A similar view was expressed by Silvalake Financial Services which stated that:

> Disclosure of commission could lead to [advisers'] inability to properly cater to the medium to bottom end of [the market] as if disclosure leads to lower commission, they will be unable to provide proper advice to these people.[32]

6.41 Silvalake proposed that consumers would end up purchasing products that were inappropriate for their needs or otherwise would not purchase insurance at all.

6.42 Mr Ross questioned how consumers would gain if disclosure placed downward pressure on commissions and forced advisers to charge fees for their services. He proposed that:

> When doing business is so costly, or the margin is so low that a business simply cannot survive, that business will adjust and aim for a different client type…they will look for a client who can and will pay for their service. The loser is the lower income client who cannot afford the necessary level of fees.[33]

6.43 He referred to the findings of the ACA/ASIC study that lower income individuals were often unable to access financial planning advice because of the cost involved and the lack of preparedness of financial advisers to take them on.[34]

## Loss of claims handling services

6.44 The Committee heard that market developments prompted by commission disclosure would see advisers discontinue or downgrade their claims handling services because it would not be commercially viable to retain them in their current form.

6.45 Mr Brian Lewis said in his submission that it would be difficult to charge clients a fee for claims handling. He argued that if commissions were driven down and there were not 'adequate provision of remuneration at some time in the delivery process of the product for the adviser', they would 'simply leave the market'.[35]

---

31 *Submission* 8.

32 *Submission* 1.

33 *Submission* 47.

34 *Submission* 47. The report on the ACA/ASIC survey appeared in the 23 January 2003 issue of *Money Management*.

35 *Submission* 36.

6.46 In its submission, the ARA indicated that consumers' perceptions of value for money were quite different at point of sale compared with their perceptions at the time of making a claim. At claim time, the ARA said, the claims handling services offered by advisers were highly valued by consumers and were their 'first point of call'.[36]

6.47 At the hearing, Mr Menkens, ARA, suggested that consumers would not factor in the claims handling services offered by advisers when comparing remuneration disclosures, and thought it would be to consumers' detriment if they could not call on an adviser to help at claim time. He said consumers tended to assume that lower costs represented better value for money and he thought this would translate into misconceptions about commission levels. In this regard, he referred to actual and hypothetical cases he had encountered or was likely to encounter in his own business:

> 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…I had been paid commission up-front by that guy 4½ years ago. He did not pay me now…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.[37]

6.48 Mr Brown provided the Committee with details of the work entailed in handling income protection claims. He commented that only an adviser specialising in life risk advice had the requisite knowledge in claims procedures and policy terms to properly represent clients' interests.[38]

6.49 Risk advisers have argued that, by requiring them to disclose commissions, the legislation has failed to strike a balance that will achieve the Act's objects. They claim that disclosure of commission will cause market distortions which, in turn, will pave the way for the introduction of level commissions, give salaried advisers an unfair competitive advantage, and drive commissioned advisers out of business. They say consumers will suffer because of this in the following ways:

- The remaining commissioned advisers will be forced to accept lower commissions and operate on lower profit margins. In order to survive, they will not be able to service consumers in the middle to bottom end of the market or those with non-standard risk profiles. Claims handling services will also be substantially reduced or not offered at all.

---

36 *Submission* 17.

37 *Committee Hansard,* 5 March 2003, p. 22.

38 *Submission* 46A.

- Once advisers are forced out of business, their expertise will not be replaceable. The quality of advice to consumers will therefore suffer.
- The market will be dominated by advisers who are directly linked to the major insurance providers and under pressure to push their products. Consumers will therefore have fewer opportunities to access independent advice.
- The concentration of distribution through insurance offices or dealerships owned by large financial institutions and the loss of smaller advisory groups or sole practitioners will see a retreat of services from country areas. Many consumers, particularly in these areas, will be denied access to face-to-face independent advisers.
- The move to level commissions will not only cause the demise of small businesses but will take away an incentive for advisers to effectively review their clients' cover.[39]

## Evidence refuting risk advisers' claims

6.50 For those advocating commission disclosure, there was no substance to risk advisers' predictions of doom for small businesses. It was argued that, because financial planners had successfully adjusted to the introduction of mandatory commission disclosure several years ago, risk advisers would as well.

6.51 Mr Nick Bruining, who described himself as a 'small dealer' with a financial planning business said in this regard that:

> This disclosure business has not affected us at all…we have been doing it since 1994…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…that we are turning away clients at the moment.[40]

6.52 Similarly, Mr Michael Rabbitt, financial planner and small business operator, disputed that disclosure would be bad for small risk insurance businesses and said this had not been the case for financial planners when disclosure was introduced in the early 1990s. He considered that commission disclosure had resulted in many positives such as fee reductions over a wide range of products, improved service, enhanced competition and greater consumer awareness and expectations.[41]

6.53 Mr Tony Negline, ICAA, echoed these sentiments. He noted that commissions had been falling for the past 10 years from roughly 100-120 per cent of initial premiums with a volume bonus, to around 30-50 per cent with no volume bonus and trail commission of between 20-50 per cent. He was sceptical that disclosure would drive advisers out of business and said similar claims made when commission

---

39 *Submission* 46.

40 *Committee Hansard*, 5 March 2003, p. 16.

41 *Submission* 4.

disclosure was introduced for savings products in the late 80s had proved unfounded.[42] He commented that:

> [Commission disclosure] 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.[43]

6.54 Mr Con Hristodoulidis, Financial Planning Association of Australia Limited (FPA), was not convinced that commissioned advisers would lose out to salaried advisers. In fact, he said that when commission disclosure was introduced for investment products, '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'.[44]

6.55 According to Mr Hristodoulidis, commission disclosure did not disadvantage any sector in particular and any changes in 'market dynamics' were occurring for reasons other than commission disclosure. He considered there were 'opportunities for any size player [in the current market] if they structure themselves in an appropriate manner'.[45]

6.56 In their joint submission, the FPA, IFSA and ACI thought that the regulatory changes brought in by the FSR Act would be beneficial for small businesses and commented in this regard that:

> Some industry participants assert that small dealerships are at a disadvantage at having to disclose the commissions they receive for risk insurance products relative to large dealer groups which are not required to disclose 'margins' or risk commission on products sold as they operate under a salary as well as performance incentives schemes.
>
> The FPA believes this is an inaccurate comparison. A more legitimate comparison is of small businesses operating under the varying disclosure regimes prior to the FSRA taking effect.
>
> At the previous PJC inquiry and public hearings, the FPA argued that existing financial planning advisory firms acting as agents of Securities licensees in general have a higher sale value (4 to 5 times commission

42 *Committee Hansard*, 5 March 2003, p. 20.

43 *Committee Hansard,* 5 March 2003, pp. 17-18.

44 *Committee Hansard,* 5 March 2003, p. 18.

45 *Committee Hansard*, 5 March 2003, p. 54.

> income) compared to risk insurance agency firms (2 to 3 times commission income) operating as agents of insurers. With that in mind we do not believe that the FSRA disclosure regime has had any adverse impact on small businesses. To the contrary, we believe that a small business operating under the FSRA disclosure regime would have an enhanced value as demonstrated above.[46]

6.57 In looking at ways that small business could adapt to change, the FPA asserted that 'there are opportunities for any size player if they structure themselves in an appropriate manner.'[47] Some also suggested that risk advisers could ameliorate the effects of cash flow shortfalls by charging up-front fees.[48]

## Assessing the evidence

6.58 The objective of the regulatory measures set out in Chapter 7 of the *Corporations Act 2001* is not only to promote 'confident and informed decision making by consumers of financial products and services' but also to do so 'while facilitating efficiency, flexibility and innovation in the provision of those products and services'.[49]

6.59 It is clear that the Act seeks to balance consumers' interests and the needs of business. The Committee uses this objective as the yardstick to measure the effectiveness of current commission disclosure requirements for risk products.

6.60 The Committee notes that one of the objects of the Act is to facilitate informed decision making by consumers of financial products. The SOA in particular is intended to protect consumers by requiring disclosure of remuneration (including commission) on the premise that remuneration carries the potential for an adviser's self-interest to override the interests of a client.

6.61 The Committee carefully examined whether disclosure of commission on risk products would, in fact, provide consumers with the information needed to protect themselves against an adviser's self-interest.

6.62 First, the Committee considers that consumers cannot detect potential bias unless they can compare remuneration paid on different products or to different advisers. The SOA and FSG do not facilitate comparability, among other things, because of the differences between remuneration structures for direct sellers and commissioned advisers. Furthermore, the Committee accepts that commission disclosure requirements could convey a misleading impression to consumers and put risk advisers at an unfair competitive disadvantage to salaried advisers.

---

46 *Submission* 45.

47 *Committee Hansard*, 5 March 2003, p. 54.

48 See *submission* 46 which dealt with this issue in detail and *submission* 47.

49 Paragraph 760A(a).

6.63 Second, turning to the matter about facilitating efficiency, flexibility and innovation in the market place, the Committee was again presented with two schools of thought. It heard conflicting evidence about whether or not the requirement to disclose commission would undermine the viability of small risk insurance businesses.

6.64 The Committee accepts the view that the introduction of commission disclosure more than ten years ago did not have an adverse effect on the financial planning industry which is now a flourishing industry. It also notes that risk products differ substantially from investment products. The Committee is therefore cautious in assuming that the experiences in the financial planning sector would apply to the risk insurance industry.[50]

6.65 Moreover, market conditions have changed significantly over the past ten years. While there has been an explosion of interest in the investment market during this time, risk insurance still tends to be undersold.[51] The manufacturing and distribution of insurance products is increasingly becoming the province of fewer and fewer players with the result that small independent risk insurance businesses are finding it harder to survive.

6.66 It appears to the Committee that the options for small risk insurance businesses are limited. If only because of the high costs involved in restructuring and obtaining an FSR licence, many small businesses and sole practitioners would not have the option of combining with others to reach the scale needed to make licensee status cost effective.

6.67 For businesses facing cash flow shortfalls, it will not make any difference in the short term how they align their businesses or structure themselves. Furthermore, assuming it was commercially viable for a risk adviser to charge fees for advice, the Committee has doubts over the preparedness of consumers to pay these fees.

6.68 The Committee envisages that the difficulties would be all the more pronounced were risk advisers forced to charge for claims handling services which, according to the evidence, can be highly labour intensive.[52] It is well aware that commission is factored into the cost of premiums (as is the remuneration of salaried advisers) so that consumers ultimately pay for the advice and claims handling services they receive. It nevertheless seems to the Committee that this is presently more acceptable to consumers than paying an up-front fee.

## Implications for competition in the risk insurance industry

6.69 For life and general insurance, increasing competition, spurred on by the globalisation of markets, increasing regulation and rising costs, technological

---

50 *Committee Hansard*, 5 March 2003, p. 20.

51 See, for example, the evidence provided by NIBA and Mr Robert Ross, *Committee Hansard*, 5 March 2003, pp. 18 and 27 respectively.

52 See, for example, the details provided in *supplementary submission* 46A.

innovations and the blurring of traditional product provider boundaries, have contributed to substantial structural changes in the financial sector and will continue to do so. As noted in paragraphs 6.29–32, in the insurance sector, these changes have played out in the following ways:

- there has been significant consolidation in the industry as product manufacturers and retailers seek to increase their market share and realise economies of scale;[53] and
- there have been changes in distribution channels in life and general insurance as financial institutions buy up life offices and dealer groups.[54]

6.70 The Committee is not only concerned about the impact these changes are having on small risk insurance businesses but also the adverse effects that could ensue for consumers particularly with regard to the availability of quality, independent risk insurance advice and claims handling services.

## Summary of the Committee's position

6.71 The Committee accepts that there is a danger that many of the small businesses represented by industry groups during this inquiry may close down or have to downsize as a result of the pressures exerted by commission disclosure requirements. As these small businesses currently provide comprehensive consumer service, the Committee is concerned that consumers will suffer considerable detriment if the demise of these businesses results. The Committee has come to these conclusions bearing in mind the very clear trend in the insurance industry towards consolidation and concentration of manufacturing and distribution.

6.72 In essence, the Committee does not advocate commission disclosure for risk advisers for the following reasons:

- commission does not affect the end benefit received;
- the requirements have the potential to mislead consumers about the independence and reliability of advice given on risk insurance products;

---

53 In this regard, the Committee notes APRA's observations about the life insurance industry in its 2000-2001 annual report that: '*There are currently 42 life insurance companies supervised by APRA. This number is expected to decline as a result of consolidation of licences within conglomerate groups and as strategies are reassessed in the light of recent changes to the taxation of life insurance. As more of the business is associated with funds management, there is a continued focus on containing and reducing expenses with larger companies looking to compete with global fund managers.*' *APRA 2000-2001 Annual Report*, p. 11.

54 In 1996, the then Insurance and Superannuation Commission reported a growing trend towards salaried sales representatives and a 24 per cent increase in their numbers during 1995-1996. Although the Committee could not locate more recent figures, it seems reasonable to assume that the banks' increasing ownership of manufacturing and distribution will be reflected in increasing numbers of salaried advisers. ISC, *Insurance and Superannuation Bulletin*, December 1996.

- the requirements generally do not promote comparability of advisers' remuneration and, without comparability, it is difficult to see how consumers will be able to detect the potential for bias which is the underlying rationale for this disclosure requirement;
- the Act already provides sufficient protection to consumers against mis-selling of risk insurance products. These include:
  - a) the requirement for disclosure of information about associations and relationships of influence;[55]
  - b) the requirement in relation to the SOA for advisers to:
    - i) have a reasonable basis for personal advice given to a retail client (it is an offence under the Act not to have a reasonable basis for the advice);[56]
    - ii) warn clients if the personal advice is based on incomplete or inaccurate information;[57]
    - iii) provide clients with additional details if recommending the replacement of one product with another—this protects against 'churning'.[58]
- There is a real danger that disclosure would adversely affect small risk insurance businesses and consequently consumers would suffer through:
  - loss of expertise in the risk insurance business;
  - loss of independent advisers;
  - less access to risk insurance advice for those on lower incomes; and
  - an undermining of the level of service delivery especially in the area of claims handling.

6.73 With these factors in mind, the Committee makes the following recommendations.

**Recommendation 3**

**The Committee recommends that the Government amend the *Corporations Act 2001* so that licensees and authorised representatives are required to disclose in the Financial Services Guide the nature of their remuneration (i.e. whether salary, commission, etc.) but are exempted from the requirement to disclose**

---

55 Paragraphs 942B(2)(f), 942C(2)(g) (FSG) and 947B(2)(e) and 947C(2)(f) (SOA).

56 Section 945A—Requirement to have a reasonable basis for the advice.

57 Section 945B—Obligations to warn client if advice based on incomplete or inaccurate information.

58 Section 947D.

**details (i.e. quantum) of commissions on risk insurance products in the Financial Services Guide and Statement of Advice. The present remuneration disclosure requirements for Product Disclosure Statements should be retained.**

6.74 The Committee has been disturbed to find the degree of concentration of manufacturing and distribution in the insurance industry. The Committee is concerned that competition may be stymied in this environment and fail to deliver benefits to consumers that would be expected from a properly functioning market.

**Recommendation 4**

**The Committee recommends that the Government review and report on the extent and likely effect of consolidation and restructuring in the financial sector to determine its effect on the delivery of risk insurance services in metropolitan and regional Australia. The review should place emphasis on:**

- **whether there is sufficient competition in the industry to promote outcomes that are beneficial for consumers in terms of:**
  - **the quality of risk insurance advice (taking into account issues of adviser independence and expertise);**
  - **availability of face-to-face risk insurance advice;**
  - **product diversity;**
  - **services including claims handling; and**
  - **price;**
- **the role and viability of small risk insurance businesses; and**
- **whether increasing numbers of 'tied' advisers or the increasing use of direct selling are adversely affecting the quality and independence of advice available to consumers.**

**The report should formulate a remedial program to correct any identified areas of market failure.**

Senator Grant Chapman
**Chairman**

# ALP Members Minority Report

This inquiry represents the third time the Committee has examined the issue of whether there should be disclosure of commission on risk products.

Labor members of this Committee have consistently supported commission disclosure as a means of assisting consumers to assess advice given to them by their advisers.

In 2000 Labor members stated that:

> Information on commission payments may be relevant to customers in determining whether the recommendations of a financial service provider have been influenced by the payment of commission and should be disclosed.[1]

In 2001 Labor members stated that:

> It is appropriate for all consumers when purchasing any financial products—whether an investment product or a risk product—to have all the necessary information to assist them in making their financial decisions. Commission disclosure will improve transparency in the sales and advice process and help consumers to identify the potential influences and conflicts of interest which an adviser may have in recommending a product.[2]

Labor members have not seen or heard any evidence during the Committee's most recent inquiry to alter their view that disclosure of commission in the Financial Services Guide (FSG) and Statement of Advice (SOA) is necessary in the interests of consumers.

The FSG is designed to assist consumers in their decision about whether to accept services from a particular provider. The SOA is intended to assist consumers in deciding whether to act on advice that they have received from a financial services provider. In both cases, Labor members believe that the disclosure of commission is important information that is required by consumers in order to make these decisions.

In the view of Labor members there is no need for further research demonstrating the link between commissions and the mis-selling of risk products. Labor members accept the advice of ASIC that there is strong evidence of product pushing where commission is highest across the financial sector. ASIC's director of Financial Services Regulation, Mr Ian Johnston, told the Committee:

> …in regard to the principle of whether or not people will have a tendency to push a product that pays a higher commission than one that pays a lower

1 *Report on the Draft Financial Services Reform Bill*, 14 August 2000, *Minority Report*, pp.32-3.

2 *Report on the Financial Services Reform Bill 2001*, 16 August 2001, *Labor Members Minority Report*, p.107.

> 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.[3]

In addition, it is clear that the purpose of commissions is to encourage risk advisers to recommend a particular product. Given this fact, consumers are entitled to be informed about commissions that may influence an adviser's recommendation.

Labor members also reject the contention made by some witnesses that disclosure of commission on risk products is unnecessary because sales commission is not disclosed on other products such as consumer durables.

Risk products are very different from other consumer products. The features of risk products can be quite complex and consumers are heavily reliant on information from their advisers. In contrast, consumers can test the operation of products such as white goods and information on performance characteristics of such products is more readily available.

## Impact of Disclosure on the Commissioned Advisers

Despite the fact that the majority report accepts in principle that disclosure is in the interests of consumers, it then goes on to build a case against disclosure. This case is largely based upon the argument that disclosure will disadvantage commissioned advisers.

This argument is premised on the unsubstantiated assertion that consumers will be deterred from buying insurance from commissioned advisers once disclosure is required. From this basis it is argued that commissioned advisers will go out of business and that the service and expertise they provide will be lost to consumers.

Labor members believe that these views are unnecessarily pessimistic. Labor members note the evidence from members of the financial planning industry that the predictions of doom in that industry following the introduction of mandatory commission disclosure did not materialise.

Labor members do not dispute that most commissioned advisers provide a good service to their clients. We submit however that the fact that the service is valuable to clients should make it easier for advisers to justify the commission that is paid to them.

The majority report appears to argue that commissioned advisers will not be able to substantiate their services to consumers and therefore need to be protected. Labor members endorse the view put by ASIC that it is not a very meritorious argument for advisers to say that disclosure will deter consumers from buying the product.[4] Labor members believe that it is up to advisers to convince consumers of the benefits of the

---

3 *Committee Hansard*, 5 March 2003, p. 44.

4 Mr Ian Johnston, *Committee Hansard*, 5 March 2003, p. 42.

service. We endorse the comments of the Australian Consumers' Association on this point:

> 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.[5]

Commissioned advisers expressed fears that because salaried advisers offer a lower commission, consumers may feel that they offer a more independent, impartial service. Labor members believe that these concerns are exaggerated and that if anything consumers are more likely to question the independence of salaried officers working for a particular institution.

While Labor members acknowledge that the commission payable to risk advisers who are not salaried does commonly include some compensation for back-office expenses, we do not favour a blanket exemption of these amounts from disclosure requirements. Such an exception would be complex to administer and would be open to abuse as many expenses could be incorrectly described as 'back-office'. A better solution is for commissioned advisors to justify their commission structure to their clients.

Labor members note that ASIC's recent Policy Statement 175 *Licensing: Financial product advisers—Conduct and disclosure*, expresses the view that back-office costs would normally need to be disclosed.[6] Nevertheless, under the Corporations Act an adviser would not need to disclose back office expenses in the SOA if these amounts cannot reasonably be expected to be an influence on their advice.

In essence, the legislation and the ASIC policy statements leave the burden of justifying a decision not to disclose back-office expenses upon the adviser. Given the strong policy arguments in favour of disclosure, Labor members are satisfied that this is appropriate.

Labor members note that the Government has already rejected a recommendation of a majority of this Committee that there should not be a requirement to disclose the quantum of commission on risk products. In its response to the Committee's report on the Draft Financial Services Reform Bill, the Government stated that:

5 Ms Catherine Wolthuizen, *Committee Hansard*, 5 March 2003, p. 11.

6 This is expressly stated in relation to the SOA and implied in the case of the FSG.

> The disclosed information helps the consumer evaluate any possible influences on the adviser in recommending a particular product…
>
> For a consumer to assess possible conflicts an adviser may have in recommending a product they need to know the quantum.[7]

Labor members agree and urge the Government to once again reject this recommendation of the majority report.

**Senator Penny Wong** | **Mr Anthony Byrne MP**

**Senator Stephen Conroy** | **Mr Alan Griffin MP**

7 *Government response to the Joint Statutory Committee on Corporations and Securities Report on the Draft Financial Services Reform Bill*, 29 March 2001, pp. 4-5.

# Senator Andrew Murray: Australian Democrats

## Supplementary Remarks

In the Committee's Report into the Inquiry into the Financial Services Reform Bill 2001 in August 2001, I added some Supplementary Remarks concerning the topic of the disclosure of commission on risk products.

In part, I said the following:

> It was suggested to the Committee that agents are not influenced by commissions paid, but are concerned with business considerations like competitive premiums and efficient claims departments. It was further suggested that the main customer issue is that commission is payable rather than the amount of the commission.
>
> I can understand the argument for complete exclusion of risk-based products from the commission disclosure regime. If that is a view that is carried so be it. However partial disclosure seems inappropriate.

And,

> Given a choice between requiring disclosure and not, the Democrats will almost invariably err on the side of disclosing, unless that is likely to cause too great an administrative burden, or is unnecessary.

As noted at pararaph 2.7 of the Report, the disclosure requirements introduced by the *Financial Services Reform Act 2001* build upon the framework established by the Wallis Inquiry that are intended to promote 'informed decision-making by consumers of financial products' by enabling them to 'compare product characteristics, costs and expected rates of return'.

At paragraph 3.7, the Report notes that the commission disclosure in the Statement of Advice (SOA) is intended to protect the consumer against the possibility that a financial service adviser, acting out of self-interest, may give biased advice. In so doing, the presumption is that the consumer will be disadvantaged by such advice and could suffer detriment.

Bias is predicated on any of or a mix of self-interest arising from financial, business and relationship considerations; as a consequence of instructions from product owners; or as a consequence of 'influence' by product owners.

Commissions that are a simple payment for a sale need to be distinguished from commissions that are structured to be incentives to sell one product as against another. As a matter of practicality, a regulator would have difficulty separating out the two types.

As a generalisation, prima facie the potential for commissions to result in products being 'pushed' is reflected in the statement of Mr Ian Johnston of ASIC that 'there is strong evidence that product pushing takes place where the commission is highest'.

It is also reflected in various witnesses believing that the purpose of paying commissions is to increase or 'incentify' sales, although that is unlikely to be true in all cases, particularly where the product has the characteristics of a commodity and is not highly differentiated.

The difficulty previously discovered by the Committee, and again uncovered by this Inquiry, is that hard evidence on the effects of non-disclosure of commission on risk products remains poor, and assertions dominate.

The principles established in the legislation mean that informed decision-making by consumers of financial products requires full disclosure and transparency to enable consumers to compare product characteristics, costs and expected rates of return.

Such principles could only be overturned for risk products if the costs outweighed the benefits.

In the absence of definitive findings and sufficient factual evidence on costs and benefits, the choice of the Senate will come down to three views:

- that the general principles of the Act should apply regardless;
- a belief that the market costs and negative supplier effects for small business resulting from disclosure, would be greater than the benefits to consumers;
- a belief that the costs to consumers of non-disclosure would be greater than the benefits to small business of non-disclosure.

Earlier I used the term 'full' disclosure.

There is a view that the intended disclosure will be partial, and directed at the vulnerable small business end, leaving a big business oligopoly of product owners able to continue manipulating the market. This sort of view is expressed in an additional submission, which concludes:

> The Committee should either
>
> (1) endorse disclosure of ALL influence, including life risk commissions,
>
> or
>
> (2) take the UK option, and recommend NIL disclosure on life risk products.[1]

1 Mr Bill Brown, ACT Insurance Brokers, 25 March 2003.

Having in my August 2001 Supplementary Remarks said that partial disclosure is inappropriate, I have sympathy for the view that the proposed disclosure regime must ensure full disclosure, so that those with 'influence' further up the distribution chain do not profit from partial regulatory change by increasing market dominance and financial return.

The evidence of risk advisers in the Report seems to suggest two conflicting concepts.

Chapter 4 suggests that consumers are not particularly interested in commissions paid to their advisers. This should mean disclosure would not be expected to change consumer behaviour. In these circumstances, any effects on small business of disclosure could only be supplier and not consumer effects.

In chapter 6, the evidence is that disclosure would result in the demise of small businesses, particularly in country areas. This could mean disclosure *would* change consumer behaviour, so any effects on small business of disclosure would be consumer effects as well as supplier effects.

I suspect the latter case is more likely, with both consumer and supplier effects. The stronger objection that some small business witnesses have is that while both partial and full disclosure will change consumer behaviour, partial disclosure runs the risk of allowing big business to concentrate the market to their benefit and greater profit, leaving small business squeezed in between.

To mitigate the impact on small business, it may be appropriate to include with the commission disclosure some commentary that the commission includes a back-office, salary and service component that would not normally be included in the commission of a salaried employee of the product manufacturer or owner. In this way, small business operators in regional areas would be helped in justifying their commissions to consumers to demonstrate that the price of the risk product is not significantly different despite the nominally higher commission.

If small business operators are offering quality after-sales service and selling reasonably priced products, (and explaining these benefits to customers), the commission disclosure should not be expected to significantly impact their relationship with customers.

If there is to be disclosure, commonsense and equity demands a full disclosure regime, not a partial disclosure regime. To determine full disclosure, in the manner advocated by some witnesses, will be a complex task, and require considerable consultation.

Full disclosure has the benefit of meaning that regulatory harmony and consistency will not be jeopardised by the exemption for stand-alone risk insurance products. It has been argued that exemptions could lead to restructuring of products to avoid some commission disclosure and create the potential to 'top-up' commissions on risk products, with a corresponding reduction in disclosed commissions on investment products.

The reaction of Government to the Committee's views, and to my own findings above, will affect the Democrats' determination on this issue when legislation is before the Senate. The Democrats will assess any attempt to water down the principle of disclosure critically and will have a preference for full, rather than, partial disclosure.

**Senator Andrew Murray**

# APPENDIX 1

## SUBMISSIONS RECEIVED AND ADDITIONAL INFORMATION

1 Silvalake Financial Services

2 Insurance Council of Australia Limited

3 Denarval Pty Limited trading as Wilburtins McDonald

4 Mr Michael Rabbitt

5 Corporate Superannuation Association Inc

6 Life Advisers Action Group

7 MGA Insurance Brokers Pty Ltd

8 Dr Phil Dixon

9 Mr Barrie Moyle

10 Mr Barry Nixon

11 Mr Don Stratford

12 Hayes Financial Services Pty Ltd

13 Ron Hudson & Associates Pty Ltd

14 AAA Shares & Investments Pty Ltd

15 Mr Douglas Ng

16 Millennium3 Financial Services Group Pty Ltd

17 Authorised Representatives' Association

18 National Insurance Brokers Association of Australia

19 Insurance Advisers Association of Australia Inc.

20 R & J Holt Consultants Pty Ltd

21 Mr Peter Rae

22 Mr Michael MacQuillan

23 Mr Roger Budd

24 Mr Reg Stenhouse

25 Mr Russell Collins

26 Williams Insurance and Money Management

27 Mr Peter Chan

28 Suggars & Associates

29 NOW Financial Services Pty Limited

30 The Royal Automobile Association of South Australia, The Royal Automobile Club of Queensland Ltd and The Royal Automobile Club of Western Australia Inc.

31 CONFIDENTIAL SUBMISSION

32 Association of Financial Advisers

33 Ced Hartmann & Associates

34 Australian Securities & Investments Commission

34A Australian Securities & Investments Commission (Supplementary submission)

35 APFS Ltd

36 Mr Brian Lewis

37 Mr Matt Accadia

38 The Institute of Chartered Accountants in Australia

39 Mawson Group Australia Limited

40 Mrs Liz Penfold MP

41 Mr Sandy Dunshea

42 Mr Michael Murphy

43 Mr Jim Rundle

44 Mr Bill Stanford

45 Financial Planning Association of Australia Limited, Investment & Financial Services Association Ltd, Australian Compliance Institute

46 Bill Brown and Associates Trading as ACT Life Insurance Brokers

46A Bill Brown and Associates Trading as ACT Life Insurance Brokers (Supplementary Submission)

47 Mr Robert Ross

47A Mr Robert Ross (Supplementary Submission)

48 Australian Consumers' Association

49 Mr Gary Plumridge

50 Cursley & Clowes Financial Services

## Additional Information

Additional information accepted as public evidence:

- 5 March 2003 — Case Study—Risk Commission Disclosure & Variability of Commission to Advisor, provided to the Committee by Mr K Hajaj, Financial Planning Association of Australia Limited, at the hearing on 5 March 2003
- 12 March 2003 — Letter from Mr Michael Rabbitt
- 19 March 2003 — Letter from the Association of Financial Advisers
- 20 March 2003 — Letter from the Association of Financial Advisers
- 20 March 2003 — Letter from the Association of Financial Advisers
- 25 March 2003 — Letter from Mr Bill Brown
- 26 March 2003 — Letter from the Association of Financial Advisers
- 26 March 2003 — Letter from the Association of Financial Advisers
- 7 August 2003 — Letter from the Financial Planning Association of Australia Limited
- 8 August 2003 — Email from the Investment and Financial Services Association

# APPENDIX 2

## WITNESSES AT HEARINGS

**Wednesday, 5 March 2003–Canberra**
**Association of Financial Advisers**
Mr Robin Yates, National President
Mr Michael Murphy, Vice-President
Mr Dugald Mitchell, Political Research Officer
Mr Russell Collins, Member

**Australian Consumers' Association**
Ms Catherine Wolthuizen, Senior Policy Officer, Financial Services

**Authorised Representatives' Association**
Mr Leo Menkens, Chairman
Mr Ross Vanderwolf, Director

**Mr Bill Brown, Principal, ACT Life Insurance Brokers**

**Corporate Superannuation Association Inc**
Mr Mark Cerche, Chairman

**Dr Phil Dixon**

**Financial Planning Association of Australia Ltd**
Mr Con Hristodoulidis, National Manager, Policy & Government Relations
Mr Khaldoun Hajaj, Adviser, Policy & Government Relations
Mr Neil Whelan, Chief Executive Officer, Australasian Association of AMP Advisers, FPA Regulations Committee
Mr Nick Bruining, NC Bruining & Associates Pty Ltd, FPA Board Member

**Mr John George, MGA Insurance Brokers Pty Ltd**

**Insurance Advisers Association of Australia Inc**
Mr Brian Enever, Vice-President
Mr Murray Morgan, Chief Executive Officer

**Investment & Financial Services Association Ltd**
Mr Richard Gilbert, Chief Executive Officer

**Life Advisers Action Group**
Mr Darryl Foster, Committee Member
Mr Greg Veivers, Committee Member

**National Insurance Brokers Association of Australia**
Mr David Squire, Director
Mr John Hanks, Consultant

**Mr Michael Rabbitt, Principal, Prism Financial Planners**

**Mr Robert Ross**

**The Institute of Chartered Accountants in Australia**
Mr Tony Negline, Technical Consultant
Ms Kristen Brown, Manager, Government Affairs

**Australian Securities & Investments Commission**
Mr Ian Johnston, Executive Director, Financial Services Regulation
Ms Pamela McAlister, Director, Legal & Technical Operations
Mr Mark Adams, Director, Regulatory Policy

**Department of the Treasury**
Mr Nigel Ray, General Manager, Financial System Division (FSD)
Mr Mike Rosser, Manager, Consumer Protection Unit, FSD
Mr Dave Maher, Analyst, Consumer Protection Unit, FSD

**Wednesday, 12 March 2003–Adelaide**

**Mr John Fotheringham, Chief Executive, Royal Automobile Association of South Australia Inc; Royal Automobile Club of Queensland Ltd and Royal Automobile Club of Western Australia Inc**