

Issues Paper Response to Proposed Standard APES 230

Introduction

I appreciate you taking the time to read my submission. In this paper, I outline the reasons why the implementation of Proposed Standard APES 230 would be detrimental to both the industry and, importantly, to consumers.

My Background

I graduated from the University of Melbourne in December 1967 with a Bachelor of Commerce, majoring in Accounting and Economics.

I have a CFP designation and I am a certified Self Managed Super Fund Specialist. I am also a Fellow of CPA Australia.

On 1st February 1968 I joined Legal and General as a Life Insurance Agent and soon after, formed a Partnership with my brother, Joseph Bongiorno, a similarly qualified FCPA, Bachelor of Commerce, University of Melbourne.

Together we started what was then the very first Financial Planning firm in Australia. Under the one roof, we provided co-ordinated financial advice to a client base consisting predominantly of Doctors and Dentists.

I believe that NAB and Westpac records will confirm that I have organized between \$1.2 billion and \$1.6 billion in finance for clients over this period and hopefully both institutions would judge me to be very experienced in this area.

Furthermore, I believe that records from Legal and General, National Mutual (now AXA), AVIVA and MDRT (Million Dollar Round Table) will confirm that over the past 43 years, I have sold more Life Insurance than anyone in Australia's history.

You will notice that with Insurances I unashamedly use the word "sold". It is a fact that Life Insurance, and the associated Risk Insurance products are not bought, but sold.

I am limiting this paper to Insurance and Finance advice as I expect most other submissions to focus on financial product advice.



Section One - Insurance

Dangers

There are several key dangers associated with the Proposed Ruling:

- The proposed commencement date of 1st July 2011 is not only too early to allow businesses to organize their affairs but is also completely out of alignment in a situation where a new Minister and new Government have yet to release legislations on this issue.
- The reality is, of course, that APES Draft 230 ought to be dealt with in conjunction with and commencing in tandem with proposed legislative change set to occur on 1st July 2012. It would be unreasonable to confuse us any further when we have no idea, as yet, as to what final legislative changes we have to deal with.
- The introduction of a Retrospective Ruling is clearly an intolerable dent in our democratic system of Government. We are all acutely aware of the dangers involved in any form of retrospectivity. This aspect of the draft is completely unacceptable and any changes must be *prospective* only. Retrospectivity of any type is completely unacceptable.

The danger here is that you will establish a precedent which goes against every principle that we believe in as Australians.

I discussed this issue of "retrospectivity" with a member of "The Bench" and the analogy he used was as follows. He is a member of a defined benefits superannuation scheme. At age 64, 2 to 3 years prior to his retirement, a retrospective change is made to his defined benefits super scheme. The change converted it to an accumulation scheme – "Oops sorry you have lost so much because of the GFC, sorry about all those years where you thought that you had built up an asset to provide for your retirement. Better luck in the next life." Clearly this is *not* acceptable.

The key danger with insurance is that people often don't understand the actual "sales process". In my 43 years, I could count less than a dozen people who have proactively called up to *buy* life or income protection insurance. Unlike car or household insurance, it's a product that needs to be *sold* and sold *properly* to ensure that adequate cover is provided to the policy holder. People genuinely believe that they will never die (*Appendix 1 Independent Bushfire Commission Facts*). There is almost always initial client reluctance and it's often difficult to convince the clients to proceed with the insurance. Unlike tax or accounting services, where clients are *pro-actively* seeking effective solutions, people so rarely pro-actively seek life/income protection as they never truly believe that "something will happen to them".

A good question to ask is "can each committee member recall the process they went through when they were approached to buy life or income protection insurance?"

I have provided a list of claims that we have processed for my clients in the last 12 months. None of these clients pro-actively asked me for insurance (*Appendix 2 List of Claims*). However, when my clients *have* called me, they invariably have had health problems.

By understanding the process involved in selling insurance, the committee will see that a fee for service approach is impossible, completely impossible, to operationalise. There is however an acceptable alternative which I have proposed under the “opportunities” section of this paper.

Typically, which I will gladly explain at a face to face meeting with the committee, establishing and confirming the need for cover with a client is a difficult task. Often, the client doesn't proceed.

If there was a process by which we could interview some of the people who so sadly perished in the 2008 Bush Fires in Victoria, we would probably find that a large percentage of them had, at some time in their life, had insurance proposed to them but had rejected the idea. The low level of cover would indicate that this is the case. Or perhaps some had purchased insurance then cancelled. Perhaps some had never been approached.

The danger with a “Fee for Service Model” becomes increasingly apparent where there is an insurance claim.

In addition to the list of the insurance claims made by my clients in the last 12 months, I have also included an email example which highlights the highly emotional and fragile state of the claimant. We are dealing with people who find themselves in extremely challenging situations. Could we seriously send someone an invoice, a “fee for service”, at an emotional time like this?

However, some claims such as numbers 3 and 5, are complicated and have taken up 40 to 50 hours of work and are still a “work in progress”. The work I have done to date on these claims has been at no charge to the client. And herein lays the key danger with the proposed ruling. While it is inconceivable that I could send these clients an invoice during their time of suffering (*Appendix 3*), I could not afford to dedicate such significant time to the claim without some form of remuneration. In addition, if I was to charge a “fee for service”, there would be instances where the fees would outstrip the claim!

I welcome the opportunity to bring on my witnesses, the claimants, to advise you on how time, effort and compassion are needed in these delicate scenarios. You would then witness firsthand what's involved. We would welcome any committee members to sit in on such a meeting.

In addition, I believe clients would find a “fee for service” model unacceptable, specifically for smaller sums insured. The sales process is complicated and time consuming and consumers would be disadvantaged if they had to pay for the time involved in writing the insurance policy. For example, establishing a \$2m sum insured with a \$1000 premium could require 8-10 hours of work. This could result in a fee of up to \$3000, which would not be tolerated by a client. Even if commission was to be rebated at the rate of ~\$750 in the first year and ~\$200 in subsequent years, the client would still be worse off for up to 10 years.

The *complexity* of introducing a “fee for service” model cannot be ignored and becomes more apparent when considering that I provide a holistic offering to my clients. Rarely would I meet with a client *purely* for the purpose of discussing insurance. Rather, my experience, qualifications and authorisations permit me to advise clients across insurance, accounting and taxation, financial planning and finance. It would be difficult to attribute a specific “fee” to the time I spend discussing “insurance”? It is obviously in the very best interests of my clients for them to receive this advice in a holistic and integrated manner, yet there is no transparent and effective means of charging *exclusively* for the “time” spent positioning the insurance product and understanding the client's needs in order to advise on the correct level of cover. We simply do not operate in the straight forward manner of other “fee or service” professionals such as Solicitors in respect to “fees”. Conversely, at what point in time would we commence charging a fee? As previously mentioned, many hours can be involved in performing a client “needs analysis” and in “selling” the product. At exactly what point in the “sales process” would the “charging” commence?

Opportunity

The opportunity that we are presented with is to create a changing environment which will reward the adviser while simultaneously giving the client (potential client) a comprehensive needs analysis in order to satisfy their cover and protection requirements.

We believe that as a group, we have been “agents of change” in the industry:

Fact: In 1977, the Bongiorno Group was the first group in Australia to approach NML (National Mutual Life) to change the Commission structures on Life Policies from payment based on the *Sum Insured* to payment as a *% of premiums*. Eighteen months later, all life insurance companies followed suit.

Fact: In 1993, the Bongiorno Group introduced to the then Norwich Union (Aviva Australia) the concept of *Level* commission rather than *Up Front* commission. We also introduced what is called *Hybrid* commission at that same time. Don Campbell (then General Manager) and Dr. Peter Johnson can confirm this. Both AXA and Aviva will confirm that these two initiatives have revolutionised adviser remuneration.

Fact: We have just completed our new “administration fee process” with a major insurer and propose to release this onto the market early 2011. It has been 14 months in the making to date.

Our client Statement of Advice (*Appendix 4*) clearly shows that we give clients a choice on fee for service or commission including ongoing.

Under the new administration fee for service model, we will be billing the insurance company a % of premium as an administration fee for carrying out a multitude of services on their behalf. This will probably be done via a recipient created tax invoice.

The abovementioned facts illustrate that we are committed to the continuing evolution of our industry. We are agents for change and have been at the forefront of change in our industry for 43 years.

We believe that it should be compulsory for all accountants to give clients the choice – Fee for Service or Commission.

In a free market, we (as CPAs/CAs who also sell insurance) should not be placed at a competitive disadvantage with insurance advisers who would be exempt from this ruling and who could therefore provide a more competitive client offering.

I propose that we empower the client from the onset via a “Terms of Engagement.” A quote should be given up front so that the client can make an *informed* decision. If the client chooses the “fee for service” option, then the commission must be rebated.

This is a time for careful consultation and with so many other changes occurring within and impacting upon the industry; the timing of July 1st 2012 seems the only appropriate way forward.

The issue on retrospectivity is not only unacceptable but will also create legal issues with existing policies. I am waiting for the “Legal Team” at one of our major insurers to call back with the issues surrounding this. It may well be that the insurance company cannot rebate to clients the existing trail commissions and that they need to retain them. What would be in it for the consumer if the life companies just kept the extra commissions because they cannot change existing policies?

The view initially expressed is that the insurer may need to alter every policy in a particular “class”. Counsel advice in regards to the terms and conditions of all policies will be sought.

In conclusion

Arthur Miller wrote a wonderful play titled "The Death of a Salesman". The story of Willy Loman is very sad. Is it happening again? Perhaps, albeit in a different way.

I am making an impassioned plea – don't let it happen. Circa 1988 – 89; NML and AMP had around 3,000 Life Agents. Today there are approximately 20,000 Financial Planners in Australia. I believe that industry statistics will show that less than 2,000 sell more than \$10,000 of premium a year.

We are grossly underinsured as a Nation and we need to *encourage* not *discourage* the process.

Sell is not a dirty word. And by all means make it compulsory to give clients the choice up front.

Section Two - Finance

Dangers

Again, the proposed timing of the implementation of the ruling, 1st July 2011, is unrealistic, particularly in light of other recent changes impacting the industry. To apply the ruling “retrospectively” is equally unacceptable.

On 1st July 2010, the Government introduced a new *Credit Regime*. The introduction of yet another change, within such a small time frame, will impose compliance pressures on our business and will, importantly, place us at a significant competitive disadvantage to Banks and Brokers. This disadvantage would extend to the client who would be incurring additional costs. As such, we would be *harming* rather than *assisting* the client.

Why is this so?

Pricing models at Banks don't give them the ability to price an “off the street” loan any cheaper than if the loan was processed via a “finance referring accountant”. This is because the banks give their Managers (home and business lenders) targets and reward target achievement via a commission payment, known as “a bonus”. The cost of this “bonus” payment means that the bank cannot offer loans any cheaper directly than through a third party (e.g. brokers or finance referring accountants). If the client has to pay us, as referring accountants, a “fee for service”, then they are essentially paying for “something” (i.e. the loan) which they could get for “nothing” by dealing *directly* with a Bank or a Broker.

A client would simply not pay a fee. Why would they accept additional costs when their underlying objective is to minimise the cost of their Finance arrangements? This proposal actually seems to be more in line with assisting the larger Banks rather than the smaller groups.

We are confident that we adopt a very responsible approach when organizing finance for a client. The process begins with a *Terms of Engagement (Appendix 5)* which is completed in conjunction with a *Preliminary Assessment (Appendix 6)*, the objective of which is to assist the client with appropriate structuring to meet their goals and objectives.

The danger with the proposal is that it would not only place us at competitive disadvantage, but would cost the consumer more and reduce competition, giving the Banks even more power. Importantly, the consumer is placed at a further disadvantage as the Banks and Brokers do not provide professional advice on finance structures to ensure that the client ends up with the most *effective* solution.

Please don't let the actions of some Accountants taint the image of our group at large.

Opportunity

We must allow the new credit licensing regime to operate for a few years. We are all liable for the advice we provide in this area and are in no way abrogating any responsibility.

Provided that they (Finance referrer Accountants) comply with the new regime of licensing and that society members give their clients a choice, *Fee for Service* or *Commission* (which would be mandatory for all society members) how could a consumer be disadvantaged?

I invite you to interview any of my clients and to gauge from them their level of satisfaction with the choice that we provide them.

Strengths

By the committee putting their weight behind the Government's new rules and making society members give their clients a choice, the system can only be improved.

Consumers are not foolish when it comes to Finance. By the time a consumer takes the first step to meet with someone who can organise their Finance, they typically will have spoken to their existing bank and in most cases would have "cyber-shopped" at one of multitude of Finance web-sites. Gen Y's and X's are very savvy about rates and are very rate sensitive.

A Case Study: How advice from a "Finance Referrer Accountant" results in a more beneficial consumer outcome

When my clients Mr. X and his wife divorced recently, they decided to sell the family home and divide the proceeds up between themselves in an agreed manner.

Their Bank was preparing settlement documents and assured each party (both professionals) that they each qualified for a new loan.

If we had not become involved and it had been left to the Bank, the bank was going to pay out all loans and leave the balance in cash in two separate accounts. The gross error of this would have been that tax deductible loans would have been paid out instead of retained. Fortunately, we managed to have them secured at settlement by cash and that cash was used by the two clients to buy their next home while the deductible loans were subsequently secured against the new houses purchased.

The proposed ruling, as it currently stands, will minimise market place competition and result in less constructive consumer outcomes. I urge you to consider the alternative opportunities I have presented and welcome the opportunity for further open dialogue.