

ARGYLE ADVOCATE

I advise and sell risk insurance product such as Income, Life & Trauma insurances. Do I need to disclose to clients my commissions received? If so, in what format – dollars or percentages?

It has been said that FSR adopts a “one size fits all” approach. To work within FSR the life insurance industry in particular has had to undergo significant adjustment. Agents that issue risk products on behalf of insurers or advise clients on risk products must now, like other financial advisors, obtain an AFS licence or become the representative of a licensee. This question deals with one of the main areas of change, the level of required commission disclosure.

Does the risk product advisor have to disclose to the client commissions received? On this point, the Corporations Act (“**ACT**”) is clear. Yes. Full disclosure of all remuneration including commissions to clients is one of the key objectives of FSR. This disclosure regime applies to ALL financial products. Risk products are treated in the same way as other financial products such as managed funds.

Under FSR, disclosure is achieved through three documents, the Financial Services Guide (“**FSG**”), the Statement of Advice (“**SOA**”) and the Product Disclosure Statement (“**PDS**”). Risk product advisors must comply with both the FSG and SOA requirements. The PDS is a disclosure document that the insurer, as the product issuer, must comply with. There are effectively no PDS disclosure obligations in relation to advisor remuneration, however, the FSG and the SOA do impose extremely comprehensive and prescriptive disclosure requirements in relation to commissions and other remuneration.

A FSG has to be provided to a retail client at a very early stage, generally before financial services are provided to the client. It is designed to ensure that clients are able to make an informed decision about the services that the advisor will provide. It should be provided well before the advisor considers whether the insurance is suitable for the client.

Under Section 942C(2)(f) of the Act, the advisor is required to disclose in the FSG information about the remuneration (including commissions) and other benefits the advisor will receive “in respect of, or that is attributable to, the financial services” to be provided by the advisor. The Regulations to the Act set out in greater detail how this information must be disclosed. Where the amount of the commission is able to be ascertained at the time the FSG is provided, then the amount must be set out in the FSG. If it is not possible to ascertain the precise amount, then the FSG must set out how and when the advisor becomes entitled to a commission and how the commission will be calculated. Policy Statement 175 (**PS 175**) sets out ASIC’s expectations on this aspect. Ranges, rates, comparisons, simple tables and formulas should normally be included in an FSG. Also worked dollar examples should be included where the actual amount cannot be ascertained at the time the FSG is provided.

ASIC expressly forbids the disclosure of commissions to be in general language such as words to the effect “that a commission will or may be received by the advisor” or statements that further details can be provided if the client wishes to know. The precise amount needs to be stated and, where it cannot be stated, then ranges, tables and comparisons need to be given.

ASIC describes in **PS 175** (paragraph 52) the type of disclosure it considers is necessary where the precise amount of a benefit (such as a commission) is not known at the time the FSG is provided. ASIC suggests disclosure along the following lines (as you will see, ASIC expects a lot of detail):

“I will receive an upfront commission from the product issuer where you decide to buy a product I recommend to you. Usually this upfront commission is 5% of the amount you invest, although the exact amount may vary from 3% to 10% depending on the product. For example, for an investment of \$10,000 in a product whose manager pays me 5%, I will receive an upfront commission of \$500. In addition to the upfront commission payment, I will also receive ongoing commissions – the amount I will receive varies depending on the circumstances, although typically I receive an ongoing commission of 1% per annum of the value of your holding in a product (as at 30 June each year) for as long as you hold the product.”

This example given by ASIC is not the law. This is ASIC’s interpretation how the requirements of the Act should be applied in practice. Is ASIC’s interpretation correct? The interpretation may be wider than what the Act and its Regulations actually say, however, the truth is that ASIC is the regulator appointed by the Government to administer the Act and it is prudent to follow its interpretation and expectations.

The SOA must be given to retail clients when personal advice can be given. SOAs have been the feature of a previous Ask Argyle article (published 13 November 2003). Essentially, the SOA can be either the means by which the advice is provided or a separate record of the advice that was provided. Section 947C(2)(e) requires the advisor to disclose in the SOA information about any remuneration, including commission, that “might reasonably be expected to be or to have been capable of influencing the advisor in providing the advice”. The Regulations clarify this requirement by essentially repeating the FSG requirements; that is the SOA must set out the total amount of the commission or, if it cannot be stated as an amount, then a description of the method of calculating commissions, including worked examples. ASIC interprets this to require disclosure of both the dollar amount and the percentage of the value of the financial product (paragraph 142 of **PS 175**). However, if there was any doubt as to this interpretation, the Regulations were amended in December 2003 so that with effect from 1 July 2004 the commission must be disclosed “as an amount in dollars”. If this is not possible, the commission must be disclosed as a percentage. It is only if an amount cannot be stated as a dollar amount or a percentage that the advisor is permitted to have a more general description such as the method of calculating the commission entitlement.

The only relevant exception to these disclosure requirements recognised by ASIC is the case of where the commission is rebated in full back to the client. Here it is not necessary to include information on the commission in the SOA.

Sections of the insurance industry have lobbied hard to make life insurance agents a special case in relation to commission disclosures. The Joint Parliamentary Committee on Corporations and Financial Services recommended to the Government in August 2003 that life insurance agents should be allowed to be exempt from having to disclose the details of their commissions (including the quantum) as they fear that this requirement and additional burdens involved would force many of them out of business. The Government has not adopted these recommendations so the position of life agents is no different to that of other financial advisers.

The FPA made submissions to the Joint Committee on this issue (jointly with the Investment and Financial Services Association and the Australian Compliance Institute). The FPA does not share the Joint Committee’s view and opposes treating risk products as a special case and opposes allowing them to be exempted from the commission disclosure regime. The FPA is also of the view that where possible the commissions should be disclosed in dollar terms to ensure that retail clients have adequate information to base their decisions.

Its clear the Act now places a much greater emphasis on the disclosure of commissions and other benefits. No doubt this has represented a considerable change for the insurance industry as, apart from everything else, the disclosure needs to be comprehensive and in actual amounts and made at the earliest stage of the client engagement. Your best protection is to ensure that your procedures and processes are not just adequate but are properly established to comply with the Act and to address ASIC's expectations in this area.