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REPORT 107

Compensation arrangements for financial services licensees—Research into the professional indemnity insurance market

December 2006

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COMPENSATION ARRANGEMENTS FOR FINANCIAL SERVICES LICENSEES

RESEARCH INTO THE PROFESSIONAL INDEMNITY INSURANCE MARKET

December 2006

TABLE OF CONTENTS

EXECUTIVE SUMMARY

The Australian Government has announced its intention to introduce regulations which will give effect to Section 912(B) of the Financial Services Reform Act (FSRA) in 2007, to provide a source of compensation for retail clients in circumstances where a licensee breaches its license obligatio0ns.

- Professional Indemnity Insurance (PII) is commonly used by professionals to manage their risk exposures and indemnify them for their liabilities to clients.

- The draft regulations propose inter alia to require licensees to have adequate PII arrangements.

- This report documents research into the current and prospective conditions in the Australian insurance market for PII especially for small and medium size businesses.

- It examines aspects of availability, affordability, the level of cover purchased, excesses carried, and importantly the scope of cover provided by different policies and the extent to which their policies meet licensees' risk exposures and obligations under the Act.

- Claims against licensees are most typically for inappropriate advice, although they can also be for misappropriation of funds and breaches of trade practices provisions.

- The report also considers the factors that need to be taken into account in arranging insurance, the scope of what may be considered 'adequate', 'best practice' and 'ideal cover' and makes certain recommendations about providers, disclosure and transitionary arrangements.

- Currently the market for PII is well supplied with a wide choice of providers, policies and special schemes. It is highly competitive on price with few concerns about affordability or premium levels. It is not expected that licensees, who are not presently insured, will experience difficulty in obtaining PII unless they have a poor track record or present unusually high risk exposure.

- As would be expected in a competitive market, insurers offer a variety of covers, terms and conditions and some target specific market segments. Underwriting and risk assessment criteria also vary from insurer to insurer. However, while there are different approaches, the underwriting controls, risk assessments and policy terms and conditions are stringently observed and are quite tight.

- There is little indication that these underwriting controls will be relaxed, especially in an environment of price cutting, so expansion of cover is unlikely.

- The immediate outlook for the market is positive, with predictions that the present favourable market conditions for licensees will continue. It is also expected that there will be a market correction within three years. Developments further into the future will be largely determined by the economic outlook and the re-insurance market.

  A range of entities supplies the PI market: group schemes, affinity groups and buying groups for authorized representatives, industry associations and individual licensees

- Using the PI market to protect retail clients from impecunious licensees raises significant challenges. If the insurance market is the preferred solution, then it must also be accepted that the market is dynamic and that affordability and availability of PI cover is subject to change. There is a risk that licensees are unable to purchase comprehensive or adequate PI and that retail clients may not be able to recover their losses against licensees.

- Adequacy presents a range of issues which require careful consideration including:

  - Cover is bought/sold to cover all of the entity's liabilities for all of its business activities. It must therefore be adequate to cover wholesale as well as retail exposures and activities beyond the scope of the FSRA.

  - Cover includes for defence costs in defending the licensee against actions brought by a consumer (or others). These need to be assessed in addition to the required 'limit of indemnity' to meet compensation claims.

  - Consumers have no direct right of access to PII policies.

  - Insurers are not a party to External Dispute Resolution (EDR) schemes determinations. A licensee's exposure to an EDR scheme is broader than the protection under a PII policy.

  - Insurer's monetary exposure to EDR scheme determinations is capped by individual claim **and** in the aggregate.

  - Excesses are amounts for which the licensee is not insured. These are a standard feature of all contracts. The licensee needs to have the capacity to meet its exposure to paying claims within its excess.

  - Although cover is widely available, blanket cover is not.

  - No insurer offers insurance that covers all possible acts or omissions by all possible persons (from employees, directors, sub-contractors and authorized representatives) for which a Licensee may be liable to any number of retail clients.

- The terms and conditions vary considerably between insurers. There is no ‘standard’ cover for licensees, except where an industry association has developed a scheme (as in the case of the National Insurance Brokers Association (NIBA) scheme). A buyer with significant market power is able to negotiate wider PI cover than one that does not.

- At present, there is patchwork coverage of some key areas that may leave retail clients exposed: authorized representatives acting outside the scope of their authority, fraud and dishonesty, and many conflicts of interest claims, and claims in respect of products not on an “approved product list”.

- In addition, there is a many policies provide an inadequate level of cover for specific types of claims. Critically, many policies limit the liability of an insurer for multiple claims arising from one event and may not have sufficiently high liability limits to meet claims for breaches of FSR obligations, in addition to other common law and statutory obligations.

Guidance for licensees on what is an adequate PI policy requires a balance between:

- cover which sufficiently maximizes the chance that retail clients are able to recover from licensees; and

- cover which is reasonably available and affordable for licensees, having regard to the dynamic nature of the PI market.

Guidance on adequate cover, as well as levels of cover which are best practice if available on the market, are set out in the report.

Disclosure to retail clients in a Financial Services Guide (FSG) needs very careful consideration to ensure that unrealistic expectations are not raised amongst consumers.

The nature of the insurance market practices and the need to cater for existing arrangements suggest that a twelve month transition period would be most efficient.

1 INTRODUCTION

1.1 OBLIGATION ON LICENSEES TO HAVE COMPENSATION ARRANGEMENTS

Section 912B of the Corporations Act 2001 (Act) requires that a financial services licensee that provides a financial service to *retail clients* must have *arrangements* for compensating those persons for loss or damage suffered because of *breaches* of the relevant obligations under Chapter 7 of the Act by the licensee or its representatives (s912B(1)).

The Act provides the flexibility that the arrangements must either meet requirements made under regulations (if any) or be approved by ASIC (912B(2)).

Regulations may be made to specify the requirements that are applicable to all arrangements, a kind of arrangement, or to the matters to which ASIC must have regard in determining whether to approve an arrangement (s912B(2)(a) and 912B(3)(c)). As at the date of writing no regulations have been made to set requirements under s912B.

The manner in which ASIC is to approve arrangements is subject to a further provision. Before approving arrangements under s912B(2), ASIC *must* have regard to:

(a) the financial services covered by the licence;

(b) whether the arrangements will continue to cover persons after the licence ceases carrying on the business of providing financial services, and the length of time for which that cover will continue; and

(c) any other prescribed matter.

As at the date of writing, licensees are relieved from their obligations under s912B of the Corporations Act pursuant to CO 06/495 which expires on 31 December 2006, but are subject to various transitional requirements.

Section 912B requires licensees to have arrangements for compensating retail clients for loss or damage suffered because of breaches of the relevant obligations under Chapter 7 of the Corporations Act 2001 (Act) by the licensee or its representatives.

The relevant provisions under Chapter 7 of the Act include the 'civil liability provisions' of that chapter. Some of the key provisions of the Act allow for compensation for retail clients for loss or damage:

- when the licensee is advising and where (953B):
    - the Statement of Advice (SOA) contains a misleading or deceptive statement;
    - there is an omission of material that is specifically required to be in the SOA or material required by the sections that allow for an alternative to disclosure via a SOA (eg remuneration and commissions);

    - the licensee does not give the client anything purporting to be the required SOA;

    - the licensee does not give the SOA by the time they are required to do so,

- the personal advice given by the licensee is given without a reasonable basis, or the advisor fails to warn the retail client if advice based on incomplete or inaccurate information (s945A, 945B);

- where general advice is provided to retail client but breaches the obligation to warn that client that advice does not take account of client's objectives, financial situation or needs (s949A);

- when a FSG is required to be given to the retail client and where (953B):

    - the FSG contains a misleading or deceptive statement;

    - there is an omission of material that is specifically required to be in the FSG or material required by the sections that allow for an alternative to disclosure via a FSG (eg remuneration and commissions);

    - the licensee does not give the client anything purporting to be the required FSG;

    - the licensee does not give the FSG by the time they are required to do so,

- arising where a retail client has sought to return a product in accordance with the cooling-off provisions but the licensee has refused to comply with those provisions;

- arising where a retail client pays money to a licensee for the purchase of a financial product but the licensee has not dealt with it in accordance with Division 2 of Part 7.8 (for example the funds have not been paid into a trust account as required); and

- resulting from contravention of provisions including matters related to false and misleading statements, dishonest conduct and misleading or deceptive conduct (s1041I) - damages may include profits made by any person resulting from the contravention (1317HA).

On a strict interpretation of s912B, it might seem that the provision is intended to require licensees to have insurance arrangement to cover loss or damage arising from other ‘financial services laws’. Compliance with other ‘financial services laws’ (such as the ASIC Act and the Trade Practices Act) is a general obligation on licensees. Treasury has indicated that this was not the intention of s912B and this memorandum assumes that s912B does not extend to all TPA obligations.[1]

[1] Treasury Position Paper (2003) at para 89

1.2 DRAFT REGULATIONS

The Australian Government has released draft regulations (7.6.02AAA) together with a regulatory impact statement and explanatory memorandum in November 2006. In the absence of a further deferral of section 912B is anticipated that regulations will come into effect from the 1st of January 2007.

The draft regulations principally rely on a requirement that a licensee hold adequate PII cover, and that ‘adequacy’ is determined by reference to the binding authority of External Dispute Resolution (EDR) schemes.

The draft explanatory commentary also says, inter alia, under “Key Points”

- “The draft regulation is designed to allow the financial services market to perform its natural risk-management role and recognises that market participants are best placed to determine the level and nature of cover they need.

- The draft regulation requires that licensees must have a level of cover that is sufficient in view of their potential exposure to compensation claims brought through the dispute resolution scheme, or schemes, they belong to. The amount of cover required will differ according to the volume, scope and nature of their business.

- The draft regulation recognises that alternative arrangements may be put in place, and that certain licensees should be exempted from this requirement by virtue of the nature of their business operations.”

If adopted in their current form, the draft regulations released for public comment on 2 November 2006 (draft regulations) would require compliance with the obligation on licensees under 912B discussed above, as follows:

Group A: Exempt licensees

Exempt licensees are not required to hold PII or to disclose such insurance in a Financial Services Guide (FSG).

The following licensees would be exempt:
- a general or life insurance company, or an authorised deposit taking institution regulated by APRA); or
- a company related to one of the above that has been provided with a guarantee that ensures payment of the obligations of the related licensee to its retail clients and is approved in writing by ASIC.

Group B: Non-exempt licensees that must hold PII cover

licensees that are not exempt are required to hold PII cover that is:

- Disclosed to retail clients in summary in the Financial Services Guide (FSG) which is provided to the retail clients of the licensee, and of any authorised representative (draft Reg cl 7.6.02AAA(1));

- Adequate having regard to the *highest possible liability* of the licensee that could arise:
  - In connection with any *particular claim* against the licensee; and
  - In connection with *all claims* in respect of which the licensee could be found liable

  because of the licensee’s membership of an external dispute resolution scheme approved by ASIC (draft Reg cl 7.6.02AAA(2)(a)); and
- Adequate having regard to relevant considerations in relation to the financial services business carried on by the licensee, including:
  - The volume of business;
  - The number and kind of clients; and
  - The kind of business
  - The number of licenses held
  - The number of authorised representatives (draft Reg cl 7.6.02AAA(2)(b)).

Group C: Non-exempt licensees whose compensation arrangements do not satisfy the prescribed requirements and whose arrangements must be approved in writing by ASIC

Under the Act, where arrangements do not meet the prescribed requirements, they must be approved by ASIC (912B(2)(b)).

Having regard to the Act and the draft regulations, before approving arrangements ASIC must have regard to:

- The financial services covered by the licence (s912B(3(a));
- *Run-off cover:* Whether the arrangements will continue to cover persons after the licensee ceases carrying on the business of providing financial services, and the length of time for which that cover will continue s912B(3)(b);
- Whether the arrangements are adequate having regard to the *highest possible liability* of the licensee that could arise:
  - In connection with any *particular claim* against the licensee; and
  - In connection with all claims in respect of which the licensee could be found liable

  because of the licensee’s membership of an external dispute resolution scheme approved by ASIC (draft Reg cl 7.6.02AAA(3); and
- Whether the arrangements are adequate having regard to relevant considerations in relation to the financial services business carried on by the licensee, including:
  - The volume of business;
  - The number and kind of clients; and
  - The kind of business
  - The number of licenses held
  - The number of authorised representatives (draft Reg cl 7.6.02AAA(3)).

1.3 SCOPE OF RESEARCH

Alan Mason of Melzan Pty Ltd has been engaged by the Australian Securities and Investments Commission (ASIC) to conduct research into the current state of the PII market in Australia in relation to licensees.

Specifically the research has been asked to address the following points:

- "What PI insurance is currently available to financial services licensees (including the ease/difficulty in getting adequate cover for financial services firms)?

- What are the normal terms on which PI insurance is offered to small to medium licensees (including premium, excess, level of cover and exclusions)?

- As a matter of (a) base level standards and (b) good practice what is a reasonable or adequate PI policy in general terms?

- What criteria could ASIC use to assess the PI policy held by an individual licensee?

- What criteria would insurance brokers and/or insurers use to assess whether to insure a licensee and on what terms?

- What type and level of liabilities to retail clients are licensees typically exposed to (eg claims for inappropriate advice, misappropriation of funds etc)?

- Whether or not PI insurance will respond to the full scope of potential breaches of the legislation (eg identification of any gaps and weaknesses in available PI insurance policies)?

- In the Consultant's opinion what future developments in the PI insurance market may be expected (eg in terms of pricing and availability) and what effect might this have upon licensees?"

This report addresses the above topics and identifies the limitations of a market based approach to "consumer compensation" which relies on PII that is designed to protect licensees.

2 SCOPE OF ACTIVITY

The research was conducted as set out in the proposal presented to ASIC dated 25 August 2006.

Prior to commencement, consultation was entered into with the Chief Executives of a selection of licensed insurers and with the President and other members of the Board of the NIBA as well as the representative in Australia of Lloyds. All of these persons provided advice as to the most appropriate organisations and, more specifically, the individuals within those organisations with relevant expertise with whom to consult. ASIC provided a representative sample of licensees for further research.

The organisations and individuals consulted with have provided information about the PII market generally and the market for financial services licensees specifically. Those consulted have included people with knowledge and expertise of the National Insurance Brokers Association Scheme (NIBA), the ASX (market participants) arrangements and those directly involved in placing or underwriting cover for financial planners. Separately, discussions were held with the Finance Industry Complaints Scheme (FICS) which is the predominant external dispute resolution scheme for licensees, and with NIBA with regard to the Insurance Brokers Disputes (IBD) EDR scheme.

The views of consumers were provided through a copy of the November 2002 submission of the Financial Services Consumer Policy Centre and direct discussions.

Whilst there are a large number of underwriters (estimated at 35) and a significant number of insurance brokers trading in this market, reliance can be placed that the information gathered and views expressed are representative of current Australian market conditions.

2.1 RESEARCH METHODOLOGY

The research has taken the form of:

a) A written questionnaire developed in consultation with ASIC, which was forwarded to a selection of insurance companies, insurance brokers, underwriting agencies and the Financial Industry Complaints Service. A copy of the questionnaire is Appendix A.

b) Face to face interviews and meetings with each respondent to the questionnaire.

c) Subsequent discussions and interviews with other persons referred by the interviewees.

d) An analysis of policy wordings, endorsements, underwriting questionnaires and other material provided by interviewees and a comparison with the requirements of the Act and the Regulations.

e) An analysis of material provided by ASIC which particularly included:

i. Treasury Position Paper 2003 – Compensation for loss in the financial services sector
ii. Treasury Consultation Paper 2002 – Compensation for loss in the financial services sector – Issues and Options
iii. Financial Planning Association of Australia – Response to Issues and Options Paper
iv. APRA Information Paper – Superannuation – Trustee Liability Insurance and associated Survey of Superannuation Trustees
v. National Claims and Policies Database – Policy Data Tables – issued 20 July 2006
vi. ACCC – Fifth Monitoring Report – Public liability and professional indemnity insurance – July 2005
vii. ASIC – Policy Statement 33 – Security Deposits
viii. ASIC – QFS 100 – Are insurance brokers obliged to maintain professional indemnity

f) A survey developed in conjunction with ASIC which was despatched to a random selection of 53 financial services licensees. A copy of the survey is contained in Appendix B.

A list of the organisations consulted, who have provided material assistance to this review is contained in Appendix C. Their cooperation is gratefully acknowledged. The assistance of senior managers from ASIC, Mark Adams, Rhys Bollen and Cathy Binnington is also acknowledged.

The Consolidated Results of the Underwriters'/Brokers' interviews are contained in Appendix D, and the Consolidated Results of the licensees' Survey are contained in Appendix E

2.2 CONFIDENTIALITY

To ensure that confidential information which was received during the course of interviews and surveys is kept confidential, this report uses codes to refer to insurers and insurance brokers. Specifically five insurers are referred to as Insurer A-Insurer E and four insurance brokers are referred to as Broker A-Broker D.

3 OVERVIEW OF THE AUSTRALIAN PII MARKET

3.1 HISTORY

The recent history of PII in Australia has been similar to the history of public liability insurance.

HIH and FAI were both major underwriters. Their collapse in 2002 contributed significantly to the crisis in both the affordability and availability of PII. This occurred at a time when the insurance market generally was reacting with increased pricing, more restrictive terms and conditions and even withdrawal of capital, to burgeoning and unsustainable losses in liability classes of insurance including public liability, medical malpractice and professional indemnity.

Since that time a combination of factors have substantially improved the position. These have included:

- Significant tort law reform enacted by Commonwealth, State and Territory Governments. The major focus of this was on personal injury compensation, but the professional indemnity market was also assisted by professional standards legislation, capping, the introduction of proportionate liability and other measures.

- Much improved risk management and professional standards across the whole of the insured community, often introduced collectively by industry associations and professional bodies.

- Excellent performance of investment markets.

- The absence of unusually high shock or catastrophe losses (putting aside Westpoint).

- A significant subscription of new capital into the global reinsurance and insurance markets.

3.2 RECENT TRENDS

The Australian Prudential Regulation authority, (APRA) has recently reported:

> *"In their financial years ending between January and December 2005, private insurers reported gross premium revenue of $28.4 billion".*
>
> *"Gross premium revenue for professional indemnity insurance fell 2.1% from the previous year to 1.3 billion".*[2]

PII for all categories of risk therefore represents only 4.5 % of the available insurance market. According to APRA, in the financial years ending between January and

[2] APRA Statistics: Half yearly general insurance bulletin, December 2005 issued 3 August 2006

December 2005, private insurers reported underwriting profits of 2.9 billion, down 7.9% on the previous twelve months and 5.7% lower than the twelve months to 31 December 2003.

Underwriting results are not available separately for the professional indemnity class but from Tables 7 and 8(1) (refer Appendix F) it will be noted that PII produced gross incurred claims to the twelve months to December 2005 of $745 million and currently holds a gross outstanding claims provision of $3.282 billion or 12.5% of the industry's total outstanding claims provision

In terms of financial exposure, therefore, PII is a very significant class of business with high exposure, but the industry is more than adequately capitalised to underwrite this business and any increased business arising from the introduction of the regulations.

However APRA reports that the financial standing of the industry is at an all time high with total assets of $81.5 billion, total liabilities of $56.6 billion and net assets of $24.9 billion:

> *"The capital position for private sector insurers continues to improve. In terms of risk based capital measures the industry's capital coverage is currently 2.44 times the minimum capital requirement."*

In general, access to the market has improved significantly with, it is reported, 35 underwriters now insuring professional indemnity classes. This number includes APRA licensed insurers, Lloyds cover holders (who are also APRA regulated) and a number of underwriting agencies and representatives of direct offshore foreign insurers (DOFI's).

The National Insurance Brokers Association website (needabroker.com) lists 377 insurance brokers who arrange PII.

Access to cover

Interviews with brokers, underwriters and the survey of licensees has confirmed that the current environment could certainly be characterised as a 'soft market'.

In insurance terminology a 'soft market' is one in which there is an over supply of capacity willing to underwrite the business. This results in fierce competition, usually on price and often on scope of cover.

During the course of this research there has been no evidence of insured's or groups of insured being unable to purchase insurance and affordability has certainly improved.

Both APRA and ACCC price monitoring have confirmed that the overall market pricing has reduced; notwithstanding that these reports tend to have a significant time lag. Anecdotal information from interviewees confirms that prices have generally reduced across the board. One underwriter reported that the June 2006 renewal season saw their premiums drop across their book by an average of 25%. Many licensees have reported premium reductions ranging from 5% to 20% (refer Appendix E).

Scope of cover

The soft market has *not*, however, seen any relaxation of underwriting controls. Indeed it may to a limited extent be a response to the soft pricing that underwriters are carefully maintaining their standards on risk assessment (Refer to section 4.3). Similarly, there has not been any notable expansion in policy terms and conditions. Some policy features, for are generally speaking not automatically available as there are restrictions in the insurer's reinsurance arrangements (e.g. Terrorism exclusions and run-off covers).

One recent development reported by insurance brokers is a trend back to providing defence costs in addition to the limits of indemnity. Anecdotally, the market is said to be about 50% "cost inclusive" and 50% "cost in addition".

Whilst the Westpoint losses have not had much impact so far, it is known that one underwriter has decided to exit the market altogether, another has introduced a special Westpoint exclusion and another has excluded Mezzanine Finance. The salient point to be noted from this is that if the insurance market feels that a risk or product exposure is too high or cannot be adequately underwritten or priced then insurers may well exclude the cover from the licensee's policy.

3.3 OUTLOOK

There is almost universal consensus amongst the insurers and brokers interviewed for the preparation of this Report:

- That the present favourable market conditions from the purchasers' point of view will continue for the immediate future.

- That there will be another market correction within the next three years.

Some industry executives believe that the number of new entrants, combined with existing insurers need to achieve top line growth is driving price competition to the point where it will inevitably render the market unprofitable. There is speculation therefore that much of the most recent capacity will disappear if it fails to achieve both its top line and bottom line business objectives.

There is general consensus amongst insurers and brokers that the trigger for a change in the market will be a change in the claims experience. History shows that it is a change in economic conditions that will most likely cause a change in the claims experience. The number of claims notified and pursued has historically had a direct linkage with the economy, with downturns in investment markets, rising inflation and interest rates. Consumers who suffer financial losses, often because of economic and market conditions, often seek to find an avenue of redress or recoupment, and professional advisers backed by insurance assets are an inevitable target.

The growth of litigation funding and the recent High Court decision in the Fostif case are viewed by insurers as a serious possible source of increased claims frequency and cost.

4 AVAILABILITY OF INSURANCE FOR FINANCIAL SERVICES LICENSEES

4.1 PII GENERALLY

The market for PII for financial services licensees is quite diverse.

- For a number of licensees it is mandatory under:-
  legislation (insurance brokers)
  market rules (ASX market participants) or
  industry association membership (FPA).
  (refer Appendix G)

- Others arrange their insurances to meet requirements of schemes that come under the auspices of the Professional Standards Council e.g. accountants (refer Appendix H).

- There is then a large voluntary market for the very wide spectrum of licensees (Refer Appendix I).

4.2 AVAILABILITY OF PII FOR LICENSEES

The available market for financial services licensees is as competitive as the general market for PII.

The market is not only competitive, it is diversified and well supplied

Insurance Brokers

Insurance brokers remain subject to the indemnity insurance requirements that applied under the superseded *Insurance (Agents and Brokers) Act 1984* (IABA) (ASIC CO 06/495). Coverage is mandatory and minimum conditions are specified including minimum indemnity limits, non-avoidance clauses and run-off cover requirements. Insurance must cover liabilities incurred as a result of a breach of professional duty by the broker in the course of carrying on business as an intermediary up to an amount specified in the regulations of between $1 and $5 million. The excess cannot exceed $10,000 or 2.5% of the broker's annual income.[3] Insurance must provide "run-off" cover where the insured ceases to trade, the insurer cancels the contract the insured, or any other person who becomes responsible for the liabilities of that person, is required to continue to be indemnified in relation to a claim.[4] Notice must be given to ASIC of termination.

Any retail client who has a problem with his or her insurance broker concerning a general or life insurance product can seek dispute resolution through the Insurance Broker Disputes Limited (IBD). IBD covers products including motor vehicle, home buildings and contents, sickness and accident, life, consumer credit, travel, personal and domestic property and small business policies. Complaints which are the subject

[3] Insurance Agents and Brokers Regulation cl 2B
[4] *Insurance (Agents and Brokers) Act 1984* 9B

of legal proceedings may not be heard by IBD. IBD does not handle disputes involving claims of more than $50,000 except where the insurance broker or financial service provider and its professional indemnity insurer have agreed to waive this limit. A consumer may confirm in writing that his or her complaint is reduced to $50,000 to enable IBD (rather than the courts) to handle the complaint.[5]

The PII offered to insurance brokers includes:

- Schemes. There are a number of "schemes" available to insurance brokers.[6] They are however very similar in terms of policy terms and conditions so for present purposes may be regarded as homogenous. These include the scheme arranged by the NIBA and the schemes arranged by the so called cluster groups such as Steadfast and IBNA.[7]

- Major international brokers. The major international brokers tend to have their PII arrangements included in their worldwide insurance program often with very significant deductibles or excesses.

- Tailored to insurance brokers through endorsements but not part of the scheme.[8]

Stockbrokers

Most Stockbrokers arrange their insurance to meet the requirement of the ASX market rules.[9]

Under the ASX Business Rules all market participants must have cover against liability for negligence, errors, omissions, misstatements, statutory warranties and indemnities, infidelity of staff, loss, destruction or deprivation of securities or other documents of title. Cover must be of the kind and amount which the market participant determines to be adequate having regard to the nature and extent of the business and the responsibilities and risks assumed. The cover must include insurance against breach of duty arising from any act or omission of the market participant. The market participant must notify the ASX of the amount and period of cover.[10]

A specific scheme and policy wording has been in place for ASX members (now market participants) since 1982.[11]

It is, however, noted that many stockbrokers are also financial planners and there are licensees advising on equities who are not market participants.[12] Many of these obtain cover in the open market.

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[5] See IBD Annual Report 2005 – Limit subsequently increased to $100,000.
[6] The reference to schemes above largely refers to a facility whereby cover is offered to an agreed wording but underwriters usually reserve the right to underwrite the individual scheme member on an offer and acceptance basis and to impose specific terms and conditions.
[7] Offered by Insurer A – NIBA scheme policy. Insurer A also offers crime policy.
[8] Offered by Insurer B – policy specifically for insurance brokers.
[9] Clause 4.6 Insurance Requirements and guidance note 8 (See Appendix G).
[10] ASX Market Rules Section 4.6
[11] Offered by Broker A - specific Stockbroker policy.

Financial Planners

This is the most diverse group of market participants which ranges from the major corporates (including APRA regulated entities) to sole practitioners.

Some of the larger licensees have very many authorised representatives and they arrange a cover available for all their authorised representatives on a standard basis. In some instances, licensees contractually require authorised representatives to contribute a proportion of a large excess should a claim be made against them to which the licensee's insurance policy responds.

In some other cases authorised representatives are required by the principal to purchase their own covers. In practice this typically means that the licensee purchases its own insurance and its authorised representatives purchase additional insurance. This offers significant consumer protection, and protects authorised representatives should a licensee make a claim against them and the licensee should the authorised representative make a claim against them.

Some insurers prefer to only underwrite the corporate entities or dealer groups as they rely upon the robustness of their controls, compliance, product lists and so forth. Other underwriters will not insure corporate groups but prefer only to write the individual based on a personal underwriting assessment. Underwriters also have differing views as to whether it is more efficient, from an administration perspective, to underwrite a dealer group than multiple individuals.

The policies reviewed for the purpose of this report were policies either specifically tailored to financial planners[13] or standard civil liability policies that could be sold to an array of different professionals, including financial planners.[14]

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4.3 UNDERWRITING CRITERIA USED TO ASSESS INDIVIDUAL LICENSEES

The insurance underwriting process serves two important functions:

- it enables the underwriter to assess the risk exposures and then to determine appropriate terms and conditions, and levels of premium and excess at which the insurer will undertake the risk; and

- the insurer's questions require insured's to carefully examine their own business practices, compliance, risk management and risk mitigation.

A proper risk identification, assessment and risk management process not only reduces the cost of insurance, it reduces the likely cost of negligence or errors to the

[12] Offered by Insurer D – with special stockbroker extensions and endorsements. Insurer D also offers crime policy.

[13] Offered by Insurer C – Financial Planner policy and offered by Insurer D – Financial Planner policy. Insurer D also offers crime policy.

[14] Offered by Insurer A – with special Financial Planner endorsements. Insurer A also offers crime policy. Offered by Insurer B

licensee and ultimately is of benefit to the consumer, as it will prevent errors occurring in the first place.

In this context therefore consumer compensation and insurance should be regarded as a last resort.

For the same reason, the carriage of excesses or deductibles by licensees is a practice that is desirable, always provided that the licensee has the necessary financial resources to meet the self insured exposure.

Insurers have commented generally that the advent of costs inclusive policies with cost inclusive excesses was a contributor to the stabilisation and return to profitability of the PII market, as it led to much closer interest by insured parties in loss mitigation, defence and even early conciliation or settlement of claims. The market trend back to costs in addition and costs exclusive excesses are therefore seen to have certain downsides.

Common underwriting criteria

The matters that insurers take into account in underwriting a risk vary, as will be expected, from one insurer to the next. However, the following list of criteria is representative:[15]

- Nature of the licensee's business;
- Volume of the business (revenue, fee income assets under management etc);
- Number of authorised representatives;
- Number of employees;
- Number of clients, the nature of clients and the size and volume of individual transactions;
- Approved product list;
- Risk management procedures and controls;
- Experience and expertise of the principals;
- Previous claims history;
- Training; and
- Internal and external audit.

[15] The supplementary questionnaire in Appendix J is indicative of the additional information that underwriters will request.

Insurers place particular emphasis on assessing the approved product list and the internal processes and controls exercised by the licensee.

Not many insurers assess the financial standing of the licensee unless there is a large excess or deductible.

The volume and depth of the underwriting information that insurers seek is extensive as noted in the surveys.[16]

[16] Refer to answers to question 7 and Broker B question 3.

5 COMMON TYPES OF CLAIMS AGAINST LICENSEES

5.1 QUANTUM OF CLAIMS

- The most comprehensive information currently available about the quantum of claims in the PII market is contained in the APRA National Claims and Policy Database (NCPD). An excerpt from the section titled ‘The Selected Features – Professional Indemnity’ is included as Appendix K.

- This data is useful in that it highlights the long tail nature of professional indemnity business. Whilst claims must be made and notified in the year of the policy it takes many years to develop and pay claims. According to APRA:

- “The majority of payments being made are in respect of claims from accident years of between two and seven years before the current year”.

- As APRA commented the delay in claim notification and finalisation makes liability business particularly difficult and complex to price and manage appropriately. It should also be noted that the smaller claims will tend to be finalised first whereas the older claims are much higher in value.

- APRA data shows that the largest cause of loss for PII is coded as “Advice” for which the average cost per claim is $146,000. This average cost of claim would strongly support assertions of brokers and underwriters that a limit of indemnity of $2million would cover 90% of all claims.[17]

- Commentary from individual insurers has produced different information about average claim sizes, which is reflective of the different portfolios that they underwrite.

- However there is consistency in claims frequency where insurers and underwriting agencies alike have reported that the frequency of circumstances notified is generally speaking about 1:10 policies per annum, irrespective of the category of risk. This ratio can double in times of economic downturn. Also underwriters and claims managers reported a consistent conversion of circumstances notified to claims of approximately 20%.

5.2 CAUSE OF LOSS

- The main cause of loss to licensees is advice, although there are a number of other common causes of loss.

- Advice

- The predominant cause of loss according to the APRA NCPD data is advice. However the causes of loss vary from sector to sector.

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[17] Interview with Insurer A

- Insurance brokers. In the case of insurance brokers the single greatest cause of claims is errors and omissions, particularly administrative errors such as the failure to place cover, the failure to relay information, the failure to pass on premiums.

- Financial Planners. The Financial Industry Complaints Service (FICS) reports that the majority of its complaints against financial planners are in respect of "inappropriate advice". These complaints (199 in 2005) represent 11% of all matters dealt with by FICS.

- Stockbrokers. Statistics from FICS in respect to stockbrokers and managed investments are too small to draw any conclusions. For stockbrokers the classical claims include advice, and fraud. They are particularly subject to multiple claims for a single piece of advice, eg a flawed options trading strategy could produce many claims from different clients.

Other causes of loss

- ASIC is probably best placed through its own complaints data to analyse the causes of complaint. Nevertheless, anecdotal information from insurers and brokers is interesting and some of the key sources of claims were identified as follows:

- Acting outside scope of authority or providing advice in respect of products not on the approved product list – note insurers generally speaking will not provide this cover. [18]

- Switching. Failure of licensee or its representatives to advise on the costs and benefits of switch from one financial product to another, including superannuation schemes. Insurers are seeing early signs of problems emerging in respect to superannuation funds switching. It is reported that this is a major source of complaint in the U.K.[19]

- Misappropriation of funds is also reported as another typical claim but not of high frequency. [20] Margin lending also featured as a source of wrongful claims for financial planners. There are also a number of claims for non-fraudulent failures to pass on moneys that should be passed on to a client to that client. [21]

- Claims against financial planners for Agri-business including olive plantations resulted in many insurers not wishing to underwrite Agri-business at all.

- Breach of the Part 7.10 of the Corporations Act and Part 2 Division 2 of the ASIC Act or Fair Trading Acts for misleading and deceptive conduct.[22]

[18] Interview with Broker A
[19] Interviews with Insurer A
[20] Interviews with Insurer D, Broker A
[21] Interview with Insurer D
[22] Interview with Broker A

6 AFFORDABILITY – PREMIUMS, LIMITS AND EXCESSES

6.1 PREMIUMS

PII premiums are a normal business expense for licensees. Every respondent to the survey (Refer Appendix E) indicated that PII was "an integral part of their risk management framework"

The respondents indicated that PII premiums were:

Low cost	Moderate cost	High cost	Excessive
1	7	4	Nil

Respondents indicated that the cost of purchasing premium represented between 0.65% and 2% of the licensee's income/turnover.

Only two licensees indicated that their premiums had increased in the past year. Eight indicated it had reduced.

Only two indicated that the *level* of cover purchased was influenced by the cost of the premium. However premium saving was a consideration in the level of excess purchased for six respondents.

Average Premiums

Average premiums are a poor indicator of affordability as there is no relevant data to match the averages to in terms of limits or exposures.

However, it is indicative that the NCPD shows the average premium for PII for all categories of insured's at $4861 per annum for 2005, and for risks with an excess between $1000 and $1999 the average premium is $2400.[23] It is known that premiums will have reduced since. Minimum premiums are of the order of $1000.

6.2 LIMITS OF INDEMNITY

There are several considerations in understanding the monetary limits on a policy:

- Whether the limit is per event, per claim or per claimant and in the aggregate in any one year;
- Whether the limit includes defence costs or whether costs are" in addition";
- Whether or not the policy provides automatic reinstatements and, if so, how many;
- Whether there are "sub-limits" and whether these are part of or in addition to the main limit;

[23] Appendix K

- The number of authorised representatives "insured" under the (single) policy limit; and

- The excess under the policy.

There is no such thing as a "standard" limit. However, underwriters and brokers were able to provide some indications of "typical" limits purchased.

Typical Limits purchased are:

Category	**Turnover**	**Limits**
Sole practitioner	<$500,000	$1m - $2m
Small business	<$2,000,000	$1m - $5m
Medium business	<$10,000,000	$2m - $10 m
Large business	>$10,000,000	$5m - $20m

Most individual insurers will not sell a limit of less than $1m nor more than $20m. Larger exposures are typically shared amongst several insurers (coinsurance) or arranged in layers eg $20m in excess of $5m.

The licensees surveyed had limits of Indemnity in the following ranges:

No. of licensees .	**Limit per Event**	**Reinstatements**	**Aggregate**
3	1m	unlimited to agg	2m
1	2m	2	10m
1	2m	2	6m
1	5m	-	5m
2	5m	1	5m
1	7.5m	-	7,5m
1	10.0m	-	10.0m
1	50.0m	1	100.0m
1	50.0m	3	200.0m

It was observed by more than one interviewee that a limit of indemnity of $2m (including costs) would cover 90% of all individual claims ever lodged.[24]

One insurer noted that clients were generally unaware that premiums did not increase in the same ratio as limits. A doubling of the limit could typically cost a 30% premium increase.[25]

6.3 EXCESSES

Similarly to limits of indemnity, the wording and approach to excesses varies considerably from underwriter to underwriter and by insured sector.

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[24] See also claims data Insurer A.
[25] For a discussion on limits refer to Sections 7 and 9.

The following matters should be considered in evaluating the impact of an excess under a policy.

- Whether or not the excess is per event, per claim or as sometimes expressed "per claimant";
- Whether there is a limit to the number of excesses that can be applied; and
- Whether the excess applies to indemnity payments or defence costs or both

Research amongst underwriters has ascertained some variations in approach.

Minimum Excesses range from $1000 to $5000 with most being expressed as a % of fee income. 1% is commonplace, but it can be as high as 2.5% or as low as 0.5%. "Typical" excesses range from $5000 to $25000 but excesses of $50,000 or $100,000 are not uncommon.

licensees surveyed have indicated excesses in the range from $5,000 to $250,000. Sometimes minimum excesses are prescribed by insurers. No insurer has been found to issue a P.I. policy to a financial services licensee without an excess.

A broker noted that higher excesses were not commercially advantageous at present as the available premium savings did not warrant the increased self-retention. Higher excesses are generally cost inclusive while lower excesses generally don't apply to costs.
Higher excesses generally may have the effect of removing the insurer from a determination of an approved dispute resolution scheme.[26]

6.4 DEFENCE COSTS

Underwriters have reported that defence costs range between 30% and 50% of all claims payments. An interviewee has reported that a typical defence cost on a claim against a financial planner will be of the order of $20,000. For a small claim defence costs can range between $4000 and $5000. The fees payable for dispute resolution by schemes such as IBD and FICS are generally treated as defence costs for the purposes of policy indemnity and the application of excess.

6.5 MINIMUM REQUIREMENTS FOR LIMITS AND EXCESSES AND DEFENCE COSTS AND OTHER POLICY FEATURES

The research included an examination of the minimum requirements set out in established "schemes" including those for Insurance Brokers, Stockbrokers, the FPA members and the Professional Standards Council.

These produced a surprising diversity of approaches and are therefore of limited guidance as are insurers individual approaches (refer 6.2 and 6.3).

[26] For a discussion on excesses refer to Section 7 and 9.

	Brokers	**FPA**	**ASX**	**PSC**
Min. Limits	$1m or 15% of **Premium** Income up to $5m or if greater than $5M	$1M per claim or $2M in agg. or 50% of gross income from financial planning	Adequate	$½ M
Excess **max**	$10,000 or 2.5% of **brokerage** income	25% of surplus liquid funds	Not stated	3% of gross fees or 5% of limit of indemnity
With ASIC approval	$18,750 or 20% of surplus liquid funds			

7 MINIMUM COVER REQUIREMENTS VERSUS GOOD PRACTICE IN ASSESSING RISK EXPOSURES

The methods by which licensees determine an adequate limit of indemnity and excess generally differ according to the *size* of licensees.

7.1 LARGE LICENSEES

Larger licensees usually have the capacity to do full risk assessments and relevant financial modelling.

Larger licensees almost invariably seek external professional advice to asses their insurance requirements and all nominate some or all of the following factors:

- Volume of business transacted and number of clients;
- Worst loss scenario per individual client;
- Potential for multiple claims; and
- Number of authorised representatives and/or employees.

All respondents to the survey nominated “worst loss scenario” nominated.

Larger licensees conduct an assessment of their capacity to pay the excess (or multiple excesses) measured against the premium saving. One insurer does a financial assessment of the insured if the excess is lower than $50,000. Where the policy is bought/arranged for the benefit of authorised representatives the excesses tend to be kept at the lower levels.

7.2 SMALL LICENSEES

Smaller licensees often do not have the time, resources or sometimes the skills to perform an appropriate evaluation of risk.

It was noted during discussions that insurance brokers do not find the approach taken by APRA in its Information Paper – Superannuation – Trustee Liability Insurance to be helpful, practical, or administratively cost effective for smaller superannuation funds or their trustees[27]. The level of insurance and technical knowledge that the purchaser of insurance would need exceeds what one would expect of an informed buyer. The complexities this research has identified in the insurance market tend to support this assessment.

The insurance broker, to whom a licensee might be expected to look for advice finds it commercially unrealistic to do a full assessment of needs on an average premium of less than $5,000 for most small businesses.

[27] Interview with Insurer B

Smaller licensees therefore, predominantly rely upon the "standards" set by their industry group, regulators or the ASX and accept the minimum excesses imposed by insurers, brokers and "schemes". Brokers often simply provide the clients with a shopping list, of limits excesses and prices.

The survey of licensees (refer Appendix E) does show that all licensees take a considered approach to their risk assessment.

The **minimum** requirements are important to consider here as they are followed quite extensively by sole practitioners and small firms of licensees, and may be utilised by authorised representatives of large dealer groups.

Good practice in assessing risk exposures, whether or not a licensee is large or small, part of a scheme or group buying arrangement would be that the licensee and its advisers should:

i) Obtain a clear understanding of how the proposed policy insurer defines limits, excesses and defence costs (refer 6.2, 6.3 and 6.4).

ii) Apply a checklist which might include the following:

- Calculate the maximum exposure to a single client (investment, policy sum insured, etc.)
- Estimate the number of claims that could arise from a single event, product or advice
- Check whether defence costs are included in the limit of indemnity or are "in addition" and adjust the amount purchased appropriately
- Calculate the level of excess the business could meet without stress. NB 1 for multiple claims multiple excesses may apply. NB 2 check if the excess applies to defence costs.
- Obtain a list of key policy features ,especially exclusions
- Obtain a list of available extensions

iii) Identify the potential financial exposures which may arise from gaps in coverage (refer 8.1) and establish a risk framework to **manage** those risks.

8 SCOPE OF COVER AVAILABLE FOR FINANCIAL SERVICES LICENSEES

8.1 OVERVIEW OF SCOPE OF COVER

There is significant variation in the scope of cover available:

- From each insurer in the market;
- For each category of licensee (brokers, financial planners, stockbrokers); and
- For each individual licensee.

Cover currently available in the professional indemnity market differs considerably. There is no standard cover, although many insurers provide a similar (although not identical) scope of cover to those holding a license to provide the same financial service (such as insurance brokers or financial planners).

All PI insurance currently available is written on a 'claims made' basis. This means that the insurer indemnifies the insured against claims notified and made during the term of the policy (usually one year), notwithstanding that the act or omission may have occurred prior to the inception of the policy. This feature of PI policies is not limited to Australia, but is common across the global PI market. By comparison, public liability insurance operates on an "occurrence" basis, meaning that the policy in force at the date of occurrence of the event which gave rise to the injury or loss is the policy which will respond to the claim.

However, a PI policy made available to an licensee will typically cover:

- Civil liability for compensation from any claim made during the policy period against the insured as a result of a breach of professional duty in the conduct of the insured's profession;
- The licensee together with the licensee's principal, partners, directors and employees;
- A licensee,
- Costs and expenses of defending a claim;
- Loss of documents, breach of intellectual property rights and duty of confidentiality.

Some policies include automatic or optional extensions to cover:

- Authorised representatives (acting within authority and with respect to authorised products) and contractors;
- Fraud, dishonesty and trade practices breaches (except fraud or dishonesty by the licensee);

- Fidelity;
- Run-off; and
- Endorsement of awards made by an external dispute resolution scheme.

Many policies exclude:

- Claims arising out of a conflict of interest (unless the conflict is acknowledged by the client) and claims brought by related parties;
- Civil fines and penalties;
- Obligations which the licensee has assumed by contract which exceeds the obligations the licensee would have in the absence of that contract; and
- Aircraft and watercraft, bodily injury, nuclear, occupier's liability, pollutants, war and terrorism.

There is no direct alignment between the cover available on the market and licensees' obligations under s912B.

Policies are not currently framed on the basis of licensees obligations under 912B of the Act. Rather, they have been developed to respond, at an affordable price, to the areas of a licensee's professional activities which give rise to significant risks.

Only one policy reviewed for the purposes of this report *specifically* but partially expressed in terms of liabilities that may arise under s912. In some respects professional indemnity policies cover a wider array of liabilities (for example those stemming from loss of documents). The professional indemnity market for financial services licensees generally speaking covers the licensee's civil liability, as defined in the policy, for all aspects of the licensee or legal entity's business whether that is wholesale or retail and extends to services and business beyond the scope of the legislation.

The details of the scope of cover offered by six insurers currently offering PI to licensees is set out below.

PII currently offered

The following analysis shows the scope of PII offered by a selection of leading insurers.

	Insurance broker policies		**Financial planner policies**		**Stock broker policies**	
	Insurer A - NIBA scheme policy	**Insurer B – Insurance broker policy**	**Insurer C - Financial Planner policy**	**Insurer D - Financial Planner policy**	**Insurer E - standard PI civil liability policy**	**Broker A – Stockbroker policy**
Insuring clause	Civil liability arising in the conduct of the insured’s profession (provided they held a license at the time of the events giving rise to the claim).	Legal liability incurred or alleged in the conduct of the professional practice, meaning the carrying out of this functions by on behalf of the assured normally associated with the conduct of the specified profession.	Civil liability for breach of professional duty arising from any act, error or omission committed by the insured in the conduct of the specified professional business.	Damages resulting from any claim for any breach of duty of the insured. Breach of duty means breach of duty, negligent act, error, misstatement, breach of confidentiality or omission in performance of financial planning advice or services under a license and respect of approved products.	Civil liability to a third party incurred in the conduct of the insured professional business stated in schedule.	Civil liability incurred in connection with the Professional Services provided to third parties in respect of a claim made on the assured. Professional services are defined by reference to certain products.
Limit of liability exclusive of defence /settlement costs	✓ Plus a standard extension: for investigation costs eg Royal Commission	✓	⮙ Depends on policy: limit of liability may be expressed to be exclusive of defence costs ✓ Plus a standard extension for official inquiries	× Limit of liability inclusive of costs and expenses. ✓ Plus a standard extension paying for court attendances.	✓ Also covers costs of inquiries.	✓
Multiple claims clause	✓All causally connected or interrelated acts = a single act. Where single act leads to more than one claim, all constitute one claim under the policy (only one deductible, one limit	✓All causally connected or interrelated acts = a single act. Where single act leads to more than one claim, all constitute one claim under the policy (only one excess, one	✓All causally connected or interrelated acts = a single act. Where single act leads to more than one claim, all constitute one claim under the policy (only one excess, one limit of indemnity).	-	✓ In the aggregate, indemnity shall not exceed the policy limit For any one claim or series of claims arising from the same acts, errors or omissions.	-

	Insurance broker policies		Financial planner policies		Stock broker policies	
	Insurer A - NIBA scheme policy	**Insurer B – Insurance broker policy**	**Insurer C - Financial Planner policy**	**Insurer D - Financial Planner policy**	**Insurer E - standard PI civil liability policy**	**Broker A – Stockbroker policy**
	of indemnity).	limit of indemnity).				
Unusual exclusions	× Exclusion of liability for failure of an unauthorised foreign insurer to pay claim (unless IABA or NIBA guide followed)	× Exclusion: Any action arising from an action for refund of fees, brokerage or commission not covered		× Exclusion: does not cover delay in performing services.	× Exclusion: action for refund of professional fees or charges (by way of damages or otherwise) or repayment of loan.	× Exclusion: does not cover loss/depreciation stemming from normal or abnormal market fluctuation.
Fines and penalties	× Exclusion	× Exclusion	× Exclusion	× Exclusion	× Exclusion	× Exclusion
Breach of confidentiality	✓	× Exclusion	✓	✓	✓	-
Intellectual property, libel and slander	✓	✓	✓ Standard extension	✓	✓	-
Trade Practices	✓ Misleading or deceptive conduct under TPA pre 1998, under ss12AA and 12DB post ASIC Act	-	✓ Standard extension: Misleading, deceptive or unconscionable conduct.	✓ Misleading or deceptive conduct under the Act, ASIC Act, TPA and state Fair Trading Acts. × Exclusion anti-competitive conduct (eg restraint of trade).	✓ Unintentional breaches of the TPA or corresponding sections of state Fair Trading legislation enacted throughout Australia (but not for criminal liability).	-
Fraud / dishonesty and crime	✓ Standard extension: For actions against insured with respect to consultants, sub-contractors or agents – not insured	× Exclusion of any dishonest, fraudulent, criminal or malicious act by consultants, subcontractors or agents.	✓ Standard extension: dishonest, fraudulent, criminal or malicious act by insured's employees, partners or directors.	✓ Covers claims for fraud/dishonesty of any employee. ✓Covers fraud/dishonesty of authorised representative. × Exclusion: does not cover	✓ Dishonest, fraudulent, criminal or malicious acts or omissions by an employee or principal of the insured.	✓ Covers assured for fraud/dishonesty of partner, member, director, officer, member, consultant of the assured, but not the insured.

	Insurance broker policies		Financial planner policies		Stock broker policies	
	Insurer A - NIBA scheme policy	**Insurer B – Insurance broker policy**	**Insurer C - Financial Planner policy**	**Insurer D - Financial Planner policy**	**Insurer E - standard PI civil liability policy**	**Broker A – Stockbroker policy**
		× Exclusion of any dishonest, fraudulent, criminal or malicious act by assured.		criminal, dishonest or fraudulent act of insured.		✓ Covers liability of assured for dishonesty and fraud of authorised representatives. × Exclusion: claims arising from assured or directors' fraud/dishonesty. × Exclusion: receipt of compensation illegal or not disclosed in prospectus, improper solicitations re offerings.
Fidelity	✓ Standard extension: Sub limit		× Exclusion: Does not include moneys owed. ⮙ Optional extension: Indemnity for loss of money sustained by dishonest or fraudulent acts of employees.	-	✓ Claims re fraudulent employees and principals that involve theft or misappropriation of money, only covered if the insured kept a separate trust account for that money.	-
Loss of documents	✓ Standard extension: Sub limit	✓ Sub limit	✓ Standard extension	✓ Standard extension: Sub limit	✓	-
Non imputation and non avoidance	✓ Non imputation extension: insured's misrepresentation/failure to comply with duty of disclosure does not prejudice other named insured's	✓ Non imputation	✓ Standard non avoidance extension for life insurance broking ✓ Non imputation	-	-	⮙ Endorsement for non avoidance.

	Insurance broker policies		Financial planner policies		Stock broker policies	
	Insurer A - NIBA scheme policy	**Insurer B – Insurance broker policy**	**Insurer C - Financial Planner policy**	**Insurer D - Financial Planner policy**	**Insurer E - standard PI civil liability policy**	**Broker A – Stockbroker policy**
Conflicts of interest: claims arising from a conflict	× Exclusion can be overcome if insured obtains signed and dated document from client acknowledging the conflict of interest.	-	× Exclusion can be overcome if insured obtains signed and dated document from client consenting to the conflict of interest.	× Claims arising from failure to disclosure conflict are excluded.	-	-
Assumed contractual liability	× Exclusion	× Exclusion	× Exclusion: does not cover guarantee or warranty of insured re financial performance of an investment.	× Exclusion: does not cover guarantee or warranty of insured re financial performance of an investment.	× Exclusion	× Exclusion
Related parties	× Exclusion: Related party claimants not included.	× Exclusion: claims of related parties with an interest of over 10% of issued capital.	× Exclusion: Related party claimants not included.	× Exclusion: beneficial interest in securities over 5% of shareholding.	× Exclusion: any company or trust which is operated or controlled by the insured.	× Exclusion: claim arising from merger/acquisition
External dispute resolution scheme endorsement	✓ Covers award made by IBDF for damages costs or expenses to $100,000.	✓ Covers award made by IBDF provided award relates to a claim under policy, consent and liability for any such award is $50,000.	✓ Standard extension: Covers award by FICS to $100,000 (GI), $250,000 (life) or over with agreement from insurer	✓ Standard extension: covers awards of FICS subject to limits of loss specified in schedule. ⮙ Optional extension to Credit Ombudsman Services (Mortgage Services) and IBDF (Life Insurance)	Not applicable (as generic policy)	⮙ Endorsement. Indemnifies assured in relation to any award, including costs, made by FICS.
Coverage of insured and authorised Representative	✓ Named insured and principals, partners, directors and employees when	✓ Persons, partners and corporations named (current and previous)	✓ Persons, partnership, company, statutory authority or other entity specified in schedule.	✓Policyholder, subsidiary, principal, partner, director, employee, contractors ⮙ Optional extension:	✓Each person, firm or incorporated body identified in the schedule ✓ Agents or consultants	✓ Named assured ✓ Person who previously carried on the assured business

	Insurance broker policies		Financial planner policies		Stock broker policies	
	Insurer A - NIBA scheme policy	**Insurer B – Insurance broker policy**	**Insurer C - Financial Planner policy**	**Insurer D - Financial Planner policy**	**Insurer E - standard PI civil liability policy**	**Broker A – Stockbroker policy**
s	named ✓ Authorised representatives – only in respect of work within scope of duties ⮝ Optional extension: previous business claims made against new principal/partner/director before joined the named insured. ✓ Heirs and representatives of insured	✓ Consultant, sub-contractor or agent ✓ Heirs and representatives of insured	⮝ Optional extension: previous business claims made against new partners or directors for before they joined the named insured. × Advice or service provided outside the scope of AR's authorisation excluded. ✓ Heirs and representatives of insured	Insured defined to include authorised representatives, although they must be specified as such in endorsement. ✓ Heirs and representatives of insured	of the insured, though no explicit inclusion of authorised representatives ✓ Previous business claims made against new principals ✓ Heirs and representatives of insured	✓ Partner, member, director, officer, member or consultant of the assured ✓ Authorised representatives of the assured ✓ Estate or legal representative of the assured
Run-off cover	✓ Standard extension: Named insured that cease to exist or merge covered with respect to act, error or omission occurring before ceased to exist/merge.	-	✓	✓	⮝ Optional extension available subject to satisfaction of underwriting guidelines.	✓
Retro-active cover	✓	✓	-	✓	✓	✓

9 ADEQUATE AND BEST PRACTICE COVER

Guidance for licensees on what is an adequate PI policy requires a balance between:

- cover which sufficiently maximizes the chance that retail clients are able to recover from licensees, having regard to s912B; and

- cover which is reasonably available and affordable for licensees, having regard to the dynamic nature of the PI market.

The balance is not an easy one to achieve.

Where consumer protection might demand that exceptionally high standards of cover are required for licensees, there is a risk that the market may not meet this requirement, leaving licensees uninsured and consumers unprotected.

Guidance to licensees on adequate cover, as well as levels of cover which are best practice if available on the market, should assist to achieve this balance.

The following indicators of ‘adequate’, ‘best practice’ and ‘ideal’ cover take that into account:

- ‘Adequate’ cover meets the significant risks of civil liability under the Act and is available from most insurers.

- ‘Best practice’ cover provides a higher level of cover and addresses the gaps and weaknesses set out in the previous section of this report. This may be of restricted availability.

- ‘Ideal’ cover offers the highest level of consumer protection but is not currently available to small and medium size licensees.

9.1 LIMIT OF LIABILITY

An adequate limit of liability should be determined having regard to:

- the maximum exposure to a single client. That could be an investment, a savings, a sum insured or a limit of liability under an insurance policy, a mortgage, a superannuation fund;

- the exposure for **all** clients not solely retail clients or activities covered by the AFS license as a claim from another party could exhaust the cover, and damage the business;

- the maximum **probable** number of claims that could arise from a single event, product, or statement of advice. (Note: “Possible” has the potential to be unlimited. Insurers do not provide unlimited cover.)

9.2 EXCESSES

As will be noted from the survey of licensees, excesses range from $5,000 to $250,000. Typically an excess is around 1% of fee income. For financial planners, insurers have indicated that the excess level is very unlikely to be allowed to exceed 2%. The maximum proportion of fee income appears to be 2.5%, which applies to some insurance brokers.

An excess means that insurance policies may only respond **in part** or potentially **not at all** to the determinations of a court or an EDR scheme. Similarly, the licensee can be exposed to the payment of multiple excesses for multiple claims or claimants, depending upon the wording of the policy.

Under an adequate policy the excess level should be commensurate with licensee's turnover and limit of indemnity. A determination of excess should reflect what level of excess the business could sustain as an uninsured loss and what impact multiple claims and therefore multiple excesses would have on the net asset position. A best practice policy would not apply an excess to defence costs.

9.3 DEFENCE COSTS

Some policies *include* the costs of defending a claim in the policy limit. Interviews with brokers and insurers indicated that defence costs (for court actions rather than external dispute resolution) typically comprise 30-50% of a claim. If a policy limit is *inclusive* of costs then the available cover is much lower than it may appear from a brief glance at the schedule of a policy. For example $1M plus defence costs or $2M inclusive of defence costs.

Currently, most policies provide that defence costs are covered *in addition to* the policy limit, which provides greater transparency and, potentially, higher levels of cover for licensees.

An adequate PI policy would either specify that defence costs are in addition to the limit of liability or a limit of liability which includes defence costs should be about double that which it would be if the limit of liability was exclusive of defence costs.

Where a policy has a very high limit of liability and includes defence costs, then it may be appropriate to calculate that defence costs would form a smaller proportion of the limit of liability, although this should be carefully considered before the policy is purchased.

9.4 REINSTATEMENTS

Reinstatements are an important feature of policies to protect licensees and consequently consumers. An automatic reinstatement means that if the limit of indemnity is exhausted by a claim or aggregation of claims then the cover is automatically reinstated for the balance of the policy to period cover any new claims.

Importantly a reinstatement cannot be used to meet any shortfall in the selected limit of indemnity. A new premium has to be paid for the new (reinstated) limit.

An adequate policy would include one automatic reinstatement.

A best practice policy would include two or more automatic reinstatements.

The benefit of reinstatements to licensees and retail clients is that they effectively enable the licensee to re-purchase their insurance cover automatically. At present, one automatic reinstatement during the policy period is widely available. Two or three automatic reinstatements are more difficult to purchase.

A best practice policy would include 1-2 automatic reinstatement where the policy limits the aggregate of claims to the indemnity limit, depending on how high the aggregate level of liability is.

9.5 INSURING CLAUSE

Availability

Whether all loss or damage suffered because of breaches of the relevant obligations under this Chapter by the licensee or its representatives fall within the scope of a professional indemnity policy will depend on the insuring clause of the policy, any extensions or endorsements that cover this type of liability and any exclusions that remove this form of civil liability from cover.

The review of policies and interviews conducted for the purpose of preparing this Report did not reveal specific extensions or endorsements that cover civil liability under the Act, nor did it reveal any exclusions that remove civil liability under the Act from cover. However the scope of 'insuring clauses' differs according to licensee:

- **Insurance brokers**. The insuring clauses of the two PII policies for brokers cover civil liability to a third party incurred in the conduct of the insured professional business stated in schedule. Whether a particular policy would respond to a claim made, for example, for loss incurred due to failure of an insurance broker to provide a Statement of Advice, would depend on whether such a claim arose from the 'conduct' of the insured.

- **Financial planners**. The insuring clauses of the two financial planners' policies reviewed for the preparation of this Report are more narrowly framed. Broadly, these cover civil liability 'for breach of professional duty' arising from any act, error or omission committed by the insured in the conduct of the specified professional business. 'Breach of professional duty' is a narrower cover than 'conduct', and may not include all civil liability arising for contravention of the Act. For example, where it might cover claims arising from acts or omissions that lead to the contravention of the obligation to provide advice with a 'reasonable basis', it might not extend to a contravention of the obligation to provide a SOA at a particular time. Ultimately, this would depend on the specific circumstances of a claim, and whether the civil liability could be construed as a breach of duty.

- **Stockbrokers**: The specific stockbrokers policy reviewed for this Report has a wide insuring clause which covers civil liability incurred in connection with the professional services provided to third parties in respect of a claim made on the assured. However, this same policy has wide exclusions, excluding claims made for loss stemming from 'normal market fluctuation'. One civil liability policy for professionals generally covers civil liability to a third party incurred in the conduct of the insured professional business stated in schedule. Whether a particular policy would respond to a claim made would depend on whether such a claim arose from the 'conduct' of the insured.

Gaps and weaknesses in scope of cover provided by insuring clause

Where an insuring clause is narrowly drafted and only refers to the ‘duty’ owed by the Licensee to the client, this ‘duty’ may be construed to be the fiduciary duty owed by the Licensee to the client. A narrow clause could mean that some types of loss or damage suffered because of breaches of the relevant obligations under this Chapter by the licensee or its representatives fall outside the scope of the policy. This is a significant risk for retail clients and licensees. If the insuring clause is not wide enough, then retail clients will not have the benefit of s912 compensation arrangements and licensees may be in breach of s912B. Each policy will need to be assessed by the Licensee or their broker to ensure that it covers civil liabilities under FSR.

Only one policy reviewed for the purposes of this report specifically but partially expressed in terms of liabilities that may arise under s912. It creates an exclusion for liability ‘in relation to which you failed to provide any disclosure document or information to a person as required under Chapter 7 of the Corporations Act’.

If the obligation under s912B is interpreted widely to include not only loss or damage suffered because of breaches of the civil liability provisions under Chapter 7 by the licensee or its representatives, but all loss or damage suffered because of breaches of the relevant obligations under Chapter 7 by the licensee or its representatives (such as breaches which might give rise to damages under contract), then there may be significant gaps in PI available. All the policies reviewed for the purposes of this report excluded what is usually termed ‘assumed duty or obligation’. For example, one policy excludes ‘any claim against any insured directly or indirectly based upon, attributable to, or in consequence of any liability assumed by the assured under any contract…unless such liability would have attached to the assured in the absence of such contract’. A similar clause of another policy limits the scope of the exclusion by providing that the exclusion does not operate where the liability arises under normal contractual terms. These types of clause have a real potential to exclude from cover loss or damage suffered because of breaches of the relevant obligations under Chapter 7 by the licensee or its representatives which give rise to a contractual cause of action.

Adequacy

An adequate insuring clause would be a broad clause covering breach of duty, where duty is defined widely and would cover civil liabilities under Chapter 7 of the Corporations Act. Adequate PI cover would not include any clauses which specifically exclude cover for breaches of the relevant provisions of Chapter 7 of the Corporations Act.

A best practice insuring clause is a broad clause covering civil liability to a third party incurred in the conduct of the insured. The clause should be wide enough to cover civil liabilities under Chapter 7 of the Corporations Act. (4)

An ideal insuring clause would be a broad clause covering civil liability to a third party incurred in the conduct of the insured, with specific inclusion of civil liabilities arising under Chapter 7 of the Corporations Act.

9.6 INSURED

Availability

Section 912B of the Act requires licensees to have arrangements to compensate for the breaches of the licensee or the licensee's representatives. The 'licensee's representatives' includes an authorised representative, employee or director of the licensee; an employee or director of a related body corporate of the licensee and any other person acting on behalf of the licensee (s910A).

Generally, licensees are responsible for the conduct of their representatives that relates to the provision of a financial service, on which a third person could reasonably be expected to rely and on which that third person did in fact rely in good faith. The client has the same remedies against the licensee as against the representative (s917F).

Typically, a policy will cover the person named as the 'insured' in the schedule to the policy. Cover generally extends to loss suffered by the insured through the actions of its principals, partners, agents, employees, contractors and consultants. This cover does not generally extend to indemnify the principals, partners, agents, contractors and consultants themselves: rather it indemnifies the insured against liability arising from them acting within their authority. The policies of each insurer reviewed for the preparation of this Report also extended the cover to heirs and legal representatives of the insured, should the insured die.

Coverage of authorised representatives is much more uneven. Generally, authorised representatives are covered where they are named in the policy, although at least one insurer requires a specific endorsement to be taken out (which may attract additional premium) to cover authorised representatives.[28] The liability of the insurer with respect to the acts and omissions of the authorised representative is generally limited to the extent to the liability of the licensee.

Cover does not appear to generally be available where an authorised representative acts outside the scope of their authority.[29] In one broker's view, the liabilities that could arise for breaches which are outside an authorised representative's authority are 'too broad' for policies to respond.[30]

It appears that some licensees require authorised representatives to obtain their own PI.

Gaps and weaknesses in scope of cover currently available

The main gaps in coverage relate to authorised representatives. Our research indicates that some licensees require authorised representatives to purchase their own PI cover. Although this may have some benefits, in that it provides an incentive for authorised representatives to manage their risks effectively, it may also expose retail clients to certain risks. If this practice means that the licensee is double-insured, then the consumer would seem to benefit. However, if the authorised representatives' insurance is treated by such licensees as a substitute for the licensees' insurance, then this may leave

[28] Insurer D Financial Planners Policy
[29] Interview with Insurers D, E Brokers B and D; and Insurer C Financial Planners Policy
[30] Interview with Broker D

considerable gaps in a licensee's coverage and there may be issues about whether adequate PI is affordable for individual authorised representatives.

Acts of authorised representatives which are outside the scope of their authority, for example selling a product that is not on the list of products approved under the PI policy, are not covered by existing PI policies.

A second potential gap is coverage of directors. Although some policies cover them automatically, others do not, and whether a director can be named as an insured will depend on the underwriting guidelines if the insurer.

Adequacy

An adequate policy would cover define the 'insured' as the licensee, principal, partners, directors, employees and contractors. It would include or be able to be extended to include authorized representatives acting within scope of authority and with respect to approved products.

A best practice policy would also include the past licensee, principal, partners, directors, employees, present and include those who join the licensee during the period of insurance.

At present, some large licensees not only obtain their own cover, which extends to authorised representatives, but also requires authorised representatives. This practice of obtaining double-insurance can provide a back-up of consumer protection, in the event that one of the two policies does not respond to a claim because, for example, the limit of indemnity has been exceeded or the insured has breached the duty of disclosure.

An ideal policy would extend to licensee, principal, partners, directors, employees and contractors and authorized representatives acting within or outside scope of authority, although this cover is not currently available on the market and is unlikely to ever become available on the market.

9.7 FRAUD AND DISHONESTY

Availability of cover for fraud and dishonesty

The provisions of s912B require a licensee to have compensation for loss or damage resulting from contravention of provisions including matters related to false and misleading statements, dishonest conduct and misleading or deceptive conduct (s1041I). Damages may include profits made by any person resulting from the contravention (1317HA).

Insurance cover relating to dishonesty and fraud is quite inconsistent across the various policies. Generally, the loss suffered by an insured due to the dishonest or fraudulent behaviour of employees and principals is included. Although some policies reviewed for the preparation of this report also covered consultants, sub-contractors or agents,[31] another specifically excludes liability for this group.[32] Coverage with respect to directors

[31] Insurer A NIBA scheme policy, Broker A Stockbroker Policy
[32] Insurer B Insurance Broker Policy

is offered by at least one insurer,[33] and cover of authorised representatives varies from policy to policy, depending on whether the insured has accepted an extension to cover authorised representatives. Cover for dishonesty and fraud will not include the dishonesty and fraud of the insured themselves because of the moral hazard this would create. And would extend to cover money belonging to third parties (consumers).

Gaps and weaknesses in the availability of dishonesty and fraud

One of the difficulties of most dishonesty and fraud extensions is the way in which they interact with extensions and exclusions pertaining to breaches of the *Part 7.10 of the Corporations Act and Part 2 Division 2 of the ASIC Act* and the provisions of the ASIC Act that pertain to trade practices issues. So where one clause may cover dishonesty, another clause may not cover intentional breaches of trade practices provisions such as misleading and deceptive conduct. Provisions such as these restrict the scope of an insurer's liability to the licensee.

A number of insurers make a separate policy available to cover criminal liability, which may incorporate fraud and dishonesty cover.[34]

Adequacy

An adequate policy would cover the insured covered for dishonesty or fraud of principal, partners, directors and employees.

Best practice cover would include dishonesty or fraud by authorized representatives, consultants, sub-contractors or agents.

From a consumer protection perspective, cover would ideally extend to dishonesty or crime, including that of the insured. However, this is not currently available on the market and is unlikely to ever become widely available: it creates a moral hazard in the form of an incentive to the licensee.

9.8 FIDELITY INSURANCE

Licensees can be liable under Chapter 7 where a retail client pays money to a licensee for the purchase of a financial product but the licensee has not dealt with it in accordance with the Act (for example the funds have not been paid into a trust account as required). However, there is only limited cover for losses stemming for such contraventions of the Act.

Where fidelity insurance is available, it is usually available to reimburse the licensee for conduct such as misappropriation of funds by a licensee's employee. In this sense, it is first-party cover. Where an insured becomes liable to pay moneys to a third party, most insurers exclude such liability from the professional indemnity cover.[35] One insurer covers moneys of third parties under the professional indemnity cover, but requires licensees to obtain an endorsement or to take out a separate fidelity policy to insure

[33] Insurer C Financial Planner Policy
[34] For example, Insurers A and D.
[35] Interview with Broker B

against the misappropriation of the licensee's own money.[36] Fidelity cover is not available for the fraud of the licensee itself.

Gaps and weaknesses in the availability of fidelity cover

Fidelity insurance is an important component of a policy as it can reimburse the Licensee for monies that have been misappropriated, however it is not widely available and where it is available, it has a low cap. Often a separate policy has to be purchased.

Typically, fidelity cover is the subject of low sub limits of $30,000 to $50,000, and would not provide a reliable source of cover in the event of large losses of moneys held by licensees by retail clients. Anecdotally, it is understood that fidelity insurance is expensive to purchase and is not universally available for losses sustained by third parties (such as the retail clients with which s912B is concerned).[37]

Adequacy

Best practice cover would include indemnity for loss of funds misappropriated by employees or principals with a cap that is not lower than $30,000. Ideally, cover would extend to authorized representatives, if this cover were to become available at an affordable price.

However, as this insurance covers the licensee's loss as opposed to a consumer's loss, this feature is not directly relevant to the proposed regulations.

One of the benefits of fidelity cover is that insurers place such stringent underwriting guidelines on fidelity cover. This improves the risk management of licensees. Insurers will usually consider whether a licensee has an adequate trust account and has appropriate signatories on an account.

9.9 CONFLICT OF INTEREST

Licensees are obliged to 'manage' their conflicts of interest as a condition of their license. As recent history of FSR has demonstrated, there are a number of licensees that have had conflicts of interest when dealing with retail clients, which they have been required to manage under their licenses.

There is a clear pattern with respect to how insurers address the issue of conflicts of interest. Half of the policies reviewed for this report did not make specific mention on conflicts of interest. Whether such a policy would cover a licensee in order to compensate a retail client for loss or damage suffered because of breaches of the conflict obligations depends largely on the scope of the insuring clause.

The other half of the policies reviewed excluded claims arising from a conflict of interest. Such exclusion clauses are widely drafted to exclude, for example, 'any claim against any

[36] Interview with Insurer E

[37] There is no available data on the cost of fidelity insurance.

insured directly or indirectly based upon, attributable to, or in consequence of a conflict' or 'any claim against the insured directly or indirectly arising from any actual or alleged conflict of interest'. In some cases, such exclusion could be overcome if the insured obtained a signed document from the client acknowledging that there may be a divergence in the interests of the insured and the client.

All reviewed policies included a clause which excluded fines and penalties that a regulator such as ASIC or court might impose on a licensee.

An adequate policy would cover claims arising from a conflict of interest where the insured has obtained a signed and dated document from the client acknowledging conflict of interest. This form of cover is available from some insurers.

Best practice cover would extend to claims arising from a conflict of interest where the licensee has complied with its license condition to 'manage' a conflict of interest. The licence obligation to 'manage' a conflict of interest allows an Licensee to adopt a method of dealing with a conflict of interest that is appropriate to the circumstances, and may include disclosure (without the requirement to have a document signed). Such cover would indemnify the Licensee in the event that the retail client brought an action against them.

9.10 TRADE PRACTICES

Limited cover is offered for breaches of the TPA and relevant provisions of the ASIC and Corporations Act. This is usually provided by way of extensions and endorsements. [38] Whether a particular trade practices breach is covered by the policy is a question for careful analysis of the particular policy and the particular circumstances of the breach.

They key gap in trade practices cover is that it is universally termed by reference to specific Acts. Most cover is for the TPA and Part 2 Division 2 of the ASIC Act Acts, although some insurers extend to the Corporations Act. Many current trade practices clauses may be too narrow to respond to civil liabilities for breaches of Part 7.10 of the Corporations Act.

Adequate cover would include civil liability arising from unconscionable, false and misleading statements, dishonest conduct and misleading or deceptive conduct, being the relevant breaches under the Chapter 7 of the Corporations Act. This is available in the current market, but only in one of the insurance policies reviewed for the purposes of this report.

Best practice cover would also include civil liability arising from relevant breaches of the Trade Practices Act 1974, ASIC Act and State fair trading Acts. Conduct which is in breach of Part 7.10 of the Corporations Act may also breach other Acts or be closely related to breaches of these other Acts.

9.11 NON AVOIDANCE FOR NON-DISCLOSURE

Non avoidance clauses covering non disclosure and non notification appear to be limited to the NIBA scheme, and is not available with respect to non-insurance brokers.[39] One

[38] Interview with Broker A
[39] Interview with Insurers C, D, E Broker B, D

insurer expressed the view that there was 'no chance' of extending this across the market.[40] The reason for this appears to be that non avoidance for non disclosure is a specific exclusion in the insurer's reinsurance treaty, and must therefore be individually negotiated.[41]

Best practice cover would include an insured's misrepresentation or failure to comply with duty of disclosure does not prejudice other named insured's. Where this cover is not provided, there is a risk that if the insured misrepresents the risks it is seeking to insure or fails to fully disclose matters that it is required to disclose, then the insurer may avoid the policy.

9.12 EXTERNAL DISPUTE RESOLUTION SCHEME ENDORSEMENT

Generally, a licensee's professional indemnity cover does not indemnify them for awards made by external dispute resolution bodies unless the cover is provided as part of a scheme. For example, the NIBA scheme requires its members' professional indemnity policies to endorse awards made by Insurance Brokers Dispute Facility (IBDF). Where an endorsement is quite wide, as most are, this means that the insurer agrees to pay all awards made by the IBDF up to a sub-limit (usually $100,000, although some sub limits fall short of this). Endorsement of EDR awards means that the policy will cover awards within the jurisdiction of the EDR. If the EDR permits retail clients to complain under a civil liability provision of the Act, then it may be the case that the cover will extend to civil liability provisions of the Act. Extensions for EDR endorsement are available for IBD and FICS.[42]

It is difficult to assess how effectively PI is currently as a consumer protection mechanism for retail clients that complain to EDR schemes. There is no data available on what proportion of EDR awards are ultimately paid by the insurer as opposed to the licensee.[43]

Adequacy

An adequate policy would endorse awards made by the relevant EDR scheme up to the financial limit of that EDR scheme's jurisdiction. At present, most policies containing an EDR endorsement include costs to the EDR cap. Also the extension limit is often for a single claim or all claims in the aggregate.

Best practice cover would treat costs of the EDR award as being included in defence costs, with the limit of liability being exclusive of defence costs.

An ideal EDR endorsement, which is not currently available on the market, would endorse all EDR awards having regard to the highest possible liability of the licensee that could arise in connection with any particular claim against the licensee and in connection with all claims in respect of which the licensee could be found liable.[44]

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[40] Interview with Insurer C
[41] Interview with Insurer C
[42] Interview with Broker D, Broker A's Stockbroker policy
[43] There is some data on disputes between licensees and insurers over claims that insurers refuse to pay where those disputes are adjudicated by a court.
[44] This is the cover level proposed in the Draft Regulations.

9.13 MULTIPLE CLAIMS CLAUSES

Most policies reviewed for the preparation of this report included clauses which provide that a specified limit of liability applies to each claim. However, where one act or omission gives rise to a number of claims, those claims are deemed to be one claim because they arose from one act or omission. This would however have a corresponding negative consequence for the application of excesses. For example, in circumstances where there are 50 claims arising from a financial planner's one act or omission, then all 50 claims would be subject to the one limit of liability (for example $2M) and one excess.

Some policies do not include multiple claims clauses, although they are relatively rare.

Multiple claims clauses may also limit the liability of an insurer where PI cover endorses an award made by an EDR scheme. The policy of one insurer provides that it will indemnify the licensee for an award made by an EDR 'for an amount up to but not exceeding $100,000 any one claim or in the aggregate any one policy period. The limit of $100,000 shall include costs awarded against the insured' for representation at the EDR. Where this figure is exhausted by EDR claims, the licensee would be required to self-insure itself against further claims.

Adequacy

Multiple claims clauses significantly reduce the usefulness of PII as a consumer protection mechanism if the limit of liability is insufficient. However they provide a clear benefit to licensees as only one excess is applied.

Multiple claims clauses can be beneficial to licensees because an insured is only required to pay one excess, which is particularly beneficial when the excess is high, although where a series of claims is treated as one claim, then reinstatement of the limit of liability will also not be possible.

An adequate policy can include a multiple claims clause, provided that the licensee has purchased an appropriate limit of liability.

9.14 RUN-OFF COVER

Availability

Although run-off cover is an important for protecting consumers after an advisor retires, it is an unfortunate feature of PI policies and the PI market that run-off cover is only available in limited circumstances.

Run-off for people who retire during the policy term to the natural expiry date of the policy is a standard term of most policies offered to small and medium size licensees.[45] Generally, run-off cover is available for one year on an annual renewal basis.[46] Typically, run-off costs 100% of the previous year's premium reducing by 10% per

[45] Interview with Broker B

[46] Interviews with Insurer A, C and D, E Broker A, B, D

annum for the subsequent three years provided that no claims are made during any of those years.

The exception to one-year run-off cover is the 7-year run-off cover available to superannuation trustees.[47] Several insurers provide this 7 year run-off for a premium of at least 350% of the last annual premium for this extended run-off.[48]

Gaps and weaknesses

If a principal of a corporate licensee retires, usually the corporate licensee will continue to maintain PI insurance, including run-off cover if it is available. Sole traders who retire run the risk that when they retire, they may not be able to afford run-off cover throughout their retirement. Once retired, they may not have a continuing income and will not have the capacity to offset the insurance premiums as a business expense for tax purposes. Generally, sole traders try to sell their business to a purchaser who would continue to purchase PI cover, which would include retro cover, although this is not always possible.

Although run-off cover is available in the current market, there is no guarantee that it will be available at all times in the future. The main reason for run-off becoming less available or even unavailable is extent to which re-insurance is available to PI insurers. One insurer explains that it is offered on a year-by-year basis as it is 'totally dependent' on the availability of reinsurance cover,[49] market changes and the tendency of licensees and authorised representatives to change insurer quite frequently.[50] In addition, if a new underwriter picks up the run-off, they must do so without having had the opportunity to assess the risk.[51] That insurer currently provides run-off cover for one year, but not to individuals.[52]

Adequacy

- Run-off cover is important because it covers previous licence-holders and their employees after they have ceased operating and purchasing insurance on a regular basis. This means that the retail client will have much improved chances of recovery if the current licensee is insured. As APRA has observed in administering the National Claims and Policy Database, 'the majority of payments being made are in respect of claims from accident years of between two and seven years before the current year'. In many cases, previous license holders may have disappeared or even ceased to exist at the time a claim is made.

- In spite of its importance, there is no guarantee that the market will always offer run-off cover, or offer it at a price that is affordable.

- An adequate policy would include run-off cover for claims made against relevant persons who retire during the course of the policy period, which is usually one year.

[47] Interview with Broker B
[48] Interview with Broker B
[49] Interview with Insurer E
[50] Interview with Broker B
[51] Interview with Insurer A
[52] Interview with Insurer A

- A best practice policy would include run-off cover for claims made against relevant persons who retire during a period of one year after the expiration of the policy.

Ideally, a licensee would need to obtain run-off cover for a period of 6 to 10 years, having regard to the relevant statutes of limitation. * An ideal policy would extend to new persons prior to joining licensee, which would cover such persons from the time they join a licensee in relation to acts or omissions done while engaged at the previous licensee with which they worked. This may mean that the conduct of some persons would be 'double-insured' but would provide maximum consumer protection. *However this cover has not been found to be available for individual licensees nor is it likely to be at an affordable price.

9.15 RETRO-ACTIVE COVER

Generally, retroactive cover is available[53] if the insured previously had or currently has PII.[54] Some insurers limit the period of retroactive cover: others cover the period for which the licensee has held PI.

Retroactive cover appears to be available because professional indemnity policies are claims made policies, meaning that the policies respond to claims made during the policy period. Those claims may relate to events that occurred many years before the date on which the policy commences.[55] Typically, claims-made policies are in place for one year. One of the risks of claims-made policies is that an Licensee may not have cover at the time that a claim, such as one based on fraudulent or dishonest conduct, is actually made.

Retro-active cover is more difficult to obtain for licensees that do not already hold PI. This means that licensees that do not already hold PI should be permitted flexibility over the transition period, as they develop a track record of holding PI.

Retro-active cover forms part of best practice PI policy.

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[53] Interviews with Insurer A, D, Broker A; Insurer A and B Insurance Broker Policies, Insurer E Civil Liability Policy
[54] Interview with Insurer D, E Broker D
[55] Interview with Insurer A

10 IMPLEMENTATION

10.1 DISCLOSURE

It is proposed that a summary of PII cover be disclosed to retail clients through the medium of the Financial services Guide

In providing guidance to licensees on the way in which they might meet their obligations under s912B of the Act, ASIC may choose to provide guidance on disclosure.

At a high level the objectives for disclosure might be summed up as:

a) to demonstrate compliance with the law by the licensee;

b) to improve consumer confidence; and

c) to clearly, concisely and effectively inform the consumer.

Having regard to these characteristics of PII, any guidance on disclosure might have regard to the following:

- Disclosure through FSG

  Disclosing PII information to consumers using an FSG has both benefits and drawbacks. One of the benefits is that it would bring PII disclosure within the broader obligation to provide an FSG which is clear, concise and effective, and which does not mislead or deceive consumers. However, using FSGs as the medium for disclosure may also leave gaps in disclosure to consumers. PII policies are claims made policies which indemnify the insured against claims made during the term of the policy, notwithstanding that the act or omission may have occurred prior to the inception of the policy. There is the potential that an FSG may become irrelevant in the event that a claim is brought against the licensee after the end of the policy period in which the transaction was entered into. For example, since the FSG was produced, the licensee or the authorised representative may have changed insurer once or several times, the policy limit may have changed, the excesses may have changed, the terms and conditions of the policy almost certainly will have changed.

- Disclosure about the nature of the PII contract

  The licensee is the insured party under a PII contract: not the retail client. This can be confusing for retail clients, who may expect that the licensee's insurance covers them, and who may not be aware that the conduct of the licensee under their insurance contract can affect whether or not a claim will be paid to the licensee. For example, misrepresentations or failure to report a claim can mean that a licensee's claim will not be paid. FSG disclosure could contain a simple statement to the effect that the PII covers the licensee for their obligations to the retail client for the period of the cover, but does not directly insure the retail client.

- Disclosure of level of cover

If a retail client has a complaint against a licensee, they may make an election as to whether to proceed in the court system or through an EDR. The former has an unlimited jurisdiction, the latter has a capped jurisdiction. To assist consumers deciding between commencing court proceedings or an EDR scheme, it would be appropriate for the limit of licensees' insurance to be disclosed to consumers in the FSG.

Disclosure alone cannot avoid all potential problems for consumers. Using EDR jurisdiction as the mechanism for limiting the scope of cover required raise additional issues. Each EDR scheme continues to have a different cap and jurisdiction. Some schemes exclude complaints that fall within Chapter 7 of the Act. For example, given that some EDRs do not consider fraud, the draft regulation effectively means that some licensees will not be required to be covered for fraud because the EDR's jurisdiction does not extend to fraud.

Similarly, as noted previously, Insurance policies are restricted in the scope of cover and may not respond to all circumstances in which a licensee is liable to a client.

For these reasons very careful consideration needs to be given to the nature and scope of any disclosure.

10.2 TRANSITIONARY ARRANGEMENTS

The majority of licensees already hold PII.

In the case of Insurance Brokers all licensees are required to hold PII under transitionary arrangements which were extended by regulation until the 31st of December 2006.

Market participants of the ASX are required to have "a professional indemnity (or equivalent) insurance policy that the market participant determines (acting reasonably) to be adequate having regard to the nature and extent of the business.[56]

Principal Members of the Financial Planning Association of Australia Ltd are required to hold PII with a minimum limit of indemnity of $1M until the 31st of December 2006.[57] The minimum limit of indemnity is $1M.

If new PI requirements for licensees were introduced without an appropriate transition period, this could have undesirable consequences for licensees that did not meet the new PI requirements.

Typically, policies are sold for a 12 month period. At the point of sale, the premium is set, policy terms and conditions established, excesses applied and the risk assessment undertaken based on the information provided and the law in place at the time the contract was arranged.

[56] ASX Market Rule 4.6.1
[57] Class Order_ CO/06/495

If a licensee were required by regulation to have a policy that included new terms such as run-off or an EDR endorsement, the licensee would have to renegotiate the terms of their agreement with the PI insurer. In order to do this, the licensee would have to approach their PI insurer and seek to amend the terms of their PI insurance contract to expand the scope of their cover. As this request would affect the structure of the insurance policy, it would expose the licensee to the possibility that the PI insurer would not agree to amend the terms of the insurance contract, which could leave a licensee in breach of its license. Alternatively, the PI insurer could agree to amend the terms of the insurance contract but at an unaffordable price. The licensee may also find that this would be a lengthy process, as the insurer may need to undertake a new risk management assessment of the licensee to account for the expanded scope of cover.

APPENDIX A – SURVEY OF UNDERWRITERS AND BROKERS (INTERVIEW QUESTIONS)

MELZAN PTY. LTD.
ABN 14 398 003 119

CONFIDENTIAL

Research into Professional Indemnity Market
RE Compensation Arrangements for Financial Services licensees

Name of Organisation: ____________________

Name Of Person(s): ____________________

Position Held: ____________________

Contact details: Phone: ____________________

Email: ____________________

Date and Time of Meeting: ____________________

Follow up meeting: Y / N

Additional Documents/Information to be provided:

____
____
____
____
____
____
____
____
____

<u>Interview Questions</u>

1. Do you presently provide or arrange P.I/Fidelity insurance for AFSL holders, in particular:
    a. Financial Planners
    b. Insurance Brokers
    c. Others (e.g. stockbrokers)

2. Do you arrange underwrite or participate in any industry sector based schemes (e.g. FPA)? Please provide details.

3. <u>Scope of Cover</u>
   Are you able to provide copies of your:
    - standard wordings
    - special wordings for specific schemes

4. <u>Exclusions</u>
   Which exclusions can be removed by negotiation and/or payment of additional premium?

5. <u>Extensions + Endorsements:</u>
   Are you able to obtain/provide cover for:
    - run-off
    - retro
    - fraud
    - non avoidance/ non cancellable
    - representatives (not just AR's)
    - licensees and representatives acting outside the scope of their authorisation?

   Do you bundle P.I. with D&O covers

APPENDIX A – SURVEY OF UNDERWRITERS AND BROKERS (INTERVIEW QUESTIONS)

MELZAN PTY. LTD.
ABN 14 398 003 119

CONFIDENTIAL

Research into Professional Indemnity Market
RE Compensation Arrangements for Financial Services licensees

Name of Organisation: ______________________________

Name Of Person(s): ______________________________

Position Held: ______________________________

Contact details: Phone: ______________________________

Email: ______________________________

Date and Time of Meeting: ______________________________

Follow up meeting: Y / N

Additional Documents/Information to be provided:

____
____
____
____
____
____
____
____
____

9. What type of claims are licensees typically subjected to from 'retail' clients (e.g. bad or wrongful advice, misappropriation of funds, breach of confidentiality, IP etc)

10. What has been your experience (if any) with the ADR schemes – FICS and IBD in particular?

11. Do you have a view as to **how** licensees should determine what is an adequate level of P.I. for them to buy?

12. Do you have a view about the disclosure of policy limits/terms etc by licensees to clients (e.g. in FSG)?

13. How could the P.I. market improve/change to provide a better protection mechanism for consumers (as opposed to licensees)?

14. General Market Trends

What is your prognosis for the P.I. market, and especially for its small to medium size risks in terms of

i. availability/capacity
ii. affordability
iii. scope of cover

Over 1year
3 years
5 years

APPENDIX B – SURVEY OF FINANCIAL SERVICES LICENSEES

MELZAN PTY. LTD.

ABN 14 398 003 119

CONFIDENTIAL

Confidential Survey of Financial Services licensees
Compensation Arrangements under Section 912B of the Corporations Act

1. **Please state the core activity of your business;**
   - Financial Planner ☐
   - Insurance Broker ☐
   - Stockbroker ☐
   - Other (specify) ☐ ____________________

2. **Please specify what proportion of your business/advice is provided to;**
   - Wholesale clients ____________________
   - Retail clients ____________________

3. **Please list the main products you provide to retail clients,**
   - Managed investment schemes (type) ☐
   - Life insurance ☐
   - General insurance ☐
   - Derivatives ☐
   - Superannuation ☐
   - Other (specify) ☐ ____________________

   ____

   please note that more than one answer is possible

4. **How many licenses do you have?** ____________________

5. **How many authorised representatives do you have?** ____________________

6. **Do you currently hold professional indemnity insurance?** Yes ☐ / No ☐

   6.1 If no, what arrangements do you make for your own protection in the event of your being liable to a client/clients?

   ____

   ____

7. **How does Professional Indemnity insurance fit into your overall risk management strategy?**
   1. It is the key/only aspect ☐
   2. It is an integral part of the framework ☐
   3. It is only of low importance ☐

8. **If you have P.I insurance do you disclose this to your clients?**
   - Automatically ☐
   - On request ☐
   - Not at all ☐

8.1 If you do disclose do you disclose;

Policy limits	Yes ☐ / No ☐
Excess(es)	Yes ☐ / No ☐
Policy terms and conditions	Yes ☐ / No ☐

9. What limits of cover do you purchase?

1. Per event $
2. Number of reinstatements $
3. In the aggregate $
4. Excess $

10. How did you choose the limits you purchased? *(more than one answer is possible)*

10.1 On advice of a broker or other professional adviser (eg accountants) ☐

10.2 To meet the minimum requirements of:
- an EDR scheme ☐
- an industry association/body ☐
- a regulator ☐

10.3 Your own risk assessment takes into account matters such as:
- a) the number of clients ☐
- b) the volume of business transacted ☐
- c) the worse loss scenario per single client ☐
- d) the potential for multiple claims to arise from a single product or a single action or advice ☐
- e) The number of representatives ☐
- f) The number of employees ☐
- g) Other ______________________________ ☐

10.4 Is the amount of cover you purchase based on an affordability test ie the cost of the premium? ☐

11. Have you had to make changes to your business procedures, controls etc as a result of your risk assessment or underwriters requirements to obtain cover/reduce premium?

____

____

____

12. How do you determine what is an appropriate level of excess to carry?

12.1 The minimum requirements of an industry body ☐

12.2 The minimum requirements of insurers ☐

12.3 The financial capacity of your business or the license holder or authorised representatives to meet the excess ☐

12.4 The worse loss scenario including multiple claims ☐

12.5 The amount of premium saving that can be achieved ☐

13. Do you seek any special features in professional indemnity cover? How easy is this cover to obtain and how cost effective is it?

Product Feature	**Standard Inclusion**	**Readily Available Yes/No**	**Special Questions or notes**
Runoff			
Crime-Fraud			
Crime-Fidelity			
Non avoidance for nondisclosure			
Acting outside the scope of authority			
Acting beyond the approved product list			
D&O cover			
Extension to cover determinations of EDR scheme			
Other (please specify)			

14. Are you aware of the exclusions in your policy? Yes ☐ / No ☐
What are they?

____

____

How do you manage those exposures?

____

____

15. Affordability

15.1 Is the cost of professional indemnity insurance to you/your business;
- Relatively low cost ☐
- Moderate ☐
- High cost ☐
- Excessive Unaffordable ☐

What percentage of your fee income/turnover does the premium represent ____________

15.2 Has your premium for PI insurance in the past year;
- Increased ☐
- Stayed the same ☐
- Reduced ☐

And by what percentages ____________

16. Claims

Have you ever experienced a claim or claims against you or your authorised representative? Yes ☐ / No ☐

If so;

16.1 Did the policy provide indemnity? ☐
16.2 Was the claim within your excess? ☐
16.3 If not was the limit sufficient? ☐
16.4 Did you find the insurer responsive to your needs and helpful in defending the claim? ☐

17. External Dispute Resolution

Was the dispute referred to an EDR scheme? ☐

If so did the EDR scheme find for;

a) You ☐
b) the consumer ☐

18. Do you have any comments on your experience with the EDR scheme?

____
____
____

19. **How did you deal with the EDR scheme?**

a) Directly ☐
b) Through your P.I. Insurer ☐
c) Through your legal representative ☐

19. Are there any other comments or information you would like to provide?

____
____
____
____
____
____
____

Thank you for completing this survey. The information you have provided will be subject to the confidentiality arrangements set out in ASIC's letter of 28 September 2006.

APPENDIX C – LIST OF ORGANISATIONS CONSULTED

This page has been omitted

APPENDIX D – CONSOLIDATED RESULTS OF UNDERWRITERS/BROKERS INTERVIEWS

Refer overleaf

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer D	Broker B	Insurer B	Insurer E
Position Held	Australian PI Manager	Account Manager/National Sales & Service	Underwriting Principal	National P.I. Manager.
Date & Time of Mtg	Thursday 2/11/06, 10am	1.30 – 2.45 19th October 2006	Fri 27th October, 10am	26th October, 11am
Follow up meeting		N	N	
Additional Documents / Information to be provided	Financial Planners Insurer D Civil Liability PI Specimen Wording Insurer D Comprehensive Crime Specimen Wording			All Policies on website Endorsements – see email 6/11 Claims data – see email 10/10
Interview Questions				
1. Do you presently provide or arrange P.I/Fidelity insurance for AFSL holders, in particular a. Financial Planners b. Insurance Brokers c. Others (e.g. stockbrokers)	a. Financial Planners- Yes b. Insurance Brokers- Yes but at present limited appetite. This will be expanding in near future. c. Others (e.g. stockbrokers) - Yes but limited appetite.	Broker B covers all types of Licensees as brokers.	About 50% of their business is for financial lines.	They do financial planners but not the FPA scheme. They mainly do dealer groups. They underwrite the dealer groups because the basic approach to their risk assessment to assess the products. If there is a product EG foreign currency hedging that they don't like, they will not sub issue a policy at all or they will iss a policy specifically excluding that product. They issue cover to authorised representatives individually under a group scheme which has standard terms and conditions. Again he emphasised that they only give cover for their approved product list. They have a share of the broker scheme (20%), they also do the mortgage broker schemes. NB. Insurer E will not insure individual financial planners because there is too much work. There is just as much work to assess a corporate group as an individual and corporate groups have better training, risk management, oversight and product assessment.
2. Do you arrange underwrite or participate in any industry sector based schemes (e.g. FPA)? Please provide details.	Financial Planners- Insurer D insure principle members of the FPA and have designed a specific PI wording for the members but it is not a scheme. It is not compulsory for the members to be insured with Insurer D and it is not compulsory for Insurer D to offer terms for every member. Each risk is quoted on an offer and acceptance basis. Insurance Brokers- Insurer D provides some excess of loss capacity on schemes set up by insurance broker group networks. Insurer D does not participate on the NIBA or IBNA schemes.	They don't have any schemes except an old insurance agent's scheme in runoff	No. They only insure 1 or 2 man boutique financial planners. They will not insure the big end dealer groups. They do some incidental covers where for example some accountants have the odd financial planner or authorised rep. They do not insure the big dealer groups because whilst they are good at risk management audit etc, they are always exposed to a rogue financial planner who would have done the damage before it gets picked up. Therefore prefer to underwrite individuals and back their judgements, including imposing their minimum requirements for education, training and so forth.	No just dealer groups and the NIBA scheme (20%).
3. Scope of Cover Are you able to provide copies of your: - standard wordings - special wordings for specific schemes	See attachments to my email. The Finacial Planners wording obviously applies to Financial Planners PI. For Stockbrokers the Civil Liability wording applies. At present we don't write Insurance Brokers on a primary basis so we don't have a specific wording.	Broker B did not provide any wordings, however they did say that: - Y has over 100 endorsements - Insurer B also has over 100 endorsements and asks for far too much information (this was confirmed in my interview with Insurer B who said that their underwriting questionnaire for a financial planner could run to 40 or 50 pages. - X do a lot of financial planners. Their wordings are broad but endorsements can be removed.	Standard wording provided. Special wordings for accountants and insurance brokers also provided.	He will send me standard endorsements for financial planners.
4. Exclusions Which exclusions can be removed by negotiation and/or payment of additional premium?	Financial Planners- a. Margin Lending and Gearing b. Managed Discretionary Account Services c. Most others may be amended but not removed.		Non-avoidance is a long standing issue that can be removed for brokers. They would be very reluctant to do so for financial planners and others. In his words would be "A big leap". The broker extension has a price impact but it is not majo X underwriters have had a very painful experience in relation to superannuation choice in X and therefore generally exclude that cover here. Part of the problem in the UK was that the market came under huge pressure not to apply multiple excesses.	To be followed up✓
5. Extensions + Endorsements: Are you able to obtain/provide cover for:				

Research into Professional Indemnity Market
RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer D	Broker B	Insurer B	Insurer E
- run-off	on an annual renewable basis	Run-off cover in excess of 1 year is difficult to get except for superannuation trustees where 7 years is common. Insurers x, y and z provide multi year run-off for a premium of at least 350% of the last annual premium. Otherwise it can't be bought because of market changes, policy holders chopping and changing insurers and authorised reps chopping and changing licensees. Run-off for people who retire during the policy term to natural expiry is standard. The only opportunity to get continuity is really in group schemes.	1 year	They will not give run off cover to individuals and do not like to provide it generally. Some schemes provide the run-off cover out of the overall funds of the scheme. The problem with that is, if there is a change in insurer or underwriter, the new underwriter picks up the run-off without every having assessed the risk. Also, when the market was previously hard one could not obtain reinsurance capacity for run-off at all. It is now generally available but o for 1 year.
- retro	Yes, if the insured previously had/currently has PI insurance	Retro cover – concurrently by previous business cover, for new people coming in but this was not available 2 years ago and will probably disappear again in a hard market. How do you underwrite what authorised representatives did when they worked for a previous licensee?	yes	Yes
- fraud	Yes.	Fraud and Dishonesty – most policies exclude money.	market very soft, fraud of non principles is very easy to get	Most P.I. covers fraud and dishonesty of employees and innocent partners automatically. However he is aware that Insurer D excludes loss of money (cash). That cover is provided under a fidelity guarantee policy. Insurer E takes a different approach in that 3rd party monies covered under the P.I. policy but the firms own money is a fidelity cover. It can however be endorsed onto the P.I. policy with sub limits of $5000 up to $50,000. The sub limit is still part of the overall limit.
- non avoidance / non cancellable	Yes, for general and life insurance broking.	Non avoidance/non cancellation – this can only be obtained on insurance busin including life insurance. It is virtually unobtainable for any other product.	is available for brokers usually at a sub limit. The old agents and brokers act requirement used to be $1M or 15% of premium income and that is still used as a benchmark.	He believes this undermines the concept of utmost good faith and would not do as a one off. However they do provide it under the Barrister's scheme. This is also a specific exclusion in reinsurance treaty and therefore has to be individually negotiated.
- representatives (not just AR's)	Possibly, need to explain what kind of representatives being referred to.	Sub-representatives etc – this is easy cover to purchase in the soft market and indeed authorised representatives sometimes buy their own policies.		
- licensees and representatives acting outside the scope of their authorisation?	No.		generally no	They cover employees of the Licensee as well as the authorised reps, but again they are only talking to major dealer groups. Bundling P.I. and D&O he said there is some trend to combine products eg under association liability covers. However, these are primarily D&O covers with incidental thrown in. He knows that Insurer A recently released the product which was for tradesman and SME's.
Do you bundle P.I. with D&O covers	Not bundled as one policy but may package the 2 together.		No	

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer D	Broker B	Insurer B	Insurer E
6. Limits + Excesses What are the typical limits bought or sold for the following categories? - sole practitioner - small business - medium business - large business What are the minimum and maximum exposures you will write? Are limits per claim, per event or in the aggregate? Do policies provide automatic reinstatements? If so, how many? Excesses – what are the typical, minimum and maximum excesses that you apply? Are limits and excesses inclusive of defence costs or are costs in addition?	sole practitioner: $1m small business: $1m to $5m medium business: $1m to $5m large business: $5m to $20m What are the minimum and maximum exposures you will write? Minimum limit $1m, Maximum limit $20m Are limits per claim, per event or in the aggregate? Any one claim and in the aggregate subject to the provisions of a reinstatement. Do policies provide automatic reinstatements? If so, how many? Yes, one. Excesses – what are the typical, minimum and maximum exces ses that you apply? Minimum excess $5,000 Maximum excess no specific maximum. Are limits and excesses inclusive of defence costs or are costs in addition? Inclusive of defence costs.	Some authorised representatives are as low as $2000 the average is about $10,000 ($5000 for a financial planner) excesses can rise up to $100,000. However, higher excesses are not commercially worth it at the moment as the premium discounts are low. Accountants get cost exclusive excesses. For limits see answers to question 11 except for people under the Professional Standards Act where the minimum is $500,000 or 10 times the largest fee.	Definitions Sole practitioner turnover of between 100 and 500,000. Small business turnover up to $2M Medium 5-10M Large businesses they do not insure Typical limits Sole practitioner 1- 2M Small business 2-5M Medium 5-10M Note their main rating factor is the fees. Minimum limit 1M, maximum limit 10M. Will provide 1 reinstatement. Costs -Policies vary from cost inclusive to cost exclusive. He thinks the market is now about 50/50.	Limits Insurer E did not provide any detail. He said there was no such thing as a typical limit. He also observed that brokers do less and less work providing basically a shopping list of limits and prices to clients. Brokers rarely evaluate the merits of the policy wordings either for smaller customers under say $20,000 premium of that risk management advice is provided. Insurer E's rule of thumb is a minimum limit of indemnity of $1M with costs in addition up to the same limit. NB. Co-insurance both to the indemnity and to the costs. Excesses Rule of thumb, minimum excess is 1% of income but not less than $1000.
7. What risk assessment measures are used to determine premiums (other than claims experience), e.g. - nature of business - volume of business (revenue, fee income etc) - number of representatives - number of employees - number of licenses held - nature of clientele/size and volume of transactions - the financial standing of the licensee (assets/liabilities) personal assets or business assets other	nature of business volume of business (revenue, fee income etc) number of representatives number of licenses held nature of clientele/size and volume of transactions Claims history a. Financial Planners all of the above plus overall policies and procedures, eg: risk management; training, supervision and mentoring of employees/AR's; compliance investment committee. b. Insurance Brokers, primarily 1st 2 points above, claims history plus type of insurances the broker(s) place.	A new point made by Broker B was that Mortgage Brokers are not covered by FSR but many licensees are doing Mortgage Broker business. As the policies cover the full scope of the business mortgage claims could easily exhaust the cover. For the Mortgage Broker to get separate cover (they have a scheme) they have to be a separate legal entity. Risk Assessment - For license holders with multiple representatives good risk management is an essential feature. Key concerns are exclusions around acting outside the scope of authority or approved product list as there are thousands of products available and they change by the day. It is common for insurers to require an authorised products list. Agri business was commonly hard to place but now getting easier. Insurer D experienced huge claims from Olive plantations. Since Westpoint mezzanine in finance now being excluded by some underwriter Generally speaking risks that were unplaceable in 2002/2003 are relatively easy place now. Margin lending – loan to valuation ratios Supervision Compliance Selection processes Complaints register Training Internal and external audit Controls over authorised representatives	Rating Factors - In addition to the lists he nominated risk management controls. Qualifications, experience and background of the principles. No. of years in business. They also underwrite the product list and also check on who assesses the product list. They seem to be far more relaxed than other underwriters about hedge fun margin lending, agri business etc. Was interested in ASIC's question as to whether or not a licensee was responsible when switching or leaving a client if he did not have the client's existing product on an approved product list. Had not come across this concept before. Thought it could be interesting underwriting issue worth examining.	Insurer E provided a description of how their premium calculations work with co-efficients, loading etc. Agreed with the factors listed under item 7 except for the financial standing of t licensee where there they look for obvious signs of life but do not underwrite in-depth. Others include most importantly the approved product list and whether it is a multi-disciplinary business.

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer D	Broker B	Insurer B	Insurer E
8. Claims Experience What is your experience of: - number and frequency of notification of circumstance - conversion of circumstances to claims - average cost per claim - average defence costs per claim - highest cost per claim - highest defence cost per claim Do you believe that the trend is for growth, reduction or no change in either claims frequency or claims cost? Does this vary from sector to sector?	To answer this question accurately it would take a significant compilation of information and analysis. Another factor to be considered is that in the past Insurer D's participation in PI has not been constant, with a period of time in the 1990's Insurer D not writing any PI at all. Do you believe that the trend is for growth, reduction or no change in either claims frequency or claims cost? Our experience (not withstanding one-off events like WestPoint) is that the trend tends to be cyclical followings the state of the general economy. Does this vary from sector to sector? As previously stated in the past Insurer D's involvement and underwriting appetite in PI has not been constant to be able to answer this question.	Claims patterns are driven by the economic environment, which is currently good.	About 50% of total payments are defence costs. In the insurance broker client world they have found that in a hard insurance market they have more claims and bigger claims. Brokers were the worst experience of all categories but that was in 2002 and earlier. It has really dropped off since. Claims typically vary between 250 to 100,000. They have had the occasional claim at around 250,000 and one claim for a million dollars. For financial planners the frequency is slightly under 10% but they do not insure many. Claims experience is driven by economic conditions and investment returns. Overall their claims frequency is about 10% of all policies it hardly changes from profession to profession and about 25% of claims circumstances notified convert into claims.	See email from their claims manager.
9. What type of claims are licensees typically subjected to from 'retail' clients (e.g. bad or wrongful advice, misappropriation of funds, breach of confidentiality, IP etc)	From the examples above "bad or wrongful advice" is definitely the main source of claims, specifically miss-profiling a clients/consumer's investment appetite or tolerance to taking on risk. Another common example is the failure of the licensee or its reps to advise the costs/benefits of moving from one financial product to another. Misappropriation of funds is definitely another typical but from our experience less common type of claim.		They have never had a claim for breach of confidentiality or IP. 50/50 claims split between advice and dishonesty. They have had nil fraud claims from brokers.	
10. What has been your experience (if any) with the ADR schemes – FICS and IBD in particular?	The general feedback we get from our insured's is that FICS tends to favour the consumers. We have no experience with the IBDF to make comment.		If proceedings are threatened they appoint lawyers. The legal advisers then advice the insurer and a client as to their position but it goes to FICs they are happy to let it go through unrepresented. They think the EDR output is fair and cost effective. If the EDR limits were increased it would probably be acceptable them at a push.	
11. Do you have a view as to<u>how</u> licensees should determine what is an adequate level of P.I. for them to buy?	Financial Planners An insurance broker would be better placed to answer this question. For financial planners a rough benchmark would be a sum insured at least the equal to the largest client (in terms of investment portfolio) they provide advice and services to. Insurance Brokers Possibly the equal to the largest insurance policy they place on behalf of their clients.	Licensees should understand the structure of their policy in deciding what limits to buy, ie they need to understand whether the limits are cost inclusive or exclusive, how excess is applied to numbers of claims, how many reinstatements, etc.	Licensees could buy more cover than they do. For example they can double the cover for a 30% increase in premium an increase of 5 fold for double the price.	
12. Do you have a view about the disclosure of policy limits/terms etc by licensees to clients (e.g. in FSG)?	The consumer has significant amount of information, research and figures to digest already which must be taken into account. Maybe a general statement that the licensee does currently have PI insurance in place is all that's needed or a statem stating the period of cover and the limit o liability.	10 years ago the market had a prohibition but it is now becoming quite common place for disclosure, so not a big issue. Suggest that only the limit be disclosed, as everything else requires too much explanation. Assigned risk pools – Broker B do not think they will work at all. Indeed P.I. should be regarded as the last resort for consumer protection. All the items under section 7 provide the real comfort. Run-off cover is illusory. Thousands of HIH and FAI policyholders had run-off cover!	Is relaxed.	
13. How could the P.I. market improve/change to provide a better protection mechanism for consumers (as opposed to licensees)?	Possibly more engagement direct with the licensees in conjunction with the broker would be beneficial to all parties.		No ideas	

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer D	Broker B	Insurer B	Insurer E
14. General Market Trends What is your prognosis for the P.I. market, and especially for its small to medium size risks in terms of - availability/capacity - affordability - scope of cover Over 1 year 3 years 5 years	Over 1 year Financial Planners Continued downward pressure on pricing, capacity will still be readily available. However this may change on both points once the WestPoint losses become more apparent. There has already been some tightening of cover due to the collapse of WestPoint. Otherwise scope of cover will remain relatively static. 3 years- To difficult to tell 5 years- As above.	They share the view that the market will get hard again but at the moment its difficult to see when as there seems to be an endless supply of capital. The key this area will be the appetite of the London market. The best indicator is that notwithstanding Westpoint everyone is still pursuing the business.	Does not believe the scope of cover can get any broader. In the past year the market has averaged 25% discount on price. He can't see it changing in the immediate future because everyone is still making money. However he does believe that when the market hardened it will be all the frills that will come back to bite people and this is where the market tightening is likely to be manifest.	
General / Additional Comment / Supplementary Note			They made a couple of interesting general observations as follows: 1. All agency agreements tend to require a minimum level of P.I. cover which is specified. 2. They do not like the APRA approach to trustee liability as they found it very time consuming, very expensive and lacked certainty.	

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer C	Broker C	Broker A	Insurer A
Position Held	M. D.	Manager	Managing Principal	National Claims Manager
Date & Time of Mtg	Nov 1st, 3pm	9.30 Friday 13th October 200	Friday 13th October, 11.30am	26/10/06, 4.15pm
Follow up meeting	N	Y	N	
Additional Documents / Information to be provided	Insurer C proposal (professional) Insurer C policy (FP) Insurer C Addendum (FP)	Managed Investment Scheme PS 179 ASIC Managed Investment Scheme PS 131 ASIC Managed Investment Policy Business Guard NIBA P.I. Policy Civil Liability Policy I(AIB) Act Regulations		Underwriting questionnaire Civil Liability Policy Financial Institutions Crime Policy Financial Institutions P.I. Policy FPA Endorsement Terms & Conditions
Interview Questions				
1. Do you presently provide or arrange P.I/Fidelity insurance for AFSL holders, in particular a. Financial Planners b. Insurance Brokers c. Others (e.g. stockbrokers)	They insure mainly Financial Planners Premium Income (and some Mortgage Brokers) + $6 or 7 million per annum. Have been underwriting since the year 2000 They do not insure any financial institutions.	They are the largest broker of professional indemnity for insurance brokers in Australia. They manage the NIBA scheme. They are one of four brokers authorised to place business with the NIBA scheme. They also do some financial planners and one of the cluster groups. They have a financial institutions book with fund managers, managed investments and they also manage the underwriting agencies council facility.	All of the above.	Insurer A insure the full spectrum of FSR Licensees include Financial Planners, Insurance Brokers, Trustees, Financial Institutions and Underwriting Agencies.
2. Do you arrange underwrite or participate in any industry sector based schemes (e.g. FPA)? Please provide details.	No scheme. Their preference is to sell online to brokers with automatic rating, binding and issue. The brokers support the approach.	See above. Note also that Insurer E is owned by Broker C.	See Above	Yes NIBA scheme and also the non NIBA scheme for brokers. They think the FPA scheme is either led by y or Lloyds. Note the non NIBA scheme and NIBA scheme policy wordings will probably be identical next year. Insurer A does all types of financial institutions except banks (eg Credit Unions and so on). Insurer A issues a policy to the Licensee and then the Licensee pays an additional premium for each authorised representative who is nominated.
3. Scope of Cover Are you able to provide copies of your: - standard wordings - special wordings for specific schemes	Wording – Insurer C provided their financial planner proposal policy and endorsements. All of their products are on their website except for their endorsements.	See front page for a list of things provided. Managed Investments Act documents are well worth studying it is all non scheme. All offer an acceptance whether it is Bank or a boutique agency. The policy covers the responsible entity and its compliance committees and includes P.I., D&O crime and fidelity often with sub-limits.	Copy of NIBA P.I wording provided for exclusions. Most exclusions can be negotiated but his view was that it is impossible to go beyond the approved product list for financial planners.	Various wordings provided for exclusions. See examples provided. Examples of exclusions that can be removed through payment of additional premium include: - derivatives - unauthorised foreign insurer - agri business
4. Exclusions Which exclusions can be removed by negotiation and/or payment of additional premium?	None really.	NIBA has a very broad cover. It has a DOFI exclusion which can be removed. The X facility excludes IP but that can be written back. The X wording is a Y standard wording with no added benefit. It therefore only covers the security, ie the underwriter suing the underwriting agency for breach of authority. It particularly excludes the ultimate consumer.		See above
5. Extensions + Endorsements: Are you able to obtain/provide cover for:				

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer C	Broker C	Broker A	Insurer A
- run-off	Run-off is not automatic. They only do it for past clients and it has to be bought annually.	For most retail it is 1 year. Insurers x and y will write large organisations for up to 6 years for a single premium	yes 1 year	Run off cover is made available on a year on year basis. Totally dependant on the availability of reinsurance cover.
- retro	yes provided insurance was previously in place.	can buy unlimited if the cover has been continuous.	yes	Retro covers are not a problem since the advent of claims made. Non avoidance and non cancellation for non disclosure, this is unique to the NIBA scheme. They do not provide it to others. Insurer A thought that there was "no chance" of extending this across the market.
- fraud	cover innocent partners only.	see wordings Fraud – he noted that the ASIC requirements re fraud are inconsistent. The market response in terms of cover is equally inconsistent. X will provide a million dollar sub-limit for crime with extensions to include the compliance committee. Also the definition of fraud by officers and interpretations by ASIC are said to be vague. It is hard to differentiate between third party and first party loss cover and Broker C believes ASIC need to set out an ambiguous guideline. The accountants have a scheme which meets the requirements of the professional standards council. The limit is low only $500,000. Importantly the policy has no TPA exclusions.	yes	Innocent parties are covered, misappropriation of funds is excluded but innocent parties are covered for failure of professional duty. There is an absolute exclusion for products not on the approved product list. The insured needs to demonstrate Insurer A that they have a proper process for dealing with changes to the approv product list.
- non avoidance / non cancellable	no, they will not provide this under their wording at all.	yes for brokers	only in the NIBA and law society schemes. Broker A think this cover is needed. It is the biggest growth area for claims and is essential for consum protection. Other extensions and endorsements trade practices and fair trading standards (are now given by the London market).	
- representatives (not just AR's)	check their definition of the insured on their policy. Employees are automatic some other categories will need to be underwritten on a case by case basis.	most policies will cover but only the vicarious liability the AR or Licensee not the acts of agents or defacto employees themselves unless this is specifically noted on the policy.		Representatives other than authorised representatives, employees covered automatically. If the insured appoints a sub-representative or authorised representative and that person is named then the insured's cover extends to include any liability of the insured but not the sub-representative themselves.
- licensees and representatives acting outside the scope of their authorisation?	Acting outside scope of authority will not give the cover.	Broker C believes the liability over the Corps Law is strict liability. The legislation is too broad and policies do not respond. Note also EDR extensions for IBD and FICS.		See approved product list above. That apart Insurer A do not have a problem provided it is not fraudulent activity and it fits within the description of the business.
Do you bundle P.I. with D&O covers	Bundling is not common but they are thinking about it.			Bundled P.I. and D&O is done for stockbrokers and credit unions. The downside is that there is a shared limit. Limits are also all cost inclusive and Insurer A applies the deductible to costs.

Research into Professional Indemnity Market
RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer C	Broker C	Broker A	Insurer A
6. Limits + Excesses What are the typical limits bought or sold for the following categories? - sole practitioner - small business - medium business - large business What are the minimum and maximum exposures you will write? Are limits per claim, per event or in the aggregate? Do policies provide automatic reinstatements? If so, how many? Excesses – what are the typical, minimum and maximum excesses that you apply? Are limits and excesses inclusive of defence costs or are costs in addition?	Sole Practitioners typically buy $1 – 2 million ranging up to the medium to large businesses buy a $10 million limit which however could cover 10 authorised reps in the aggregate. Limits are cost inclusive by preference but will do costs in addition. Cost inclusive deductibles is a fair issue. The change to cost inclusive deductibles had a very big impact on loss ratios (improved them). Also had a very positive impact on risk management and in his view was beneficial to the consumer. The trend in the other direction is by definition not so desirable. Reinstatements 1. Excesses minimum $2000 up to $50,000. Rule of thumb is 1 to 1 ½% of fees bu market has now dropped this down to ½% of fees. 2. The higher the excess the more chance of it being cost inclusive.	Broker C noted that section 912B is silent on the subject of excesses. The old IABA guideline required limits of up to $10M with the excess set at 1% of fees with a minimum of $5000. Generally speaking smaller excesses are exclusive of cost and large excesses are inclusive of costs . The move back to cost exclusive excesses is a feature of the market. Limits are generally costs inclusive, costs in addition covers are not common but starting to become more prevalent. Note t the professional standards legislation also deals with this point. Excesses per claim or per claimant. One approach to financial planners is to calculate the excess per claimant that cap the number of excesses under the policy at 4 or 5. Reinstatements – NIBA has 2 free reinstatements, the scheme has no upper lin Insurers E & A do top up for 5 million excess of 5 million and there is plenty of other capacity. Investment managers usually buy $5 million with a $25,000 excess.	Sole Practitioner – ½ million Small business – ½ million to 1 million Medium – 1-2 Large 2-10 Limits are generally any one claim and in the aggregate. Reinstatements usually one automatic but some companies will give 2 or 3 for an additional premium. Excesses – typical excesses are around $5000. Some of the higher excesses are unaffordable eg $100,000 and are being imposed by underwriters post Westpoint. Defence costs 50% of the market is inclusive which is the trend. 50% of the market is in addition. As Brokers therefore they advocate that if one was to choose a $1 million limit exclusive of costs you should choose a $2 million limit inclusive of costs. He believes that cost exclusive excesses are here to stay as they would definitely have gone in a soft market.	(Typical) Sole Practitioners 1:2M, small businesses 1:10M, medium 2:20M, large businesses 5:20M. Insurer A minimum limit is 1 million with 3 reinstatements and maximum is up to 20M with 1 reinstatement. Limits are any one claim and in the aggregate. Can purchase additional reinstatements (maximum of 3) from Insurer A but not after a claim. Standard excess is 1% of fees, minimum excess is $5000, maximum excess $500,000, typical excess is in the range of 5:25,000. If the excess is over $50,000 Insurer A ask to underwrite a set of accounts.
7. What risk assessment measures are used to determine premiums (other than claims experience), e.g. - nature of business - volume of business (revenue, fee income etc) - number of representatives - number of employees - number of licenses held - nature of clientele/size and volume of transactions - the financial standing of the licensee (assets/liabilities) personal assets or business assets other	Nature of business and volume of business and fee income by product are their biggest rating factors. See proposal form. Do not worry about number of licenses, ask questions about 5 largest clients, don't underwrite the financial robustness of the licensee.	Other risk factors include: - Risk management procedures and controls, (see proposal forms). - Experience/expertise of principles - Past practice, previous business exposures - Approved product list and product rulings	All of the above. Broker A provided a list of underwriting questions that need to be provided financial planners<u>which is attached</u>	Insurer A charge a base premium followed loading and discounts for each of the features we have listed plus risk management, internal controls, audit, segregation of duties, training, etc.

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer C	Broker C	Broker A	Insurer A
8. Claims Experience What is your experience of: - number and frequency of notification of circumstance - conversion of circumstances to claims - average cost per claim - average defence costs per claim - highest cost per claim - highest defence cost per claim Do you believe that the trend is for growth, reduction or no change in either claims frequency or claims cost? Does this vary from sector to sector?	Their frequency rate is about 20% and for the most part maximum claims have not got over half a million. Claims aggregation they are of the view it is highly unclear how Westpoint will work especially regarding multiple claims.	Defence costs run at between 30% and 40% of total claims costs. In a buoyant economy frequency is down but there is no change to the quantum claims. They believe that the change to include litigation funding and class actions will s a growth in this sector.	A question for underwriters	Insurer Ahas been underwriting P.I. for 10 years. They have found that other than engineers, the claims frequency is consistent across the whole portfolio and all occupation types. For the first 6 or 7 years the frequency was around 20% but in the last 3 years has remained around 10%. Approximately 1 in 5 of all circumstances notified converts into a claim (note: Westpoint will change the numbers). Average cost per claim $18,000 costs inclusive. Average defence costs $4-5000 An active genuine claim will run up typical defence costs of around $20,000 and a typical financial planner claim is about $200,000. NB. believes that a policy limit of up to $2M would cover 98% of all claims ever notified. Tort reform has made a difference in the P.I. area especially by reducing the bod injury exposures and raising consumer awareness about the reality of life. Nevertheless he believes that the trend will definitely be up as interest rates, economic environment, the insurance environment and tort environment change, especially if the judiciary doesn't hold the line.
9. What type of claims are licensees typically subjected to from 'retail' clients (e.g. bad or wrongful advice, misappropriation of funds, breach of confidentiality, IP etc)	Claims for Financial Planners often arise from Super switching and margin lending Advice on an existing product not on the product list wouldn't void the policy but would go to the issue of negligence.	Brokers hardly every receive claims from retail clients. Generally speaking of course, most retail insurance is dealt with between the consumer and the retail insurer directly. Most broker claims are for admin errors (eg failure to place cov rather than advice. Not a single claim out of HIH collapse.	Main problem is authorised representatives acting outside the scope of thei authority and breaches of theTrade Practices Act. There may be a problem for brokers in the application of excesses.	Failure to pass on money, wrongful advice and a new phenomenon, superfund switching.
10. What has been your experience (if any) with the ADR schemes – FICS and IBD in particular?	Their experience is FICS pro investors. The Financial Planner is the one who has the direct dealings with FICS. It was an interesting observation that the FICS fee $4,000 is double the typical excess. FICS is very expensive. As underwriters they treat the FICS fee as a defence cost under the policy. They have a view that the FICS process is just a free fishing expedition for consumer lawyers.	Suggested should speak to NIBA. There is a view that FICS is not up to speed with current levels of market products and dynamics.	Broker A experiences generally negative. Poor decision making and not enough use of evidence.	FICS ill-equipped to handle the legal issues the issues that come before them. Increasing the limit would be very worrying. X view is that policy wordings are not framed capriciously and policy holders are informed buyers who themselves use professional brokers. Would be much happier if an appeal mechanism was built in.
11. Do you have a view as to<u>how</u> licensees should determine what is an adequate level of P.I. for them to buy?	It is almost impossible to get it right unless you go to the maximum possible liability but what is the potential default rate? Big firms have the capacity to do a risk management evaluation but small firms simply can't.	Some suggestions included for insurance brokers. - What is the average sum insured for a household insurance policy? - What is the average personal injury claims settlement? NB add cost to the limit - What is the average size of investment in the portfolio Note largest IBD loss ever was $600,000.	Should be a formula based on a percentage of revenue or fees with a minimum of $1 million. Very dangerous to talk about X. Accountants minimum is 500,000, everyone else is $1 million.	Could use the same factors as underwriters use. See section 7. Should also consider their highest individual exposure, highest aggregate exposure, number of clients and what deductibles they can afford.
12. Do you have a view about the disclosure of policy limits/terms etc by licensees to clients (e.g. in FSG)?	They don't have much difficulty with disclosing a minimum statutory requirement.	Again remember the policy is there to indemnify the insured. The consumer needs to have this explained to them so that their expectations are not unrealistically raised. This requires very clear regulations which can be reflected in the FSG.	Disclosure is inevitable. There are no policy conditions in place that would preclude it and it is discoverable anyway.	Insurer A would not be concerned about the disclosure of limits but would have an issue around the disclosure of terms and conditions.
13. How could the P.I. market improve/change to provide a better protection mechanism for consumers (as opposed to licensees)?	Only ideas they had were first party covers which were currently not available at al for the licensee to purchase a bond.	They believe the insurance should be with an APRA regulated insurer. The process should be centrally regulated and recorded by ASIC. However, major problem for large purchases eg International Brokers, cluster groups etc if there is a DOFI exclusion.	He believes it should be made compulsory. It should include aTrade Practices Act extension.	Insurer A have a fundamental concern with using P.I. as a consumer protection device – not appropriate. Perhaps the policies could be split between retail and wholesale with a sub limit retail which had more sideways cover. In present markets saw no need to consider an assigned risk tool but who knows what the market will look like in 2 to 3 years.

Research into Professional Indemnity Market

RE Compensation Arrangements for Financial Services Licensees

Name of Organisation	Insurer C	Broker C	Broker A	Insurer A
14. General Market Trends What is your prognosis for the P.I. market, and especially for its small to medium size risks in terms of - availability/capacity - affordability - scope of cover Over 1 year 3 years 5 years	Consistent with everyone else. Next year cheap, 3 years tougher, 5 years hard.	Future outlook – there is plenty of capacity, lots of new entrants for at least 25 providers excluding DOFI's. Affordability has improved enormously, see latest KPMG research but the scope of cover is still somewhat restricted. The long term issue is whether compulsion is going to necessitate a right of a consumer to directly access the policy which will change the whole nature of the product.		
General / Additional Comment / Supplementary Note			Everyone should have P.I cover. A million dollars is as good a minimum limi as any. There probably should not be a prescribed form of cover but everyone sho have non avoidance cover. Suggest examine clauses 9 and 10 of the NIBA wording. The ASX makes P.I. cover mandatory for Stockbrokers but not al Stockbrokers are members of the ASX. Need to keep an eye out for mortgage brokers and originators who not currently licensed. If people can't get cover then what happens? Perhaps we need a one year transition. Claims attitudes vary markedly between companies. Application of excesses – he says there is a debate between multiple excesses for multiple clients or 1 excess based on one piece of product research or advice which might be sold to multiple clients.	Their views were interesting in some respects including: 1. The growth of litigation funding is a concern and could increase costs and exposures in the future. Especially defence costs. 2. Insurer A suggested that in principle there should be a standard scheme to meet FSR requirements with minimum terms and conditions 3. Insurer A not supportive of the FICS EDR scheme. Has similar concerns about Professional Indemnity being a consumer protection vehicle.

APPENDIX E – CONSOLIDATED RESULT OF SURVEY OF FINANCIAL SERVICES LICENSEES

No. of Surveys	Despatched	Declined /Undeliverable	Replies	No Reply
Financial Planners	26	3	6	17
Insurance Brokers	14	1	3	10
Stockbrokers	13	3	4	6
Totals	53	7	13	33

Question 2

The percentage of respondent's business which was retail was lowest for Insurance Brokers (average 20%) widely spread for Stockbrokers (5% to 75) and, with one exception (NIL) highest for Financial Planners (95% to 100%).

Question 3 - Products

- Insurance Brokers naturally provided general insurance.
- Stockbrokers products included not only equities but also managed investments, derivatives, life insurance and superannuation.
- All but one financial planner nominated managed investments. All provide life insurance and superannuation and some do property investments.

Question 4 – licensees

Only 2 respondents had multiple licenses.

Question 5 – Authorised Representatives

Nil	2
One	2
Two or More	9
No of AR's	310

Question 6 – P.I. Insurance

All respondents had P.I Insurance.

Question 7 – Importance

All respondents said it was an integral part of their risk management framework.

Question 8 – Disclosure

Replies were as follows:

Automatically	2
On request	10
Not at all	1

Note that the one "not at all" said it had never been requested, as did other respondents.

Question 9 – Disclosure Details

The replies indicated that the majority (8) of the sample did not disclose anything other than the existence of the insurance, but some noted that it had never been requested. Of those that did disclose, none disclosed policy terms and conditions. Only two disclosed excesses and the majority (5) disclosed the limit of indemnity.

Question 9 – Limits

The licensees surveyed had limits of Indemnity in the following ranges:

No. of licensees	**Limit per Event**	**Reinstatements**	**Aggregate**
.			
3	1m	unlimited to agg	2m
1	2m	2	10m
1	2m	2	6m
1	5m	-	5m
2	5m	1	5m
1	7.5m	-	7.5m
1	10.0m	-	10.0m
1	50.0m	1	100.0m
1	50.0m	3	200.0m

From this it will be noted that there is no "standard" approach.

Question 10 – Limits

The responses to these questions showed a noticeable pattern of different behaviour between the medium to large licensees and the small companies or sole practitioners.

5 large but only 1 small company use external professional advice.

3 large and 5 small licensees purchase limits to satisfy the externally imposed requirements but **all** respondents perform some degree of internal risk assessment with every respondent nominating the "worst loss scenario per single client".

Question 11 – Changes to business practices linked to insurance

The answers to this question were interesting in that only one respondent disclosed **any** changes to practices arising out of their own or underwriters risk assessment. If this is correct the risk management benefit of the insurance mechanism is indeed questionable.

Question 12 – How to determine an appropriate level of excess

The responses were as follows (note that more than one response was possible:

12.1	The minimum requirements of an industry body	4
12.2	The minimum requirements of insurers	6
12.3	The financial capacity of the business…	8
12.4	The worst loss scenario	3
12.5	The amount of premium saving	6

It is difficult to draw a conclusion from this.

Question 13 – Special Features

The consolidated replies were quite confusing but largely reflected the variety of covers available under schemes vs the open market.

Question 14 – Exclusions

Nearly all respondents were aware of their policy exclusions, a surprising but desirable result.

Question 15 – Affordability

Responses indicated that premiums ranged between 0.65% and 2% of income or turnover, and that premiums had reduced between 5% and 20%.

Question 16/18 – Claims

A surprisingly high number of respondents had experienced claims.

None had found that their limits of indemnity were insufficient and little quantitative or qualitative comment was provided.

Question 19 – General

No useful general comments were noted.

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Confidential Survey of Financial Services licensees
Compensation Arrangements under Section 912B of the Corporations Act

1. **Please state the core activity of your business;**

Financial Planner	**6**
Insurance Broker	**3**
Stockbroker	**4**
Other (specify)	**-**

2. **Please specify what proportion of your business/advice is provided to;**

Wholesale clients **REFER TEXT**

Retail clients

3. **Please list the main products you provide to retail clients,**

Managed investment schemes (type)	**7**	
Life insurance	**5**	
General insurance	**3**	
Derivatives	**1**	
Superannuation	**6**	
Other (specify)	**6**	**EQUITIES 4, PROVISIONS 1, PROPERTY 1**

please note that more than one answer is possible

4. **How many licenses do you have?** **REFER TEXT**

5. **How many authorised representatives do you have?** **310**

6. **Do you currently hold professional indemnity insurance?** Yes **13** / No **-**

   6.1 If no, what arrangements do you make for your own protection in the event of your being liable to a client/clients?

7. **How does Professional Indemnity insurance fit into your overall risk management strategy?**

1.	It is the key/only aspect	-
2.	It is an integral part of the framework	**13**
3.	It is only of low importance	-

8. **If you have P.I insurance do you disclose this to your clients?**

Automatically	**2**
On request	**10**
Not at all	**1**

8.1	If you do disclose do you disclose;		
	Policy limits	Yes **5** / No **8**	
	Excess(es)	Yes **2** / No **11**	
	Policy terms and conditions	Yes **-** / No **13**	

9. What limits of cover do you purchase?

1.	Per event	$	**REFER TEXT**
5.	Number of reinstatements	$	
6.	In the aggregate	$	
7.	Excess	$	

10. How did you choose the limits you purchased? *(more than one answer is possible)*

10.1	On advice of a broker or other professional adviser (eg accountants)		**6**
10.3	To meet the minimum requirements of:		
	an EDR scheme		**2**
	an industry association/body		**5**
	a regulator		**5**
10.3	Your own risk assessment takes into account matters such as:		
	a)	the number of clients	**7**
	b)	the volume of business transacted	**9**
	c)	the worse loss scenario per single client	**11**
	d)	the potential for multiple claims to arise from a single product or a single action or advice	**8**
	e)	The number of representatives	**4**
	f)	The number of employees	**3**
	g)	Other ______________________	**2**
10.4	Is the amount of cover you purchase based on an affordability test ie the cost of the premium?		**2**

11. Have you had to make changes to your business procedures, controls etc as a result of your risk assessment or underwriters requirements to obtain cover/reduce premium?

REFER TEXT

____

____

____

12. How do you determine what is an appropriate level of excess to carry?

12.5	The minimum requirements of an industry body	**4**
12.6	The minimum requirements of insurers	**6**
12.7	The financial capacity of your business or the license holder or authorised representatives to meet the excess	**8**
12.8	The worse loss scenario including multiple claims	**3**
12.5	The amount of premium saving that can be achieved	**6**

13. **Do you seek any special features in professional indemnity cover? How easy is this cover to obtain and how cost effective is it?**

Product Feature	**Standard Inclusion**	**Readily Available Yes/No**		**Special Questions or notes**
Runoff	**7**	**5**	**N1**	
Crime-Fraud	**7**	**5**	**N1**	
Crime-Fidelity	**6**	**6**	**N2**	
Non avoidance for nondisclosure	**4**	**3**	**2**	
Acting outside the scope of authority	**3**	**2**	**4**	
Acting beyond the approved product list	**2**	**1**	**5**	
D&O cover	**2**	**5**	**1**	
Extension to cover determinations of EDR scheme	**5**	**6**		
Other (please specify)	-	-	-	

14. **Are you aware of the exclusions in your policy? Yes 11 / No ☐**
What are they?
A FEW LISTED ALL EXCLUSIONS – MOST SAID TOO MANY TO ANSWER

How do you manage those exposures?
NO USEFUL REPLIES

15. **Affordability**

15.1 Is the cost of professional indemnity insurance to you/your business;

Relatively low cost	**1**
Moderate	**7**
High cost	**4**
Excessive Unaffordable	**-**
What percentage of your fee income/turnover does the premium represent	____________

15.2 Has your premium for PI insurance in the past year;

Increased	**2**
Stayed the same	**3**
Reduced	**8**
And by what percentages	____________

16. **Claims**

Have you ever experienced a claim or claims against you or your authorised representative? Yes **5** / No **8**

If so;

16.1	Did the policy provide indemnity?	**Y-5, N1**
16.2	Was the claim within your excess?	**Y-2**
16.3	If not was the limit sufficient?	**Y-3**
16.4	Did you find the insurer responsive to your needs and helpful in defending the claim?	**Y-4**

17. External Dispute Resolution

Was the dispute referred to an EDR scheme? **1**

If so did the EDR scheme find for;

c) You ☐

d) the consumer ☐

18. Do you have any comments on your experience with the EDR scheme?

____

____

____

19. **How did you deal with the EDR scheme?**

a) Directly **4**

b) Through your P.I. Insurer ☐

c) Through your legal representative ☐

19. Are there any other comments or information you would like to provide?

____

____

____

____

____

____

____

Thank you for completing this survey. The information you have provided will be subject to the confidentiality arrangements set out in ASIC's letter of 28 September 2006.

APPENDIX F – TABLES 7/8 INDUSTRY PREMIUMS AND CLAIMS BY CLASS OF BUSINESS (APRA)

Table 7 Industry premiums and claims by class of business

Financial years ended in the 12 months to December 2005

($ million)

Class of business	Gross premium revenue	Reinsurance expense	Net premium revenue	Gross incurred claims [a]	Reinsurance recoveries revenue [a]
Direct business					
Houseowners/householders	3,326	1,159	2,167	1,919	520
Commercial motor vehicle	1,356	117	1,239	1,022	61
Domestic motor vehicle	4,985	2,132	2,853	4,323	1,700
Travel	448	127	321	136	32
Fire and ISR	2,812	1,227	1,584	1,040	327
Marine and aviation	611	136	475	283	56
Mortgage	625	128	497	49	0
Consumer credit	211	20	190	44	1
Other accident	1,078	274	803	418	91
Other	673	144	529	265	73
CTP motor vehicle	2,427	429	1,998	1,908	423
Public and product liability	1,969	330	1,639	975	74
Professional indemnity	1,281	320	961	745	104
Employers' liability	1,177	67	1,110	909	6
Total direct business	**22,978**	**6,610**	**16,368**	**14,037**	**3,469**
Total inwards reinsurance	**5,416**	**467**	**4,949**	**3,419**	**124**
Total	**28,394**	**7,077**	**21,317**	**17,456**	**3,593**

Notes:

It is not possible to show the breakdown of 'net incurred claims' at class of business level as 'non-reinsurance recoveries' are not reported to APRA.

[a] Gross incurred claims and reinsurance recoveries revenue in this table relate only to current and prior years.

Australian Prudential Regulation Authority 15

Table 8 Industry outstanding claims provision by class of business

Financial years ended in the 12 months to December 2005

($ million)

Class of business	Outstanding Claims Provision	Reinsurance recoverables	Non-reinsurance recoverables	Net outstanding claims provision
Direct business				
Houseowners/householders	948	224	66	658
Commercial motor vehicle	454	39	109	306
Domestic motor vehicle	1,067	386	275	406
Travel	108	35	1	72
Fire and ISR	1,247	658	53	537
Marine and aviation	309	75	20	214
Mortgage	74	3	2	69
Consumer credit	48	2	1	45
Other accident	443	171	24	248
Other	311	139	12	160
CTP motor vehicle	9,079	1,376	963	6,740
Public and product liability	5,551	1,238	181	4,132
Professional indemnity	3,282	937	296	2,050
Employers' liability	3,310	301	100	2,909
Total direct business	**26,233**	**5,582**	**2,104**	**18,546**
Total inwards reinsurance	**7,018**	**656**	**328**	**6,035**
Total	**33,251**	**6,238**	**2,432**	**24,581**

Notes:

All items in this table are reported in relation to the 75 per cent level of sufficiency. Please refer to the provisioning data note in the explanatory notes.

Australian Prudential Regulation Authority 16

APPENDIX G – INSURANCE REQUIREMENTS, ASX RULES, FPA AND INSURANCE BROKERS

Overview

Principal members of the Financial Planning Association (FPA) are considered leaders in the financial planning industry in terms of ethical standards and compliance best practice. As a Principal member of the FPA, you agree to abide by and promote the FPA Constitution and Code of Ethics and Rules of Professional Conduct.

Eligibility

To be eligible for Principal membership, you must hold a current Australian Financial Services Licence to give personal financial advice issued by the Australian Securities and Investments Commission (ASIC). Principal members must conduct business providing personal financial planning advice to retail clients.

All applications for Principal membership are subject to assessment. The FPA may in its absolute discretion refuse to approve membership. The FPA is not required to give any reason for the rejection of an application. An applicant whose application for membership has been rejected by the FPA may appeal to the Board within 30 days of the receipt of the notice of such rejection.

Accountability

Principal members are responsible for both their own acts and those of their representatives/authorised representatives (even if they are not FPA members themselves). Principal members are accountable to their clients through the Financial Industry Complaints Services (FICS) and the FPA Disciplinary Regulations. The FPA Constitution includes provision for the conduct of compliance reviews to ensure members meet minimum professional standards. Please read this application form in conjunction with the FPA Code of Ethics and Rules of Professional Conduct information booklet.

Professional indemnity insurance requirements

The FPA requires each Principal member to have professional indemnity insurance. Each member is encouraged to obtain professional advice as to the type and level of cover most appropriate to their business activities. However, the FPA imposes minimum insurance requirements, which may be amended from time to time set out as follows.

Minimum limit of indemnity:

- $1,000,000 per individual claim
- $2,000,000 aggregate, but not less than 50% of estimated gross income from financial planning/advising
- A maximum deductible (excess) of less than 25% of current surplus liquid funds or net tangible assets as defined in the member's licence.

Policy extensions:

- Loss of documents
- Libel and slander
- Fraud and dishonesty
- Trade Practices Act and Fair Trading legislation
- Retroactive cover
- Intellectual property
- Fidelity
- Run-off cover.

The FPA requires all Principal members' professional indemnity policies (except where the maximum deductible (excess) is $100,000 or more) to be endorsed with the following form of words:
"It is agreed, subject to the terms, conditions and exclusions of this certificate, that the Insurer shall indemnify the Insured against liability to meet any Award under FICS. The liability of the Insurer shall not exceed $100,000 unless otherwise agreed by the Insurer. The term Award is deemed to include any costs which are awarded against the Insured".
Exemptions to these minimum requirements and variation to the endorsement wording can be authorised by the CEO upon receiving a written request. Policies must be endorsed at least from the date of approval of Principal membership.

Resignation

A member may resign from the FPA on six months' prior notice in writing to the association, as stated in clause 3.1.1.2 of the FPA Constitution.

During the notice period and except as specifically provided all of the member's rights and obligations of membership shall be suspended including the obligation to pay membership fees falling due in that period which are waived for the duration of the notice period provided that the member shall remain bound by the provisions of clause 3.3 Offences and shall be subject to the provisions of the FPA Constitution and the Disciplinary Regulations with respect to the commission of any offence under clause 3.3 Offences.

Principal members are required to include with their letter of resignation their Principal member certificate and must cease promoting their Principal member status of the FPA on all stationery and other

EFFECTIVE AS OF 1 JULY 2004

ASX

ASX Market Rules
Guidance Note No. 8

KEY TOPICS

1. Notification to ASX Compliance Services
2. Monthly Reporting to ASX Risk Management
3. Self- Insurance by a related body corporate
4. Notification and Monthly Reporting of Claims
5. Amendment or Cancellation of Insurance
6. Failure to Obtain or Retain Professional Indemnity Insurance

ASX Market Rules

1. 4.6

Guidance Note History

Re-issued:
11 March 2004

Previously:
11 September 2003
ASX GN 4/03

INSURANCE REQUIREMENTS

Purpose

The purpose of this Guidance Note is to provide assistance to ASX Market Participants ("Market Participant") on the interpretation of the ASX Market Rules ("Rules") in relation to matters dealing with professional indemnity insurance.

Background

The Rules require Market Participants that act for any person other than itself or a related body corporate to take out and maintain professional indemnity (or equivalent) insurance. The professional indemnity insurance policy taken out by Market Participants must include cover against a breach of duty the Market Participant owes in a professional capacity. The policy may be specific to the Market Participant or may be a policy of a parent company or related body corporate which names the Market Participants as one of the parties covered.

Notification & Monthly Reporting of Claims

Notification to ASX Compliance Services

Participants are required to immediately notify ASX of details relating to any liability or potential liability referred to in the Rules. This must be at the time they notify their underwriter of "a circumstance" that may give rise to a claim and must be in writing.

It is common for insurance policies to require the notification of claims, potential claims or circumstances. The *Insurance Contracts Act (1984) Cth* provides that if an insured notifies the insurer (under the terms of the policy during the period of the policy) of a circumstance that may give rise to a claim, then any subsequent claim relating to the circumstance notified is covered by that policy, subject to the policy conditions. It is important matters be notified promptly in order to avoid any suggestion by an insurer that a claim, potential claim or circumstance has not been notified within a particular policy period.

In consideration of these provisions under professional indemnity insurance policies, ASX's policy is that ASX Market Participants must, at the time they notify their underwriter of "a circumstance" that may give rise to a claim (whether under a notification clause in their professional indemnity insurance policy, to obtain the benefit under the *Insurance Contracts Act (1984) Cth* or otherwise), immediately notify the Exchange in writing, of the details referred to in ASX Business Rule 5B.6.4 to in the Market Rules and preferably all of the details listed below.

At a minimum, the following should be notified immediately to ASX Compliance Services.

- Date that the Market Participant was first aware of a claim, potential claim or a "circumstance".
- A full description of the claim, potential claim or "circumstance" including sufficient information to allow ASX to understand the basis of the client's allegation.
- Gross contingent liability arising from the claim, potential claim or circumstance. This is the maximum potential exposure or claim made on the Market Participant.
- Net contingent liability arising from the claim, potential claim or circumstance. This is the gross contingent liability net of the available cover and excess (if any). (i.e. net contingent liability = gross contingent liability – (cover – excess)).
- Nature of insurance cover, if any.
- Full name of cover provider.
- Date claim, potential claim or circumstance was notified to cover provider.

Monthly Reporting to ASX Risk Management

This information should also be reported on a monthly basis in the capital liquidity returns , specifically, Section 12.41 – Legal Proceedings and Insurance Claims (this can be located via the following steps in v3.2 of ASX Returns: Financial Position Details (Section 12), Legal/Insurance/Encumbrances (Section 12.4), Legal Proceedings and Insurance Claims (Section 12.41)).

This ensures that ASX is kept up to date on an on going basis with any liability or potential liability and the accounts and financial position are accurately reported as required under the Rules.

ASX

Self- Insurance by a related body corporate of a Market Participant

Certificate Evidencing the Self-insurance

Where the professional indemnity insurance is provided by a related body corporate, the Rules require Market Participants to provide a certified copy of evidence to demonstrate that the insurer is a related body corporate of the Market Participant and a certified copy of the certificate evidencing the insurance or self-insurance.

At a minimum the certificate evidencing the self-insurance, should include:

- the name of the related body corporate and confirmation that it is a related body corporate within the meaning of the Corporations Act and the Rules;
- the level of cover;
- the level of excess; and
- the period of cover.

The certificate should also contain statements to the effect that:

- the related body corporate[1] does and will continue to guarantee payment of all liabilities of the Participant and its officers in respect of a breach of duty it owes in a professional capacity and has the financial capacity to do so;
- the guarantee is in lieu of taking out professional indemnity insurance and with the intention of "self insuring" for those risks;
- valid claims made against the Participants will be satisfied by the Market Participant or by the related body corporate if the Participant fails to pay; and
- the related body corporate will advise the Market Participant immediately of any material change in its financial circumstances that may impact on the ability to provide the insurance and that the Participating Organisation is required to notify ASX.

[1] If the related body corporate is a Participant of ASX, any guarantee provided would be subject to the Rule in relation to Guarantees and Indemnities. This Rule prevents a Participant from giving a guarantee outside the ordinary course of its (*emphasis*) business unless the amount of the maximum liability is specified in the guarantee. ASX is of the opinion that a guarantee given by a Participant for the purpose of another Participant's self insurance, is outside the ordinary course of its business. Hence if a Participant gives a guarantee for the purposes of insuring another Participant, the amount of the maximum liability specified in the guarantee would have to be treated as an Excluded Liability (refer the definitions section of the Rules in relation to Capital Liquidity) and then deducted 100% from Liquid Capital (refer the definitions section of the Rules in relation to Capital Liquidity).

The Directors of the Market Participant are required to provide to ASX, in writing, an outline of how they formed the opinion that the level of insurance cover and excess is reasonable and how they have satisfied themselves, and will continue to satisfy themselves, that the related body corporate has adequately provisioned for the level of cover it is providing and hence the capacity to pay, in the event that it needs to. This should be provided to ASX within 14 days following the issue of the self-insurance policy and annually thereafter.

Notification and Monthly Reporting of Claims

Market Participants that are self-insured through a related body corporate, are still required to notify and report claims to ASX in accordance with the requirements set out earlier in this guidance note.

Amendment or Cancellation of Insurance

Should the Market Participants' professional indemnity insurance policy be dishonoured, amended, cancelled or partially cancelled, the Market Participant should notify ASX Compliance Services immediately, in writing.

Failure to Obtain or Retain Professional Indemnity Insurance

The failure by a Market Participant to obtain or retain professional indemnity insurance, through either method, will cause ASX to consider taking immediate action to protect the interests of ASX, the market and the National Guarantee Fund.

Qualification

ASX has published this note to promote commercial certainty and to assist Market Participants. Nothing in this note necessarily binds ASX in the application of the Rules in a particular case. In issuing this note ASX is not providing legal advice and market participants should obtain their own advice from a qualified professional person in respect of their obligations. ASX may replace this Guidance Note at any time without further express notice to any particular person. Readers may contact ASX to ensure they have the latest version.

SECTION 10(B)

INSURANCE (AGENTS AND BROKERS) REGULATIONS

Statutory Rules 1985 No. 367

CITATION

1 These Regulations may be cited as the Insurance (Agents and Brokers) Regulations.

Interpretation

2(1) In these Regulations, 'the Act' means the *Insurance (Agents and brokers) Act 1984.*

(2) In these Regulations a reference to a form by number is a reference to the form in the Schedule that bears that number.

APPROVED AUDITOR

2A(1) For the purposes of the definition of "approved auditor" in section 9 of the Act, the following class of persons is specified, namely, the class consisting of any person, being a registered company auditor in a State or Territory, who, in relation to a registered insurance broker or a registered foreign insurance agent, is an independent auditor.

2A(2) In subregulation (1), "independent auditor" means an auditor who, in relation to a registered insurance broker or a registered foreign insurance agent, does not have an interest, pecuniary or otherwise, in the business of insurance intermediary carried on by that registered insurance broker or registered foreign insurance agent, being an interest that could conflict with the proper performance of the auditor's functions as an auditor of the accounts of that business.

EXTENT OF INDEMNITY UNDER CONTRACT OF INSURANCE - PARAGRAPH 9B(1)(C) OF THE ACT

2B(1) For the purposes of paragraph 9B(1)(c) of the Act, the following provisions of this regulation apply in regard to the extent to which a person is to be indemnified under a contract of insurance in respect of the prescribed liabilities arising out of or in the course of the person's business as an insurance intermediary.

2B(2) Subject to subregulation (3), the maximum amount payable as indemnity to a person under a contract of insurance referred to in subregulation (1):

(a) if the person did not carry on business as an insurance intermediary in the financial year (in this regulation referred to as the "previous financial year") immediately before the financial year in which the contract is entered into - must be not less than $1,000,000; or

(b) if:

(i) paragraph (a) does not apply; and

(ii) 15% of the total amount of the premiums entered in the accounting records of the person in respect of his or her business as an insurance intermediary in the previous financial year does not exceed $5,000,000;

must not be less than:

(iii) $1,000,000; or

(iv) the amount equal to 15% of the total amount referred to in subparagraph (ii);

whichever is the greater; or

(c) if:

(i) paragraph (a) does not apply; and

(ii) 15% of the total amount of the premiums entered in the accounting records of the person in respect of his or her business as an insurance intermediary in the previous financial year exceeds $5,000,000;

must be not less than $5,000,000.

2B(3) If a contract of insurance referred to in subregulation (1) makes provision for an excess or deductible:

(a) the amount of the excess or deductible must not, except with the approval of the Commissioner, exceed:

(i) if paragraph (2)(a) applies in relation to that person - $10,000; or

(ii) if paragraph (2)(b) or (c) applies in relation to that person:

(A) $10,000 or

(B) an amount equal to 2.5% of the insurance brokerage income of that person in respect of the previous financial year;

whichever is the greater; and

(b) in calculating, for the purposes of subregulation (2), the maximum amount payable as indemnity to a person under a contract of insurance, the amount of the excess or deductible must be subtracted from the amount that would otherwise be the maximum amount payable as indemnity under the contract.

2B(4) In subregulation (3), "insurance brokerage income", in relation to a person, means:

(a) moneys received as brokerage fees or as commission by the person in relation to the person's business as an insurance intermediary; and

(b) interest, dividends or other income received by the person from:

(i) any account maintained under subsection 26(1) of the Act;

(ii) any investment made under subsection 26(4) of the Act.

PRESCRIBED LIABILITIES—PARAGRAPH 19(1)(B) OF THE ACT

3 For the purposes of paragraph 19(1)(b) of the Act, the following liabilities are prescribed, namely, liabilities incurred as a result of a breach of professional duty.

3A Omitted by SR No.325 of 1994.

4 Omitted by SR No.325 of 1994.

(d) that has executed under Part 5.3A of that Law a deed of company arrangement that has not yet terminated; or
(e) that is under official management; or
(f) that is being wound up; or
(g) in respect of which a provisional liquidator has been appointed and not since removed;

'insolvent under administration' means a person-

(a) who, under the *Bankruptcy Act 1966* or the law of an external Territory, is a bankrupt in respect of a bankruptcy from which he has not been discharged;
(b) who has executed a deed of assignment under Part X of the *Bankruptcy Act 1966* or the corresponding provisions of the law of an external Territory where the terms of the deed have not been fully complied with;
(c) who has executed a deed of arrangement under Part X of the *Bankruptcy Act 1966* or the corresponding provisions of the law of an external Territory where the terms of the deed have not been fully complied with; or
(d) whose creditors have accepted a composition under Part X of the *Bankruptcy Act 1966* or the corre sponding provisions of the law of an external Territory where a final payment has not been made under the composition;

'insurance broker' means a person who carries on the business of arranging contracts of insurance, whether in Australia or elsewhere, as agent for intending insureds;

'insurance intermediary' means a person who-

(a) for reward; and
(b) as an agent for one or more insurers or as an agent for intending insureds,

arranges contracts or insurance in Australia or elsewhere, and includes an insurance broker;

'insured', in relation to a contract of life insurance, means a person (other than the insurer) who is entitled to a benefit under the contract, whether that person is the life insured or some other person, and 'intending insured' has a corresponding meaning;

'life insurance broker' means a person who is for the time being registered under Part III in respect of life insurance business;

'life insurance business' has the same meaning as in the *Life Insurance Act 1945*;

'registered foreign insurance agent' means a person who is for the time being registered under Part 111A;

'registered insurance broker' means a person who is for the time being registered under Part III, whether in respect of general insurance business or life insurance business or in respect of each of those businesses;

'unauthorised foreign insurer' means an insurer who:

(a) does not have an authority under the *Insurance Act 1973* to carry on insurance business;
(b) is not a person who, because of section 5 of that Act, is not required to have such an authority; and
(c) carries on insurance business outside Australia and the external Territories to which the *Insurance Act 1973* extends.

SECTION 9A - MEANING OF REFERENCES TO ARRANGING CONTRACTS ETC. WITH UNAUTHORISED FOREIGN INSURERS

9A A reference in this Act to a person arranging a contract as agent for an unauthorised foreign insurer or arranging a contract with an unauthorised foreign insurer includes a reference to the person arranging a contract as agent for, or arranging a contract with, two or more insurers including one or more unauthorised foreign insurers.

SECTION 9B - MEANING OF ACCEPTABLE CONTRACTS OF PROFESSIONAL INDEMNITY INSURANCE

9B.(1) An acceptable contract of professional indemnity insurance, in relation to liabilities that are prescribed for the purposes of a nominated provision, means a contract of insurance:

(a) that is accepted by the Commissioner; and
(b) that contains a clause indicating that the parties to the contract intend that any claim under the contract will be determined according to the law of a State or Territory specified in the contract; and
(c) under which the insured is indemnified to the extent required by the regulations in respect of the prescribed liabilities arising out of or in the course of the insured's business as an insurance intermediary.

(2) Regulations specifying the extent to which a person is to be indemnified under an acceptable contract of professional indemnity insurance may make provision for different amounts according to the date on which the contract is entered into or renewed.

(3) Despite section 28 of the *Insurance Contracts Act 1984*:

(a) failure to comply witha duty of disclosure by a person seeking to enter into an acceptable contract of professional indemnity insurance; or
(b) a misrepresentation by such a person to an insurer before such a contract was entered into;

whether that failure or misrepresentation was fraudulent or not, is not a ground for the insurer to avoid the contract or to reduce its liability under the contract.

(4) An acceptable contract of professional indemnity insurance in respect of liabilities that are prescribed for the purposes of a nominated provision must provide that, despite the fact:

(a) that the person entering into the contract subsequently ceases to trade as an insurance intermediary; or

(b) that the contract is cancelled under subsection (5);

that person, or any other person who becomes responsible for the liabilities of that person, is to continue to be indemnified in relation to a claim:

(c) that is made in respect of a contract of insurance entered into by the insurance intermediary; and

(d) that gives rise to such a prescribed liability;

if that claim is made within the period after entry into that last-mentioned contract of insurance that is, at the time of entry into that contract, prescribed by regulations made for the purposes of this subsection.

(5) The insurer under an acceptable contract of professional indemnity insurance must not cancel the contract unless, at least 3 business days before the date of intended cancellation of the contract, the Commissioner is notified in writing by the insurer or by the agent of the insurer:

(a) of the insurer's intention to cancel the contract; and

(b) of the date of the intended cancellation of the contract; and

(c) of the reason for the intended cancellation of the contract.

Penalty: 150 penalty units.

(6) For the purposes of subsection (5), the following days do not count as business days:

(a) a Saturday or Sunday;

(b) a day that is a public holiday or a bank holiday;

(i) in the Australian Capital Territory; and

(ii) if the insured is a natural person - in the place of residence of the insured; and

(iii) if the insured is a company - in the State or Territory in which the insured is incorporated; and

(iv) if the insured is a partnership or a body corporate other than a company - in the principal place of business of the insured.

(7) A provision in a contract of professional indemnity insurance has no effect if it purports to permit the contract to be cancelled by a person (the 'premium funder') who has entered into a loan agreement with the insured for the provision of all or a part of the premium payable under the contract if the insured is unable or unwilling to comply with the terms of the loan agreement.

(8) In this section:

'nominated provision' means:

(a) paragraph 19(1)(b); or

(b) subparagraph 31B(1)(a)(ii) or (b)(ii).

SECTION 9C - APPROVED FORM

9C.(1) In this Act, a reference to an approved form is a reference to a form that is approved, by written instrument, by the Commissioner.

(2) The instrument by which a form is approved under subsection (1) after this section commences is a disallowable instrument for the purposes of section 46A of the *Acts Interpretation Act 1901*.

PART II - GENERAL

SECTION 10 - INSURANCE INTERMEDIARIES OTHER THAN BROKERS TO OPERATE UNDER WRITTEN AGREEMENTS

10.(1) An insurance intermediary (other than an insurance broker) shall not arrange, or hold himself out as entitled to arrange, a contract of insurance as agent for an insurer unless an agreement in writing between the intermediary and the insurer authorizes the intermediary to arrange-

(a) that contract;

(b) any contracts of insurance; or

(c) a class of contracts of insurance in which that contract is included,

as agent for that insurer.

(2) An insurer shall not cause or permit an insurance intermediary (other than an insurance broker) to arrange, or

hold himself out as entitled to arrange, a contract of insurance as agent for that insurer unless an agreement in writing between the insurer and the intermediary authorizes the intermediary to arrange-

(a) that contract;

(b) any contracts of insurance; or

(c) a class of contracts of insurance in which that contract is included, as agent for that insurer.

(2A) An agreement referred to in this section must specify whether an insurance intermediary can appoint a person as his or her agent for the purposes of the agreement.

(3) Sub-sections (1) and (2) do not apply in relation to any act or thing done by an employee of an insurer in the course of performing his duties as such an employee.

(4) Where an insurance intermediary to whom sub-section (1) applies proposes, or holds himself out as entitled, to arrange, or has arranged, a contract of insurance as agent of an insurer, the Commissioner, or the intending insured or the insured, may request the intermediary to give him a copy of the agreement authorizing the intermediary to arrange that contract, and, if such a request is made, the intermediary shall comply with the request within 7 days after the day on which the request is received by him.

(5) The Commissioner may request an insurer to give him a copy of the agreement referred to in sub-section (2) that is in force between the insurer and an insurance intermediary referred to in the request, and, if

ASIC
Australian Securities & Investments Commission

Frequently asked questions about financial services regulation

QFS 100
Are insurance brokers obliged to maintain professional indemnity insurance?

Yes, at least until 31 December 2006.

Under the transitional compensation arrangements for AFS licensees, insurance brokers remain subject to the professional indemnity insurance requirements that applied under the superseded *Insurance (Agents and Brokers) Act 1984* (IABA).

These transitional arrangements are inserted by reg 7.6.02AA of the Corporations Regulations and initially applied until 10 March 2005 (they were later extended to 30 June 2006). Class Order [CO 06/495] has extended these arrangements until 31 December 2006 while the Australian Government considers its position on a final compensation regime under s912B of the *Corporations Act 2001* (Corporations Act).

Excesses or deductibles on PI insurance

ASIC's interim position on the circumstances in which we will permit excesses or deductibles on professional indemnity insurance cover to exceed the level prescribed by IABA is set out in Information Release [IR 03/15]. These interim arrangements will also continue to apply until 31 December 2006. Under these arrangements, we will permit an excess or deductible to exceed the IABA requirements, provided the excess or deductible does not exceed $18,750 or 20% of the surplus liquid funds (SLF) of the AFS licensee, whichever is greater. In order to qualify, the licensee must apply to us in writing. **For more information see Information Release [IR 03/15]**.

Compensation regime under s912B

On 24 December 2003, Treasury released a position paper, Compensation for loss in the financial services sector, which outlined the Government's position on appropriate compensation mechanisms for the financial services sector and sought comment on further issues.

After 31 December 2006, s912B will more generally require all AFS licensees (including insurance brokers) who provide financial services to retail clients to have arrangements for compensating those persons for loss or damage suffered because of breaches of Chapter 7 obligations by the licensee or its representatives.

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APPENDIX H – POLICY STATEMENT ON PII – PROFESSIONAL STANDARDS COUNCIL

POLICY STATEMENT
ON
PROFESSIONAL INDEMNITY
INSURANCE

FOR COVER OF EXCELLENCE™ SCHEMES UNDER THE
PROFESSIONAL STANDARDS ACT 1994

PROFESSIONAL
STANDARDS
COUNCIL

February 2005 (Updated 17 November 2005)

**POLICY STATEMENT
ON
PROFESSIONAL INDEMNITY INSURANCE
FOR COVER OF EXCELLENCE SCHEMES UNDER THE
PROFESSIONAL STANDARDS ACT 1994**

What is this policy about?
An occupational association, any of whose members subject to a scheme in force under the Professional Standards Act, is required to have the benefit of an insurance policy to cover their limitation amount/cap. Occupational associations set insurance standards of members. When approving and monitoring Cover of Excellence™ schemes, the Council will consider the insurance standards, specified by an occupational association according to this policy statement. This policy statement refers to:

- What does the Act say on PII?
- Who must have PII?
- What are the minimum standards of PII?
- What are the additional requirements if the PII is sourced through overseas insurers, mutuals and captives?

This is a statement of the Council's observations and policy and is not a substitute for obtaining a separate legal advice.

1. **Legislative Requirements**
2. **The purpose of this Policy**
3. **Application of this Policy**
4. **Who must comply with this Policy?**
5. **Minimum Insurance Policy for a Scheme**
6. **Overseas Insurance Requirements**
7. **Captives and Mutuals**
8. **Claims Data**

Summary

- In order for limited liability to apply under schemes approved under the *Professional Standards Act 1994* (NSW), certain provisions require the person to have the benefit of an adequate insurance policy.

- An association may specify insurance standards members must comply with. The Council considers these standards when approving and reviewing schemes and requires the occupational association to ensure compliance by its members with these standards.

- Members of an occupational association may obtain insurance from an Unauthorised Foreign Insurer (UFI) or through captive and mutual arrangements under certain circumstances.

- Captives and mutuals that are not subject to Australian prudential regulation must not be used unless first approved by the Council.

- The terms of insurance policy must be sufficient to indemnify persons subject to a scheme for "occupational liability."

1. Legislative Requirements

1.1 The Professional Standards Acts 1994 (NSW) provides for the limiting of occupational liability of professionals and other occupational groups under professional standards schemes approved by the Professional Standards Council.

1.2 Before approving a scheme, the Council must consider the following:

(a) all comments and submissions made to it in accordance with section 9,
(b) the position of persons who may be affected by limiting the occupational liability of members of the occupational association concerned,
(c) the nature and level of claims relating to occupational liability made against members of the occupational association concerned,
(d) the risk management strategies of the occupational association concerned,
(e) the means by which those strategies are intended to be implemented,
(f) the cost and availability of insurance against occupational liability for members of the occupational association concerned,
(g) the standards (referred to in section 27) determined by the occupational association concerned in relation to insurance policies.

Refer: s10 Professional Standards Act 1994 (NSW)

1.3 The objects of schemes are to limit the civil liability of professionals and other occupational groups, improve occupational standards and protect consumers.

1.4 A scheme may provide that if a person to whom the scheme applies and against whom a cause of action relating to occupational liability is brought is able to satisfy the court that the person has the benefit of an insurance policy:

(a) insuring the person against that occupational liability, and

(b) under which the amount payable in respect of the occupational liability relating to that cause of action is not less than the amount of the monetary ceiling specified in the scheme in relation to the person at the time at which the act or omission giving rise to the cause of action occurred,

the person is not liable in damages in relation to that cause of action above the amount so specified.

Refer: s21 *Professional Standards Act 1994* (NSW)

1.5 A scheme may provide that if a person to whom the scheme applies and against whom a cause of action relating to occupational liability is brought is able to satisfy the court:

(a) that the person has business assets the net current market value of which is not less than the amount of the monetary ceiling specified in the scheme in relation to the person at the time at which the act or omission giving rise to the cause of action occurred, or

(b) that:

(i) the person has business assets and the benefit of an insurance policy insuring the person against that occupational liability, and

(ii) the net current market value of the assets and the amount payable under the insurance policy in respect of the occupational liability relating to that cause of action, if combined, would total an amount that is not less than the amount of the monetary ceiling specified in the scheme in relation to the person at the time at which the act or omission giving rise to the cause of action occurred,

the person is not liable in damages in relation to that cause of action above the amount so specified.

Refer: s22 *Professional Standards Act 1994* (NSW)

1.6 (1) A scheme may provide that if a person to whom the scheme applies and against whom a cause of action relating to occupational is brought is able to satisfy the court:

(a) that the person has the benefit of an insurance policy:

(i) insuring the person against that occupational liability, and

(ii) under which the amount payable in respect of the occupational liability relating to that cause of action is not less than an amount (in this section called the "limitation amount"), being a reasonable charge for the services provided by the person or which the person failed to provide and to which the cause of action relates, multiplied by the multiple specified in the scheme in relation to the person at the time at which the act or omission giving rise to the cause of action occurred, or

(b) that:

(i) the person has business assets and the benefit of an insurance policy insuring the person against that occupational liability, and

(ii) the net current market value of the assets and the amount payable under the insurance policy in respect of the occupational relating to that cause of action, if combined, would total an amount that is not less than the limitation amount, the person is not liable in damages in relation to that cause of action above the limitation amount.

(2) In determining the amount of a reasonable charge for the purposes of such a provision, a court is to have regard to any amount actually charged and to:

(a) the amount that would ordinarily be charged in accordance with a scale of charges accepted by the occupational association of which the person is a member, or

(b) if there is no such scale, the amount that a competent person of the same qualifications and experience as the person would be likely to charge in the same circumstances.

(3) This section does not limit an amount of damages to which a person is liable if the amount is less than the amount specified for the purpose in the scheme in relation to the person.

Refer: s23 *Professional Standards Act 1994* (NSW)

1.7 A scheme may specify different maximum amounts of liability for different classes of persons within an occupational association or different kinds of work, or both.

Refer: s24 *Professional Standards Act 1994* (NSW)

1.8 For the purposes of a scheme, an insurance policy must be a policy, or a policy of a kind, which complies with standards determined by the occupational association whose members may be insured under such a policy, or a policy of such a kind.

Refer: s27 *Professional Standards Act 1994* (NSW)

1.9 (1) An occupational association may require its members to hold insurance against occupational liability.

(2) Such a requirement may be imposed as a condition of membership or otherwise.

(3) The occupational association may set the standards with which the insurance must comply (for example, as to the amount of the insurance).

(4) The occupational association may specify different standards of insurance for different classes of members.

Refer: s34 *Professional Standards Act 1994* (NSW)

2. The purpose of this policy statement

2.1 The purpose of this policy statement is to identify and specify the basis for the Council's consideration of insurance standards to be adopted by occupational associations for the purposes of the *Professional Standards Act 1994* (NSW).

2.2 The policy statement applies in respect of occupational associations with a Cover of Excellence™ Scheme, or in respect of occupational association that may apply for a Scheme. This policy provides a basis for occupational associations to assess the adequacy of their insurance standards.

2.3 This policy is necessarily broad and general to encompass the range of professional and occupational associations that might be covered by professional standards schemes and the variety of insurance arrangements those associations might need to engage in because of their particular circumstances.

3. Application of this policy

3.1 An occupational association will adopt these insurance requirements to qualify for a Cover of Excellence™ Scheme, but may deviate from the requirements if it is satisfied that such a deviation does not pose unacceptable risk to the consumer, or that insistence on compliance in that particular case would be inappropriate, given the reality of professional indemnity market. However such deviations must be within parameters pre-approved by the Council. The Council may not approve or renew a scheme, or may revoke a scheme, where an occupational association does not comply with these requirements and or where deviations from the requirements are not within parameters -approved by the Council.

3.2 Where members of an occupational association who are subject to the association's Cover of Excellence™ Scheme that requires the member to have the benefit of an insurance policy, the insurance policy and the insurance provider must be of a standard that is consistent with the standards of the occupational association as agreed by the Council.

3.3 For the purpose of occupational associations' administration of compliance by members with the standards, a member who is subject to the associations' Cover of Excellence™ Schemes must comply with the requirements at the date of issue or renewal of membership. The member must not subsequently during the policy year reduce the standards of insurance in respect of that insurance policy. Where during the annual membership period the insurance policy is renewed or new policy issues, the subsequent insurance must comply with the requirements unless deviation from the standard is agreed by the association, as permitted. Where during the policy year the standards of the insurer changes (for example, where the Rating Agency issues a Financial Strength Rating less than "A"), compliance with the requirement is deemed to continue until the end of the policy year.

3.4 The standards of the occupational association may provide the association with discretion to allow a member to deviate from the association's standards on the merits of each case. The association may only allow a deviation within specified bases, criteria or parameters that are agreed by the Council. The association must report annually to the Council on the exercise of the association's discretion, including the number of granted applications for deviation, the nature and extent of deviations, and the reasons for the deviations.

3.5 Standards of insurance applying under other Australian statutory regulation prevail over the requirements in this policy statement to the extent of their inconsistency.

3.6 Where, in this policy statement, an occupational association has a discretion to allow a deviation where insurance of the standards is not reasonably available, "reasonably available" includes whether insurance of the standard is at that time offered by insurers and is offered at reasonable cost.

3.7 These requirements apply only to insurance required in respect of the particular Cover of Excellence™ Scheme. Where a person who is subject to a Scheme chooses to purchase insurance at a level higher than is provided by that scheme, the requirements apply only to that portion of insurance required under the Scheme.

3.8 This policy will apply from a date specified by the Council

3.9 This policy will be reviewed annually to take account of changes in the insurance market and regulatory environment.

4. Who must comply with this policy?

4.1 A scheme applies to the members of an occupational association. It is most common that such associations have individuals as members but some do have firms as members. A scheme also applies to partners and employees of those members. Sole practitioners, partnerships and incorporated firms whose liability is limited by a scheme must comply with the insurance standards set out here.

4.2 Occupational associations with schemes are required to specify insurance standards consistent with this policy statement, administer those standards upon their members and ensure members' compliance with the standards.

5. Minimum Insurance Policy Requirements

5.1 Where an occupational association proposes, or has an approved scheme, the standards of insurance specified by the association must, as a minimum, require members of the association to whom the scheme applies to have and maintain an insurance policy that meets or exceeds the following.

5.2 Insuring Clause

5.2.1 Covers the persons and entities to which the scheme applies, including the company or firm, its directors, principals, partners and employees.

5.2.2 Covers acts, errors, and omissions committed by the insured or other person to whom the cover extends (such as employees) occurring in the course of their business.

5.2.3 Covers misleading and deceptive conduct under the Trade Practices Act (and state fair trading legislation), the Corporations Act, and ASIC Act where relevant, and is reasonably available.

Note: Broad-form insuring clause is preferred to the minimum cover stated above, subject to it being reasonably available.

5.3 Policy Extensions and Policy Exclusions

5.3.1 Extends cover where the insuring clause does not cover liability that would be limited by a scheme for activities/services of the person.

5.3.2 Does not exclude liability that would be limited by a scheme for activities/services of the person.

5.3.3 Aligns cover with the business activities of the insured.

5.4 Deductibles or Excess

5.4.1 Where a Cover of Excellence™ Scheme limits liability by reference to insurance alone, any deductible or excess applying under the insurance policy must not be greater than 3 percent of the insured's gross fees, and not greater than 5 percent of the indemnity cover required under the Scheme.

5.4.2 The occupational association may allow a person to have a different amount of deductible or excess from that specified in clause 5.4.1, including a specific dollar amount of deductible. The association must exercise its discretion in accordance with the parameters agreed by the Council, which, among others, may include that the deductible or excess is a reasonable (and minor) proportion of the indemnity cover required under the Scheme and the insured has the demonstrable capacity to meet the cost of the deductible or excess.

5.5 Reinstatements

5.5.1 Provides at least 1 automatic reinstatement where the policy limits the aggregate of claims to the indemnity limit.

Note: Where reasonably available "each and every claim" cover is preferred.

5.5.2 The occupational association may exempt a person from the requirement to have 1 automatic reinstatement. The association must exercise its discretion in accordance the parameters agreed by the Council, including that reinstatement cover is not reasonably available, or is unnecessary (the association may consider that reinstatement is unnecessary where the indemnity cover is twice the amount required under the Cover of Excellence™ Scheme, or the person demonstrates based on past experience and other bases that the reinstatement is unlikely to be invoked).

5.6 Defence Costs

5.6.1 Covers the costs incurred to defend a claim including legal costs, witness costs, disbursements and other expenses an insurer normally considers as costs in defending a claim.

5.6.2 Covers defence costs in addition to the amount payable in respect of occupational liability, where cost-in-addition cover is reasonably available.

Note: Costs-in-addition cover is preferred.

5.6.3 For costs-inclusive cover, the policy of insurance must include a declaration that notwithstanding anything to the contrary in the policy, the amount payable in respect of occupational liability will not be less than a specified amount. The specified amount would be the relevant monetary ceiling or maximum amount of liability as applicable to the insured.

5.6.4 Payment of defence costs may be at the discretion of the insurer and may be proportionate to the total cost of the claim.

5.7 Retroactive Date

5.7.1 Insurance policies must be on a "claims made" basis to cover claims made during the policy period irrespective of when the act or omission occurred. Where the policy limits cover to claims that arise from acts or omissions that occur after a specified (retroactive) date, the retroactive date must not be less than the date a Cover of Excellence™ Scheme commenced to apply to the insured where such a claim would not otherwise be covered by an insurance policy.

5.8 Run-Off Cover

5.8.1 A member of an occupational association to whom a Cover of Excellence™ Scheme applies must have the benefit of an insurance policy for the period that the Scheme applies to the person. Where the Scheme ceases to apply because the Scheme expires, the insured ceases to trade or practice, or retires, or the insured entity merges with another firm, the person must have run-off cover for the longest period reasonably available, where the person will not be covered by future policies.

6. Overseas Insurance

6.1 Background

6.1.1 An unauthorised foreign insurer (UFI) is an insurer that is not authorised under the Insurance Act 1973 to conduct business in Australia and therefore not subject to Australian prudential regulation. Some offshore insurers may not be subject to stringent legal and regulatory requirements, and their offshore presence may render dispute resolution and enforcement of obligations more difficult.

6.1.2 For the purposes of this policy statement, an off-shore captive not writing third party business, and Lloyds are not a UFI

6.1.3 The term "claims data of a type and standard collected by APRA" refers to data collected by APRA under the Financial Sector (Collection of Data) Act 2001, Section 13: Reporting Standards GRS 800.1, 800.2, 800.3 and Reporting Standard LOLRS 800.1, 800.2, 800.3, or any other claims data that APRA may, from time to time, collect.

6.2 Overseas Insurance Requirements

6.2.1 Where an occupational association proposes, or has an approved scheme, the occupational association may allow a member to be insured by a UFI.

6.2.2 Where a member insures with a UFI:

6.2.2.1 An insurance policy is to be arranged through an insurance broker or agent licensed in Australia.

6.2.2.2 A UFI is to be domiciled in a member country of the International Association of Insurance Supervisors (IAIS) or other international organisation similarly reputed by the Australian Prudential Regulation Authority or similar relevant Australian Authority.

6.2.2.3 The UFI must have a minimum rating of "A" from AM Best, Moody's, Fitch Worldwide or Standard and Poor's or equivalent.

6.2.2.4 The proper law of the contract is to be Australian law.

6.2.2.5 The legal system of the domicile country is subject to treaty arrangements with Australia.

6.2.2.6 The insurer must have capacity for providing claims data of the type and standard generally available from the APRA in respect of domestic insurers.

6.2.2.7 The insured must also have an agreement with the insurer or broker, requiring the insurer or broker to provide claims data of the type and standard collected by APRA in respect of domestic insurers. The agreement must enable the data to be passed to the Council.

6.2.3 An occupational association may exempt a person from the requirements of Clause 6.2.2. within specified parameters agreed by the Council, including that the insured has the capacity to enforce the contract of insurance in the foreign domicile and that the insured will provide reliable claims data in respect of all claims made, for purposes of the Council. The standard of information must be equivalent to or better than the standard of data provided to APRA in respect of domestic insurers.

The insured must provide that data annually during their participation in the Cover of Excellence™ Scheme, otherwise the exemption may be withdrawn by the Council.

7. Captives and Mutuals

7.1 Background

7.1.1 A **captive,** without limitation**,** is an arrangement to insure the risk of the owner organisation. A captive may be wholly owned by and is part of the parent organisation. A partly owned captive may share ownership with other similar or related business such as a trade association or industry body. A captive may also be a protected cell company (PCC)- a single legal entity that provides for each cell (belonging to a separate client), legal separation and protection of assets and liabilities. It may contain both core shares that relate directly to the PCC and shares of the individual cell companies.

7.1.2 A captive could be established in an offshore domicile, offshore-established domicile and offshore emerging domicile. An on-shore domicile captive (domiciled in Australia) is subject to Australian prudential regulation.

7.1.3 Sole class captives insure one class of risk, for example, professional liability. A mixed class would cover more than one class of business risk. That diversification helps to hedge against risks. Thus, a mixed class risk diversification is preferred.

7.1.4 A **mutual** (discretionary mutual fund) may be used by similar entities within an industry group to insure all or part of their business. They are not legal entities and generally are not subject to prudential regulation. Members of the fund have continued membership and funding obligations to the mutual structure.

7.2 Requirements in case of Mutuals and Captives

7.2.1 Where an occupational association proposes a scheme, or has an approved scheme, the standards of insurance specified by the association may allow the members to be insured by a captive or mutual.

7.2.2 A captive or mutual must issue a form of "insurance policy" to the insured or member of the mutual.

> *Note: The Professional Standards Act 1994 (NSW) caps liability where the person has the benefit of an* ***"insurance policy"****.*

7.2.3 A captive may be an on-shore domicile (i.e., domicile in Australia) that is subject to Australian prudential regulation.

7.2.4 An association may allow its members with a scheme to insure with a mutual or an offshore captive where APRA or other Australian insurer regulator recognises the mutual or off-shore captive as suitable to provide mutual arrangements or insurance to insured in Australia, or where (in the absence of such recognition) the Council approves the use of the mutual arrangement or off-shore captive.

7.2.5 To obtain approval by the Council of the mutual arrangement or offshore captive, not subject to Australian prudential regulation, an occupational association must submit to the Council a business case for the captive or mutual that contains the information specified in Table 1. The Council may permit submission of an insurance certificate in lieu of a business case in some cases. However, only a certificate issued by an insurance broker or similarly qualified, independent body will be considered for this purpose. The Certificate must address matters specified by the

Council that may include sufficiency of indemnity limits, policy coverage, enforceability, dispute resolution and capital adequacy.

7.2.6 When considering a captive or mutual, the Council may obtain independent expert advice. The association will pay to the Council such amount as may be necessary to cover the full cost of assessing the captive or mutual arrangement.

7.2.7 The mutual, captive or broker must have capacity for providing claims data for the purpose of the Council - of the type and standard, generally available -to the APRA in respect of domestic insurers.

7.2.8 The mutual or captive must also have an agreement with the mutual or captive, requiring the mutual or captive to provide claims data of the type and standard collected by APRA in respect of domestic insurers.

7.2.9 An occupational association may exempt a person from the requirements of Clause 7.2.8 where the insured will provide reliable claims data in respect of all claims made, for purposes of the Council. The standard of information must be equivalent to or better than the standard of data provided to APRA in respect of domestic insurers. The insured must provide that data annually during their participation in the Cover of Excellence™ Scheme otherwise the exemption may be withdrawn by the Council.

8. Claims Data

8.1 Background

8.1.1 For the purposes of approving or renewing a scheme, Council determines the appropriate liability limitation (cap) for an occupational association based on claims data. Council cannot approve a scheme without reliable and adequate data. Data is in respect of claims made.

8.2 Claims Data Agreement

8.2.1 Where a person is subject to a Cover of Excellence™ Scheme, the requirements in this policy statement concerning the collection and provision of data apply. As a minimum, the data is to be of the type and standard provided to the Australian prudential regulator by insurers licensed in Australia. That is, data collected by APRA under the Financial Sector (Collection of Data) Act 2001, Section 13: Reporting Standards GRS 800.1, 800.2, 800.3 and Reporting Standard LOLRS 800.1, 800.2, 800.3, or any other claims data that APRA may, from time to time, collect.

Table 1: Information to be Included in the Business Case for Using a Captive/Mutual

Element	Description
Scope and Background	The scope would provide the association mandate. The background would provide information in relation to the association and its member profile.
Historical Claims Data	Historical claims data would provide information about the types of claims, frequency of claims and claims analysis.
Capital Contributions	Capital contributions would address topics such as member premium calculation, investment strategy, and determine a legal and financial framework for maintaining member contributions.
Risk Management Framework	The risk management framework would address topics related to operational and market risk.
Financial Projections	Financial projections would include short, medium and long-term projections of cash flow requirements.
Reinsurance Arrangements	Reinsurance arrangements would consider the range of reinsurance options available to the captive/mutual, including an options analysis.
Regulatory Framework	Regulatory framework would consider the legislative and regulatory framework of the proposed domicile location.
Exit Strategy	The exit strategy identifies the methodology undertaken when the captive/mutual dissolves or is no longer a viable interest.
Officers of the Captive/Mutual	Officers of the captive and/or mutual to be "fit and proper" as per APRA's definition. "Fit and proper" may refer to the overall standard of educational or technical qualifications, knowledge, skills, experience, competence, diligence, judgment, character, honesty and integrity required to satisfactorily carry out duties and responsibilities in a prudent manner.

APPENDIX I – MAIN ACTIVITIES OF LICENSEES

Main activities of licensees (self-described) Activity

Accountant
Actuary
Adviser
Approved trustee
Asset consultant
Bank
Building society
Call centre
Conglomerate
Credit union
Custodian or depository service
Derivatives dealer
Exempt stockmarket
Expert reports/research house
Finance broker
Financial planner
Foreign exchange dealer
Friendly society
Futures adviser
Futures broker
General insurance agent (single insurer)
General insurance multi agent
General insurance underwriting agency
Investment company
Investor directed portfolio service operator
Life insurance agent (single insurer)
Life insurance multi agent
Managing general underwriter
Mortgage broker
Non-public offer superannuation fund trustee
Payment product provider
Product issuer
Real estate agent
Registered general insurance broker
Registered general insurance company
Registered life insurance broker
Registered life insurance company
Responsible entity
RIOT
Securities dealer
Solicitor/legal adviser
Stockbroker/sharebroker
Superannuation service provider
Telephone sales

APPENDIX J – SAMPLE QUESTIONNAIRE FOR FINANCIAL PLANNERS

The following is provided as a guide to the information that will be required in addition to completion of the proposal form. To enable us to undertake a marketing exercise on your behalf we will require 6 bound copies of this information.

Please note depending on the Insurance Company with whom you elect to place your insurance you may be required to complete more than one proposal form this year,

- CV's of all principals and Financial Planners
- Schedule detailing all current and former proper authority holders, representatives etc. Include date of commencement, name, qualifications and date ceased.
- Copy of compliance manual
- Copy of complaints register *for* the previous 12 months
- Copy of your approved product list
- Copy of your latest corporate profile/company brochure/capability statement
- Sample of a "financial planning report" prepared for clients
- Sample of standard contract (including disclaimers & indemnity agreements) used by you when entering into contracts with third parties.
- Details of how you remunerate your proper authority holders, providing percentage breakdown between salary, commission and other income.
- AFSL License\application (only the pass setting at the specific activities licensed to carry out)
- Financial services guide (FSG)
- Statement of Advice (SOA)

APPENDIX K - APRA NATIONAL CLAIMS AND POLICY DATABASE

Selected features – professional indemnity

Figure 9

Average written premium by underwriting year

Professional Indemnity

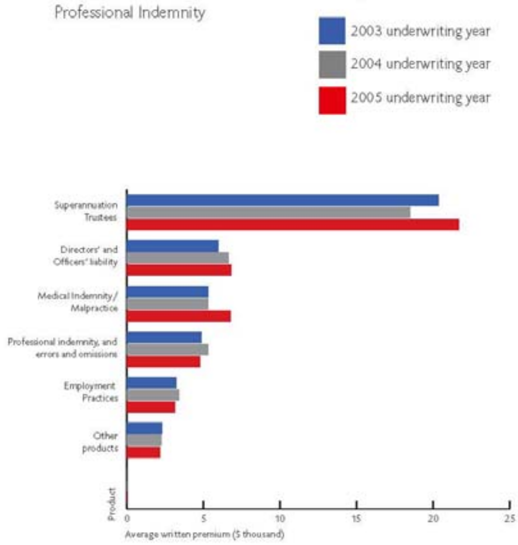
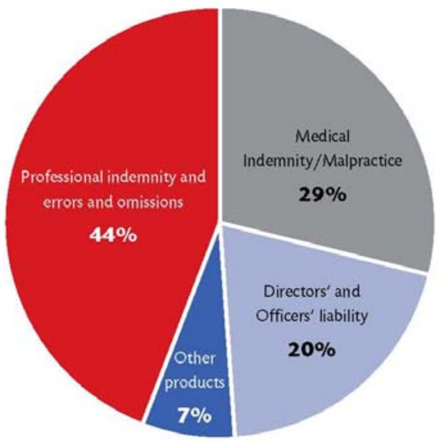


Figure 10

Product share of gross written premium in the 2005 underwriting year

Professional Indemnity



The average written premium for PI insurance in the 2005 underwriting year was $4,861. There are a number of different product types that make up the professional indemnity class of insurance.

The three largest PI product types by gross written premium are professional indemnity and errors and omissions (PII), medical malpractice (MAL), and directors' and officers' insurance (D&O), which together make up 93 per cent of gross written premium, had average written premiums of $4,880, $5,300 and $5,980 respectively.

The average written premium per risk decreased for most PI product types from 2004 to 2005. D&O fell by 10.0 per cent, PII by 8 per cent, and MAL remained relatively steady with a 0.2 per cent reduction, following the steepest reduction from 2003 to 2004 of 21.5 per cent.

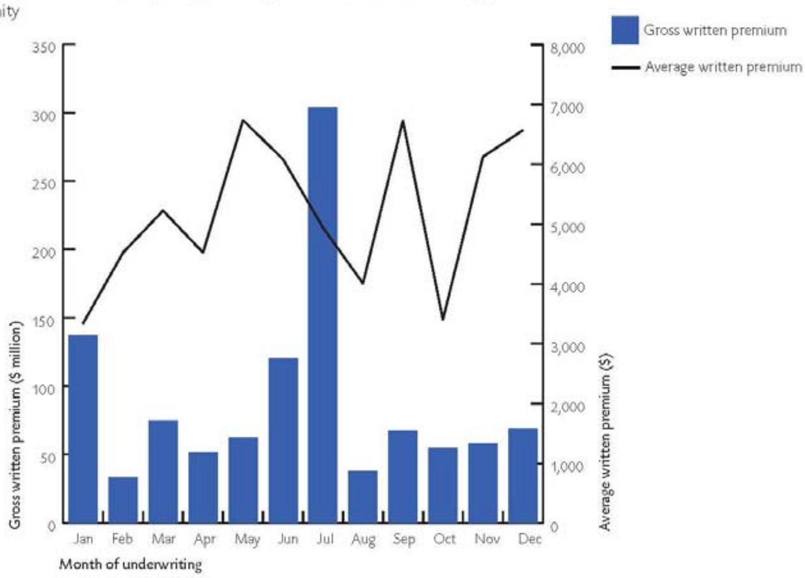
The average written premium for superannuation trustee liability (STL) increased by 10.0 per cent over the year, but is still down by 6.1 per cent on the average premium per risk in 2003. The average premium per STL risk of $20,350 is the second highest by product type.

The group of other professional indemnity products is the only category to have shown increases in the average written premium per risk over both years from 2003 to 2005, though at $2,300 for the 2005 underwriting year it is less than half the average for all products.

Figure 11

Percentage of risks by limit of indemnity and product type in the 2004 underwriting year

Professional Indemnity



Over 52 per cent of all PI business by gross written premium was written or renewed during the months of January, June and July in the 2005 underwriting year. The largest month for renewals was July, representing 28.4 per cent of PI business written during 2005.

This is in large part due to the renewal of medical indemnity policies, 88 per cent of which were reported as written in the months of January and July during the 2005 underwriting year. Medical indemnity policies represented over half the gross written premium for PI insurance in both January and July.

Directors' and officers' liability (D&O) business was steady over the year, with the exception of June, which represented over 20 per cent of the D&O gross written premium in 2005. Some 70 per cent of the premium written on Financial Institutions Policies for 2005 was written in September, contributing to the high average written premium for that month compared to the average for the full year.

Over half of written premium for 'Other' professional indemnity risks was written during January. As the 'Other' product risks have a much lower average written premium than other product types, this contributes to the lower average written premiums for that month. D&O and pure professional indemnity policies written in the month of January 2005 also have lower average written premiums per risk than the average for the full year for those products, shown in Figure 9.

D&O and PII policies written during the month of May 2005, however, had higher average written premiums per risk than the 2005 average for those products. As a result, May shows the highest average written premium for PI insurance in 2005 of $6,735.

New South Wales, Northern Territory and the Australian Capital Territory report a similar pattern of premium written by month as the national pattern, with gross written premium being highest in July, and next highest in January and June. Queensland, however, shows January as the month where the largest amount of premium was written in 2005, while remaining similar to the national pattern in other months. South Australia, Tasmania, Victoria and Western Australia were similar to the national pattern in most months, but had only relatively small amounts written in the first month of the year.

Figure 12

Number of risks written and average written premium in the 2005 underwriting year

Professional Indemnity

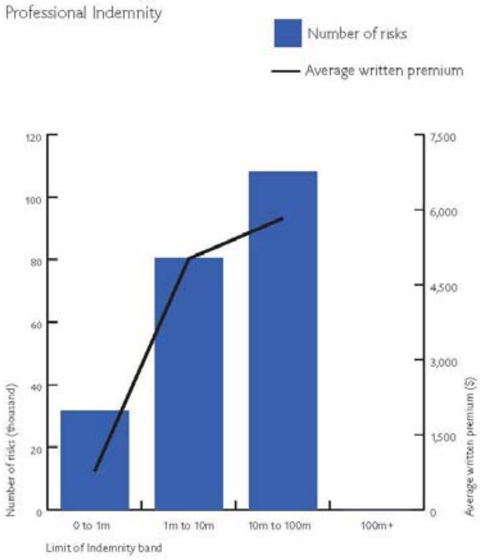
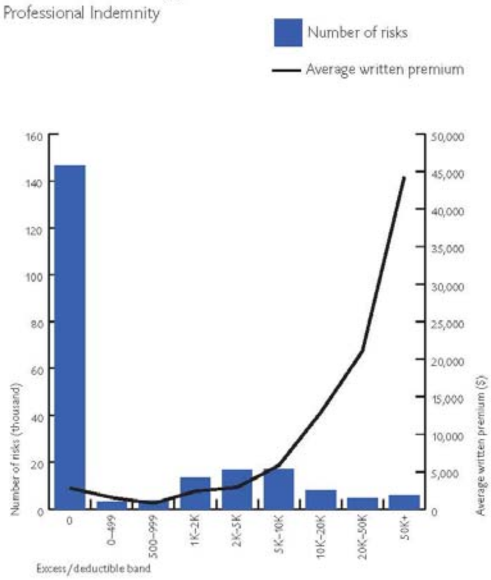


Figure 13

Number of risks written and average written premium in the 2005 underwriting year

Professional Indemnity



Almost half of PI risks written during 2005 (49.1 per cent) limit the indemnity of the policyholder to between $10m and $100 million. The majority of the remaining risks have limits between $1m and $10m (36.6 per cent) or less than $1m (14.3 per cent). Less than 0.01 per cent of PI business written in 2005 provided a limit of indemnity of greater than $100 million.

The average written premium in 2005 for risks with a limit of indemnity up to $1m was $765, increasing to over $5,000 for risks with a limit between $1m and $10m, and $5,800 for risks with a limit of indemnity between $10m and $100m.

There were less than 50 risks written with limits of indemnity greater than $100m.

The majority of PI business for the 2005 underwriting year is written without an excess or deductible. Excesses or deductibles between $1,000 and $10,000 make up the bulk of the remaining risks.

For risks with an excess of between $1,000 and $1,999, the average written premium per risk is approximately $2,400. This increases to over $5,800 for risks with excesses between $5,000 and $10,000, and doubles again to $12,800 for risks reporting an excess of between $10,000 and $20,000.

Risks with excesses or deductibles of greater than $50,000 were written with an average written premium per risk in 2005 of approximately $44,000.

The average written premium per risk increases in line with the excess or deductible associated with that risk. This is consistent with the expectation that larger risks, with correspondingly larger premiums, tend to have larger excesses.

Figure 14

Distribution by limit of indemnity of risks written in the 2005 underwriting year

Professional Indemnity

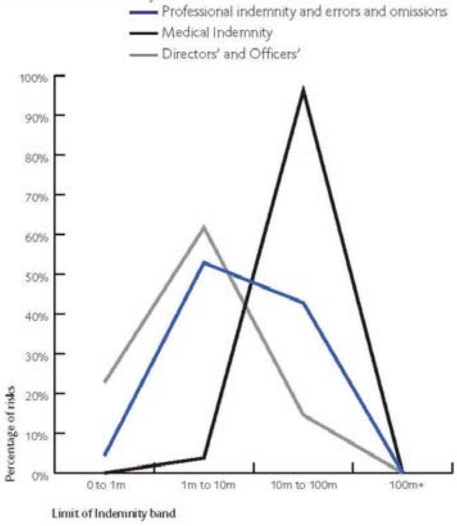
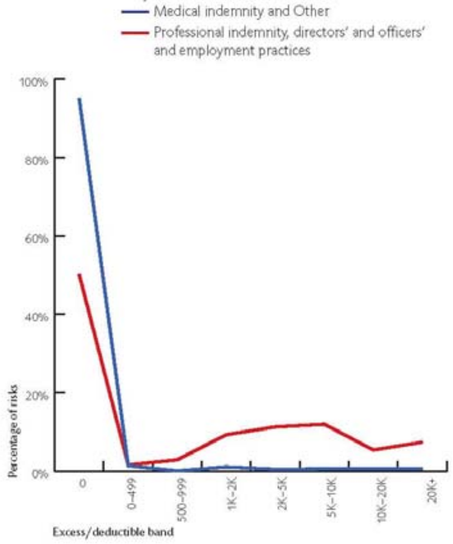


Figure 15

Distribution by excess or deductible of risks written in the 2005 underwriting year

Professional Indemnity



Almost all medical indemnity risks written in the 2005 underwriting year reported a limit of indemnity of between $10 million and $100 million, most of which are in a smaller range of between $20 million and $30 million.

Directors' and officers' liability risks written in 2005 reported 24 per cent of risks with a limit of less than $1m; 62 per cent with a limit between $1m and $10m; and the majority of the remaining 15 per cent reporting a limit of indemnity between $10m and $100m.

Pure professional indemnity has a different distribution of risks, with more risks reporting a limit of indemnity of between $10m and $100m (43 per cent) and $1m to $10m (53 per cent), with only small numbers of risks reporting a limit of indemnity of less than $1m or greater than $100m.

Risks written in 2005 with no excess or deductible represent the majority of medical indemnity and 'Other' risks, around 95 per cent of the number of risks reported.

Risks with a zero excess are also a significant percentage of pure professional indemnity, directors' and officers' and employment practices risks, at 50 per cent. Of the remaining half of the risks for these products, 12 per cent reported an excess between $5,000 and $10,000, and 11 per cent an excess in the range of $2,000 to $5,000.

Financial institutions and superannuation trustee risks have almost 45 per cent of risks reported to the NCPD with an excess or deductible of $20,000 or greater.

Products with similar distributions have been grouped in Figure 15. Others have not been shown due to confidentiality requirements.

Figure 16

Accident year of claim payments made in the 2005 calendar year

Professional Indemnity

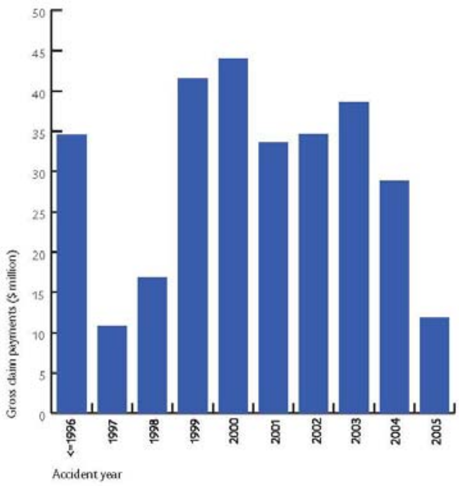
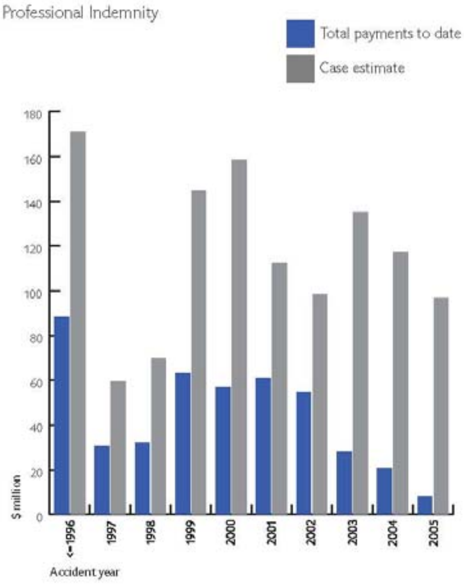


Figure 17

Accident year of case estimates and total payments to date made on claims open at 31 December 2005

Professional Indemnity



Of the claim payments during 2005, 50 per cent related to accident years prior to 2001. Only four per cent of payments made were in relation to accidents from the current (2005) accident year. The majority of payments being made are in respect of claims from accident years of between two and seven years before the current year.

The accident year of a claim is based on either the date the accident occurred (loss incurred) or the date that the claim was reported to the insurer (claims made). The majority of PI insurance is written on a claims made basis.

This figure illustrates the 'long tail' nature of PI insurance. It takes many years before an insurer is notified of and has finalised the payment of all claims that they are exposed to in a particular policy year. This delay in claim notification and finalisation makes liability business particularly difficult and complex to price and manage appropriately. One of the key aims of the NCPD is to provide insurers with additional data to assist them in their pricing and management of these classes of insurance. However, because of the 'long tail' nature of the liability classes, and the fact that the NCPD data collection only relates to periods commencing from 1 January 2003, it will be a number of years before enough claims development data is available in the NCPD for this purpose.

As at 31 December 2005, Australian APRA-regulated insurers reported total case estimates of $1.2 billion for open professional indemnity claims. As with the claim payments made during 2005, a majority of these estimates relate to claims from accident years prior to 2001 (52 per cent).

While insurers have paid out $57 million on open claims from the 2000 accident year, the estimate of the remaining payments to be made on these open claims is more than double that at $158 million.

Data submitted to the NCPD and shown in Figure 17 only relate to the claims that have been notified to insurers. Insurers also hold further reserves as estimates of claim payments that will need to be made on claims that have not yet been reported to them, known as incurred but not yet reported (IBNR) reserves. IBNR reserves for a particular accident year may be much larger than the case estimates on open claims for that year.

Figure 18

Average total payment on claims finalised between 1 July 2005 and 31 December 2005

Professional Indemnity

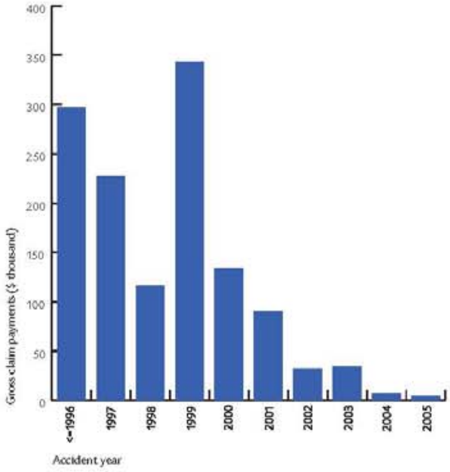
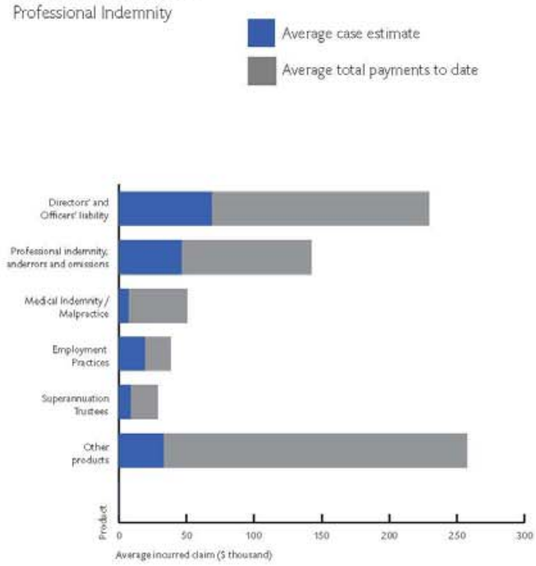


Figure 19

Average claim payments and case estimates on claims open as at 31 December 2005

Professional Indemnity



Claims on events occurring during 2005 that were finalised in the second half of the year had average claim payments of $4,900, while claims from events in 2003 that were finalised in the same period had average payments of over $34,000.

Claims finalised during the final six months of 2005 which related to accident years from 1996 or earlier had an average claim payment of $297,000.

There were close to 3,700 professional indemnity claims finalised during the second six months of 2005.

There is a clear relationship between the accident year of the claim and the total cost of that claim by the time it has been finalised; smaller claims are finalised more promptly than claims for larger amounts.

Of the individual PI products, directors' and officers' liability had the highest average incurred cost at $229,000.

Pure (PII) claims open at the end of 2005 had an average incurred cost of $142,000, more than double the next highest product of medical indemnity. For medical indemnity claims, 14 per cent of the incurred cost was represented by payments that have been made on those claims, compared to 32 per cent for PII claims, and 30 per cent for directors' and officers' liability.

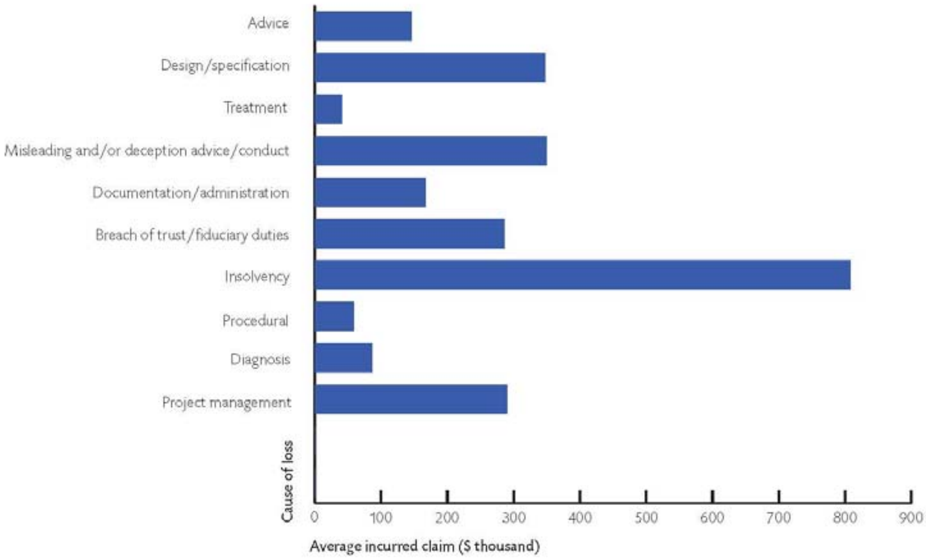
Claims on policies covering superannuation trustees had an average incurred claims cost of $29,000.

As at 31 December 2005, there were over 12,000 open professional indemnity claims reported to the NCPD by Australian APRA-regulated insurers.

Figure 20

Average claims incurred on claims open as at 31 December 2005

Professional Indemnity



The largest cause of loss for PI insurance is 'Advice', which makes up 21 per cent of the total incurred cost of open claims at 31 December 2005. The average incurred cost for claims reporting a cause of loss of advice is $146,000, 35 per cent of which has been paid, with the balance attributable to case estimates for future payments. The majority of these claims were on pure professional policies, and reported a financial nature of loss only.

A further 25 per cent of the total incurred cost at 31 December 2005 is made up of claims with a cause of loss of design/specification (17 per cent) and treatment (8 per cent). Design/specification claims open at 31 December 2005 had one of the highest average incurred costs of all causes of loss, at $347,000, while treatment claims had an average incurred cost of $40,000. Of the total incurred cost for claims open at 31 December 2005 reporting a cause of loss of treatment, 17 per cent was in the form of claim payments rather than case estimates, compared to 36 per cent of the incurred cost for design/specification claims.

Claims reporting a cause of loss of treatment on medical indemnity policies accounted for 75 per cent of the total incurred claims cost for that cause.

Claims reported with a cause of loss of legal expense coverage had an average incurred claims cost of $24,000, one of the smallest for any cause of loss. These claims were recorded as the cause of loss for 6 per cent of open PI claims at the end of 2005. The majority of these claims (78 per cent) are on pure professional indemnity and 'Other' product policies. The 13 per cent of the claims reported with a cause of loss of legal expense coverage on directors' and officers' policies had a significantly higher average incurred cost, at $65,000, compared to the total figure of $24,000.

Directors' and officers' claims with a cause of loss of misleading and/or deceptive advice have an average incurred cost of $647,000, compared to $184,000 for pure professional indemnity claims with the same cause of loss.

The top ten of the 32 PI insurance causes of loss by gross incurred claim cost account for over 71 per cent of both the number and total incurred cost of all claims open at 31 December 2005. A full list of professional indemnity causes of loss is available on the NCPD website.

APPENDIX L – APPROVED EXTERNAL DISPUTE RESOLUTION SCHEMES

Banking and Financial Services Ombudsman

Credit Ombudsman Service Limited

Credit Union Dispute Resolution Centre

Financial Co-Operative Dispute Resolution Scheme

Financial Industry Complaints Service

Insurance Brokers Dispute Limited

Insurance Ombudsman Services Limited

Superannuation Complaints Tribunal