ASIC

Australian Securities & Investments Commission

REPORT 131

Report on submissions on CP 96 Insurance requirements for registered liquidators

June 2008

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 96 *Insurance requirements for registered liquidators* (CP 96) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. For our final policy, please see Regulatory Guide 194 *Insurance requirements for registered liquidators* (RG 194).

Contents

A Overview and consultation process

1 In August 2007, the Australian Parliament introduced new insurance requirements for registered liquidators through the *Corporations Amendment (Insolvency) Act 2007*.

2 The insurance requirements in s1284 of the *Corporations Act 2001* (the Act) oblige registered liquidators to maintain adequate and appropriate:

(a) professional indemnity (PI) insurance; and

(b) fidelity insurance,

for claims that may be made in connection with externally-administered bodies corporate.

3 In Consultation Paper *96 Insurance requirements for registered liquidators* (CP 96), we consulted on how ASIC intended to administer these insurance requirements.

4 This report highlights the key issues that arose out of the submissions received and our responses to those issues. It is not meant to be a comprehensive summary of all responses received, nor a detailed report on every question from CP 96.

5 For a list of the non-confidential respondents to CP 96, see the Appendix. Copies of the submissions are on the ASIC website at **www.asic.gov.au/cp** under CP 96.

Responses to consultation

6 We received seven responses to CP 96 from a variety of sources, including professional accounting bodies (the Institute of Chartered Accountants of Australia (ICAA) and CPA Australia Ltd (CPAA)), the insurance industry (including the Insurance Council of Australia (ICA)), corporate advisory and insolvency firms and the peak body representing insolvency practitioners, the Insolvency Practitioners Association of Australia (IPA).

7 The key issues raised by respondents related to:

- transitional arrangements (see Section B);
- insurance cover of trading debts (see paragraph 34);
- cover for registered liquidators' work at previous firms (see paragraphs 45–48);
- retroactive and run-off cover (see paragraphs 28 and 53–56);
- availability of some insurance in a hardening market (see paragraph 8);

- recognition of captive insurance arrangements (see paragraph 9); and
- confidential information given to ASIC in the application process (see paragraphs 16–18).

8 One of the main issues raised by the submissions was the unavailability of certain types of insurance or terms and conditions in changing insurance markets. It was suggested that even if some types of insurance are available in the current ‘soft’ market, they may not be available in a future ‘hard’ insurance market. We will take note of changing market conditions and the availability of insurance that complies with our guidance in practice and we may update our policy to reflect changes in the insurance market.

9 Another issue was captive insurance arrangements used by certain firms. Some submissions stated that these arrangements cannot be altered to fit the requirements of a particular jurisdiction. As s1284 applies in the same terms to all firms, in our final policy we have not drawn distinctions between firms using captive insurers and those using other insurance providers.

10 Our final policy is set out in Regulatory Guide 194 *Insurance requirements for registered liquidators* (RG 194).

B Commencement and transitional arrangements

Key points

Submissions were generally supportive of ASIC's proposed transitional arrangements.

However, some submissions stated that the transitional arrangements may not provide sufficient time for registered liquidators with insurance policy renewals in June/July to comply with the new requirements.

Accordingly, we have decided to adopt transitional arrangements that align with existing insurance renewal cycles and, in addition, to provide some further time for registered liquidators whose insurance renewals are due in July 2008.

11 We consulted on allowing registered liquidators previously relying on Regulatory Guide 33 *Security deposits* (RG 33) and whose existing PI insurance policies only come up for renewal after 1 July 2008 to comply with the new insurance requirements by the earlier of the time their policy comes up for renewal or 1 July 2009: see Proposal B1 and paragraphs 8–19 of CP 96.

12 Submissions on this proposal were generally positive. However, the professional accounting bodies were concerned that the expected June 2008 date for the release of our final policy would leave insufficient time for those with June or July renewals to make the necessary amendments to their insurance policies.

ASIC's response

We acknowledge that practical problems may be encountered if liquidators are required to renegotiate their insurance cover before 1 July 2008 while the relevant policy still has some months to run.

We also acknowledge that the release of our final policy shortly in advance of 1 July 2008 may leave insufficient time for those with June or July 2008 renewals to comply with the new requirements.

We will therefore only require registered liquidators previously relying on RG 33 to have adequate and appropriate PI and fidelity insurance when they renew, vary or extend their existing PI insurance policies on or after 1 August 2008. This transitional arrangement will end on 31 July 2009. If the registered liquidator's PI insurance policy has not come up for renewal, variation or extension by 31 July 2009, they must comply with s1284 after that date: see RG 194.114- RG 194.116.

These transitional arrangements should provide registered liquidators with sufficient time to comply with the insurance requirements and reduce compliance costs by making the commencement of our final policy coincide with registered liquidators' normal insurance renewal cycles.

C Our approach to administering the insurance requirements

Key points

Almost all submissions supported our proposal to follow five key principles in administering the new insurance requirements.

We have decided to incorporate these principles into our final policy.

13 We consulted on the following five key policy principles, which will guide our administration of the insurance requirements:

(a) *Principle 1*: It is the responsibility of each registered liquidator to determine what insurance arrangements are ‘adequate and appropriate’ in their circumstances.

(b) *Principle 2*: ‘Adequate and appropriate’ broadly means that insurance is fit for achieving the policy objective and is on usual commercial terms.

(c) *Principle 3*: The insurance should be for an amount sufficient to cover claims against the registered liquidator reasonably anticipated in connection with the external administration of insolvent companies.

(d) *Principle 4*: An element of adequacy and appropriateness is what insurance is reasonably available in the market at any given time.

(e) *Principle 5*: A balance needs to be struck between the level of protection for creditors and other claimants afforded by the required insurance and the cost for registered liquidators of obtaining that insurance.

See Proposal C1 and paragraph 31 of CP 96.

14 There was general support for the proposed key principles with one respondent suggesting that Principle 4 should be an overriding consideration in our final guidance.

15 The IPA and another respondent suggested that an additional key principle should be included in our final policy, i.e. that compliance with the Professional Standards Council (PSC) ICAA- or CPAA-approved schemes will satisfy the requirements of s1284 in respect of PI insurance. This is because the PSC schemes state that liquidators must maintain a current PI insurance policy that meets the standards imposed from time to time by the relevant professional accounting body and that it is the responsibility of accountants to ensure that they comply in order to obtain the benefit of limited liability under the relevant PSC scheme.

ASIC's response

We will administer the insurance requirements in s1284 in accordance with the five key principles in Proposal C1 of CP 96.

We will not apply Principle 4 as an overriding principle in our final policy, as this may diminish perceptions of the importance of the other key principles.

However, the inclusion of Principle 4 as a key principle recognises that the insurance requirements will need to be administered flexibly to accommodate changes in the availability of insurance cover because of cyclical variations in the insurance market.

We will also reflect in our final policy the PSC requirements regarding the terms and conditions of insurance policies complying with the ICAA (NSW) PSC scheme (the Scheme) and many of the more detailed rules of the ICAA, with some modifications given the particular statutory provision in s1284. However, we will not express as a key principle that compliance with the Scheme will satisfy the requirements of s1284. Rather than reflecting a separate principle, our approach is more a practical application of the aim to minimise divergence from existing practice and reduce additional compliance costs.

We have also taken this approach so that registered liquidators that are not members of a professional accounting body are treated in the same way as registered liquidators that are members of a professional accounting body.

D Assessing and obtaining PI and fidelity insurance

Key points

Most submissions did not support our proposed application process. The majority of these comments disagreed with the requirement to provide certain information about registered liquidators' insurance policies.

While we will not require applicants for registration as a liquidator to provide copies of their insurance policies, our final policy requires applicants, and from time to time registered liquidators, to provide information in response to certain questions about their insurance. This is because such information is required to assess the adequacy and appropriateness of the insurance.

Submissions generally supported our proposal that only insurers regulated by the Australian Prudential Regulation Authority (APRA) or operating under an exemption under the *Insurance Act 1973* (Insurance Act) should generally be permitted to provide insurance for the purpose of s1284. Accordingly, we have incorporated this requirement into our final policy.

Processes for registered liquidators and those applying for registration

16 We consulted on the application process for administering the new insurance requirements, i.e.:

(a) the type of questions we would ask applicants for registration and registered liquidators about their insurance arrangements to determine whether those arrangements are adequate and appropriate (see Proposals D1 and D4 of CP 96); and

(b) that we will require a certificate of cover/currency, and in some instances a copy of the insurance policy itself, as evidence of insurance (see Proposal D2 and paragraph 37 of CP 96).

17 Most submissions received did not support our proposed application process. Specifically, respondents generally disagreed with our proposal to require information pertaining to their insurance policy and aspects of their business because:

- requiring registered liquidators to interpret and provide this information would result in additional compliance costs; and
- the information proposed might be confidential and possibly breach obligations of non-disclosure under insurance policies.

18 Some respondents suggested that a certificate of currency confirming the key details of the policy would be sufficient to assess the adequacy and appropriateness of the insurance.

19 However, the ICA agreed with our proposals regarding the application process and had no alternative suggestions.

ASIC's response

We have decided not to require applicants for registration as a liquidator to provide copies of their insurance policies, but instead they will need to provide certain information similar to that listed at Proposal D1 of CP 96 regarding their insurance policies.

The reasons for this approach are as follows:

- ASIC has a statutory duty to assess compliance with the requirements of s1284 (and therefore the adequacy and appropriateness of PI and fidelity insurance) before issuing a certificate of registration: see s1282(6).
- A certificate of cover/currency provides insufficient information to assess the adequacy and appropriateness of the insurance policy.
- We do not consider it too burdensome for applicants for registration as a liquidator to interpret their insurance policies and believe that any increase in compliance costs to understand their policies would be justified in meeting the policy objective of s1284.
- We consider it necessary for applicants for registration as a liquidator to provide accurate details of certain aspects of their insurance to ASIC in order for us to assess compliance with the requirements of s1284. The information we request is important in assessing the adequacy and appropriateness of the insurance.

From time to time we may also require liquidators with existing registrations to provide certificates of insurance cover or currency for their PI and fidelity insurance policies and other information about their insurance arrangements (such as those details referred to in Table 4 of RG 194). For example, we may ask for these documents or details when we are conducting a compliance review of a registered liquidator's firm, or as part of targeted or random reviews of PI and fidelity insurance arrangements.

Concerns that the information required is confidential do not recognise that an application lodged with ASIC for registration as a liquidator under s1279 of the Corporations Act does not appear on ASIC public registers and is not available for inspection by the public: see s1274(2(a)(i). ASIC also has a general obligation under s127(1) of the *Australian Securities and Investments Commission Act 2001* to take all reasonable measures to protect from unauthorised use or disclosure information given to us in confidence or in connection with the performance of our functions.

Who can provide the insurance cover?

20 We consulted on who could provide insurance cover for the purposes of s1284 of the Act and proposed that the insurance policy be with an insurer regulated by APRA or operating under an exemption under the Insurance Act (see Proposal D5 and paragraphs 41–42 of CP 96).

21 Some respondents indicated that only an APRA-approved and APRA-regulated insurer should be able to provide insurance. One of these respondents argued that the asset base requirements for APRA-approved insurers ensure the viability of these insurers and their capacity to meet claims.

22 However, other respondents thought that non-APRA-regulated entities should be able to provide PI and fidelity insurance under global captive insurance arrangements, because of the unavailability of adequate and affordable insurance domestically. In addition, one respondent argued that insurers may not necessarily be carrying on insurance business in Australia, in which case they would not be subject to the Insurance Act and would not need to be regulated by APRA or operating under an exemption.

ASIC's response

We have decided that generally all insurance providers should be APRA-regulated or operate under an exemption under the Insurance Act because we believe that insurance policies maintained for the purpose of s1284 should be with a reputable and reliable insurance company that is subject to prudential regulation.

In the case of the captive insurance arrangements of the big accountancy firms, these are likely to fit within the exemption in regulation 4B of the *Insurance Regulations 2002* relating to 'high-value insureds'.

However, if a firm wishes to use insurance that is neither regulated nor exempt under the Insurance Act, they will need to contact us and provide evidence that their proposed insurer is regulated by a system of foreign prudential insurance regulation sufficiently equivalent to that administered in Australia by APRA. It is important that insurers relied on for the purposes of s1284 are well capitalised and regulated.

E Adequate and appropriate PI insurance

Key points

Submissions generally supported the approach of equating fulfilment of the quantum requirements of the Scheme with adequacy for the purposes of s1284.

The majority of respondents supported our proposals on excesses and deductibles.

Although respondents generally supported our proposal on the key PI insurance policy features, concerns were raised about some certain proposed terms and conditions.

There was general support for our proposals on defence costs.

While most respondents agreed with our proposal regarding exclusions, some concerns were raised.

In relation to the adequacy of PI insurance:

- we will treat PI insurance policies that meet the quantum requirements of the Scheme as adequate; and
- excesses or deductibles will be subject to the same limits as the ICAA imposes in Appendix R4 *Professional Indemnity Insurance* (Appendix R4) to its *Regulations Relating to Certificate of Public Practice*.

In relation to the appropriateness of PI insurance we will:

- replicate the key features of the insurance policy proposed in CP 96 in our final policy with some modifications, including not requiring cover for a breach of contract that does not also constitute a breach of registered liquidators' professional, statutory or fiduciary duties;
- allow 'costs-inclusive' as well as 'costs-in-addition' insurance to cover defence costs (on certain conditions); and
- replicate the proposed guidance on exclusions in CP 96 in our final policy with some modifications for trading losses.

Adequacy: Level of insurance cover

ASIC's proposed approach regarding adequacy

23 We consulted on treating PI insurance policies that meet the quantum requirement in clause 3.5(a) of the Scheme as adequate for the purpose of s1284: see Proposal E1 and paragraphs 43–47 of CP 96.

24 Submissions generally supported the approach of relying on the Scheme. Some commented that further definition around the term 'fees' was required, while others commented that 'fees' were already defined by professional standards legislation and that any further refinement, if undertaken, should be done in a manner consistent with this definition.

ASIC's response

We have decided to treat PI insurance that meets the Scheme's quantum requirements as adequate for the purpose of registered liquidators' insurance because:

- the Scheme's requirements are based on independent actuarial assessment;
- most registered liquidators will already have PI insurance in place that satisfies the Scheme's quantum requirements; and
- adherence to the Scheme will help maintain high standards of practice for registered liquidators and uniform procedures across the insolvency services industry.

We will not seek to define fees more prescriptively.

Excesses and deductibles

25 We consulted on proposals that:

(a) there should be certain limits on excesses and deductibles; and

(b) even if an excess or deductible falls below the prescribed limits, it should be at a level that the registered liquidator's business can confidently sustain as an uninsured loss.

See Proposals E2 and E3 and paragraphs 48–49 of CP 96.

26 The majority of respondents supported the proposals on excesses and deductibles. However, those that did not argued that:

- there was an inevitable arbitrariness in specifying these limits, while there is a need for greater flexibility in assessing the appropriateness of any firm's deductible; and
- higher deductibles should be allowed where the registered liquidator's business can confidently sustain that amount as an uninsured loss, taking into account the financial resources of the registered liquidator and their firm.

ASIC's response

In our view, in order for PI insurance to be adequate under s1284, it should comply with the limits on excesses and deductibles outlined in Proposals E2 and E3 of CP 96.

> These limits reflect the rules the ICAA sets for its members in Appendix R4, which form part of the insurance standards specified by the occupational association that are taken into account when the PSC approves and monitors the Scheme. They also ensure that deductibles are not unreasonably high, which might mean that liability for claimants' losses is not met.

Appropriateness: Scope of insurance

Key insurance policy features

27 We consulted on the terms and conditions PI insurance should have for it to constitute appropriate PI insurance: see Proposal E4 of CP 96 for a list of these terms and conditions.

28 Responses generally supported our proposal on the key PI insurance policy features. However, concerns were raised regarding certain proposed terms and conditions, namely:

- Nearly all respondents disagreed with an unlimited retroactive date, on the basis that such retroactive cover is either unreasonable or commercially unavailable.
- The ICA indicated concern with the inclusion of cover for 'breach of contract' and suggested that it should be deleted because it was standard practice for policies to exclude such liability. A similar comment was made in relation to guarantees or warranties.
- One respondent suggested that the terms and conditions in Proposal E4 should operate as a guide rather than as prescriptive requirements.

29 In addition to the terms and conditions proposed, the IPA and another respondent also suggested that a continuous cover endorsement should be included in our final policy as a key PI insurance policy feature, because this would provide cover in the event that an incident was not reported in the insurance period during which it came to the registered liquidator's attention (but only later).

> *ASIC's response*
>
> We have decided that the key features we will expect in PI insurance policies will generally be as proposed in Proposal E4 of CP 96.
>
> However, we acknowledge that cover for a breach of contract that does not also constitute negligence or a breach of registered liquidators' other professional, statutory or fiduciary duties is generally unavailable and unnecessary, and have therefore removed such a requirement from our final policy.

We have amended the wording of our policy to make it clear that an unlimited retroactive date is only one of three possibilities regarding retroactive cover where there is no prior chain of PI insurance policies. Where there is such a prior chain, we have amended our guidance to reflect existing common practice that the retroactive date is the one in the first PI insurance policy in the series of continuous policies (or if there was no such retroactive date, the commencement date of that policy).

We have decided not to mandate a continuous cover endorsement, extension or clause, because even in the current soft market, fraud and dishonesty is typically excluded from such clauses and they usually only apply retrospectively to a limited period prior to the current policy period. The operation of such clauses will also usually be restricted to previous policy periods during which PI insurance was held with the same insurer as the one who currently provides the insurance cover.

The key features of PI insurance in our final policy are generally consistent with the minimum acceptable PI insurance terms in our previous regulatory guide (RG 33) and the minimum PI insurance requirements in the ICAA and CPAA PSC schemes.

Defence costs

30 We consulted on two proposals in relation to defence costs, namely:

(a) there should be ‘costs-in-addition’ cover in place to cover defence costs in addition to the policy limit of indemnity (as opposed to having to pay for the defence costs out of the sum insured); and

(b) if liquidators have ‘costs inclusive’ cover, the limit of indemnity must not be less than 25% greater than the insured amount.

See Proposals E5 and E6 and paragraphs 54–55 of CP 96.

31 There was general support for these proposals. However, one respondent felt that ‘costs-in-addition’ cover should not be mandated.

32 The ICA also suggested that the requirement relating to cover for defence costs should simply be that the limit be sufficient to cover reasonably anticipated defence costs relating to a large claim, having regard to the nature of the policy limit and any limitations that may apply to cover for defence costs. This was on the basis that there is no one definition of ‘costs-in-addition’ cover, which leaves the concept open to interpretation.

ASIC’s response

We have decided to amend our policy regarding defence costs, but to ensure that it remains consistent with the policy on defence costs of the PSC and the ICAA.

Accordingly, we have decided that there should generally be ‘costs-in-addition’ insurance in place to cover defence costs in addition to the policy's limit of indemnity (as opposed to having to pay for the defence costs out of the sum insured). If there is a limit on the amount of defence costs covered in addition, that limit should not be less than 25% of the minimum sum insured.

However, we will accept the alternative of registered liquidators having 'costs-inclusive' cover with a higher limit of indemnity, to offset the effect of costs reducing the indemnity available for meeting liability. In this event, the higher insured amount of cover should not be less than 25% greater than the sum insured as calculated using the prescribed method in RG 194.43.

Exclusions

33 We consulted on the proposal that liquidators should ensure that certain significant exclusions (or any exclusions that undermine the policy objective of s1284) do not appear in their PI insurance policies (see Proposal E7 and paragraphs 56–59 of CP 96).

34 While most respondents agreed with our proposal regarding exclusions, certain areas of concern were raised, namely that:

- trading losses and debts are usually excluded from the scope of PI insurance cover because they are not compensatory in nature;
- ASIC's proposal assumed that insurers were willing to write PI insurance policies on the terms proposed, which was not necessarily the case; and
- the specific requirements in relation to exclusions would conflict with Principle 4 because common exclusions used by insurers vary with different insurance market cycles.

ASIC's response

We have decided that most of the proposals on exclusions in CP 96 should be included in our final policy.

However, we accept that only trading debts incurred through negligence, in bad faith or otherwise in breach of registered liquidators' other professional, statutory or fiduciary duties should be covered by the PI insurance.

We have expressly acknowledged that the availability of insurance varies with changing insurance markets. We have stated that we will take note of fluctuating market conditions and the availability of insurance that complies with our guidance and we may update our policy as needed to reflect changes in the insurance market.

F Fidelity insurance

Key points

Most submissions agreed with our proposal to interpret the requirement to have fidelity insurance as requiring fidelity cover for loss of third party money or similar assets through fraudulent or dishonest conduct, or the liability insurance equivalent. This has accordingly been reflected in our final policy.

One respondent suggested that a fidelity bond arrangement, under which 'job-by-job' insurance is provided per appointment, may also fulfil the policy objective of s1284. We agree and have accordingly drafted our final policy to allow this form of product to be held in lieu of an annual fidelity insurance policy or fraud and dishonesty cover forming part of an annual PI insurance policy.

We received mixed responses on our proposals regarding exclusions. We have decided that our final policy should indicate that:

- the presence of certain blanket exclusions regarding criminal penalties and matters uninsurable by law would not render the fidelity insurance inappropriate;
- fidelity insurance should not exclude cover for claims which have been notified to ASIC or to creditors on the basis that, purely by making the notification, the registered liquidator has automatically admitted liability and thereby prejudiced the insurer;
- appropriate fidelity insurance in the form of a 'claims made' contract may contain reasonable post-discovery notification periods (i.e. of not less than 21 days) for acts of fraud or dishonesty; and
- appropriate fidelity insurance will not contain a condition requiring a successful criminal prosecution against the fraudulent or dishonest party before the indemnity is provided.

We have retained the principles-based approach to assessing the adequacy of the level of indemnity provided under the fidelity insurance. We have also broadly replicated the proposals in CP 96 in relation to the relevant factors that registered liquidators can consider when assessing the adequacy of their fidelity insurance.

Appropriateness: Scope of cover

General

35 We consulted on the following two proposals, i.e. that registered liquidators should hold either:

(a) (as a standard part of, or as an optional extension to, their PI insurance cover) cover for civil liability for third party claims for losses through fraud or dishonesty of an employee, director, officer, partner or agent of the registered liquidator or their firm; or

(b) fidelity cover for loss (resulting from fraud or dishonesty) of money or assets belonging to a third party, in the insured's care, custody or control, for which the insured is legally responsible.

See Proposal F1 and paragraphs 68–69 of CP 96.

36 Most submissions agreed with the proposed scope of fidelity or fraud and dishonesty cover.

37 However, comments received about the proposals included that:

- requirements regarding the scope of cover should be based on the condition that the insurance can be accessed by the insolvency practitioner;
- the extension of the scope of cover to loss of physical property would be acceptable, provided a connection was maintained with dishonesty or fraud on the part of an employee or officer;
- ASIC should not be too prescriptive in setting requirements for fidelity insurance, but instead should provide general guidance on this issue; and
- 'job-by-job' insurance under a fidelity bond arrangement may fulfil the policy objective of s1284 and therefore should also be permitted.

ASIC's response

We have decided to interpret the requirement to have fidelity insurance as requiring one of the following:

- fidelity cover for loss of third party money and similar assets through fraudulent or dishonest conduct;
- the equivalent liability insurance as part of or as an optional extension to PI insurance; or
- 'job-by-job' insurance, e.g. under a fidelity bond arrangement, which indemnifies the insured against claims made by a third party.

We have given further guidance that, if available at a reasonable cost, fidelity insurance or fraud and dishonesty cover should be obtained for physical assets including goods, chattels and equipment (in addition to money and similar assets), but not real property such as land or buildings.

Exclusions

38 We consulted on proposals:

(a) regarding blanket exclusions in fidelity insurance (see Proposal F2 of CP 96);

(b) that appropriate insurance may contain reasonable discovery periods for the acts of fraud or dishonesty (see Proposal F3 of CP 96);

(c) that fidelity insurance should not exclude claims arising from incidents or losses that have been notified to ASIC or to the creditors of the insolvent company to which the registered liquidator has been appointed (see Proposal F4 of CP 96); and

(d) that to be appropriate, a policy must not contain a condition requiring a successful criminal prosecution against the fraudulent or dishonest party before the indemnity is provided (see Proposal F5 of CP 96).

39 All respondents agreed with the proposals that the presence of certain blanket exclusions regarding criminal penalties and matters uninsurable by law would not render the insurance policy inappropriate.

40 All respondents agreed with the proposal that appropriate insurance may contain reasonable discovery periods. However, one respondent wanted guidance on what would be a reasonable discovery period. Another stated that PI policies that have fraud and dishonesty cover do not have discovery periods per se other than that the claim must be notified during the policy period.

41 Most respondents stated that fidelity insurance should not contain an exclusion about notifying ASIC or the creditors of the insolvent company because of concerns about admitting liability. While the ICA commented that notification of an incident would not necessarily constitute an admission of liability, they also suggested that the proposal could conflict with Principle 4 (i.e. that an element of adequacy and appropriateness is what insurance is reasonably available in the market at any given time).

42 Responses were mixed to our proposal that to be appropriate, a policy must not contain a condition requiring successful criminal prosecution. Comments included that:

- a successful criminal prosecution should be obtained, otherwise indemnity could potentially be released on unfounded claims;
- the practice would not allow adequate opportunity for liquidators to defend vexatious and malicious claims and could adversely affect the premiums payable by a liquidator if indemnity were to be released without obtaining a criminal prosecution;
- the absence of a condition requiring a successful criminal prosecution before the indemnity is provided would depend on the risk appetite of individual insurers, market conditions, and the availability of suitable insurance. Accordingly, the proposal should be rephrased so that the absence of such a condition is a guide rather than a requirement.

ASIC's response

We have decided that the presence of certain blanket exclusions regarding criminal penalties and matters uninsurable by law would not render the insurance policy inappropriate. This is because we do not consider that the policy objective requires criminal penalties to be covered by fidelity insurance, as they do not comprise a civil claim for pecuniary loss suffered by a creditor or other person.

We have decided that, in order for the insurance policy to be appropriate, the wording of a 'no admission of liability' condition must not be such as to prohibit factual notification of claims, incidents, losses, events or circumstances to ASIC or to creditors of the insolvent company. This is because such notification may be a mandatory fulfilment of the liquidator's statutory or fiduciary duties. As a matter of public policy, the terms of an insurance contract should not undermine a person's compliance with the law.

We have decided to rephrase our guidance to the effect that appropriate insurance may contain reasonable post-discovery notification periods for acts of fraud or dishonesty. Based on further research and in response to submissions, we have decided to give more specific guidance on what this means, namely that such notification periods should not be of a duration of less than 21 days.

Lastly, we have decided to maintain in our final policy the guidance that fidelity insurance should not contain a condition requiring a successful criminal prosecution, because of the higher standard of proof for criminal as opposed to civil cases and the inherent cost and delay in bringing criminal proceedings.

Adequacy: Level of cover

43 We consulted on proposals for the relevant factors that should be considered when determining the adequacy of fidelity insurance, e.g. claims history, liabilities that may arise, internal aspects of a firm, etc.: see Proposal F6 of CP 96 for the full list of factors.

44 We received mixed responses on the proposed list of factors. These comments included that:

- the prescribed list of factors could result in higher levels of cover where larger engagements are undertaken;
- larger practices would require levels of cover that are not available in the market;
- consideration should be given to allowing fidelity insurance to be held on a job-by-job basis;

- determining an adequate level of cover for an annual insurance policy is complex because of the difficulty in predicting future assignments;
- fidelity bonds may provide flexible levels of cover that may vary according to the risk in each external administration appointment;
- ASIC's view on what are adequate levels of fidelity cover is not sufficiently specific; and
- ASIC should not be too prescriptive in setting requirements for fidelity insurance.

ASIC's response

We have decided to retain the principles-based approach in determining an adequate level of fidelity insurance cover, which includes consideration of the relevant factors suggested in Proposal F6 of CP 96.

We have decided not to specify minimum levels of fidelity insurance. We will expect registered liquidators to conduct their own risk assessment of their business, considering all the circumstances of the registered liquidator and their firm relevant to the risk for which the insurance concerned provides an indemnity.

We will also treat 'job-by-job' insurance, e.g. under a fidelity bond arrangement, as providing adequate fidelity insurance so long as adequate insurance is taken out in respect of each external administration appointment. We have adopted this approach because such 'job-by-job' insurance provides flexibility, while also fulfilling the policy objective of s1284.

G Key issues for both PI and fidelity insurance

Key points

We consulted on proposals regarding:

- insurance cover for insolvency services work performed in previous firms;
- the number of reinstatements in insurance policies; and
- the length and structure of run-off cover.

While comments on reinstatements were generally supportive, we received mixed responses in relation to run-off cover and cover for insolvency services work performed in previous firms.

We have decided to:

- amend the guidance regarding cover for insolvency services work performed in previous firms to better reflect commercial practice;
- require at least one automatic reinstatement of the sum insured or a level of indemnity at least twice the minimum insured amount for PI insurance; and
- require automatic run-off cover once an implementation period of two years has elapsed.

Work performed in previous firms

45 We consulted on proposals that PI and fidelity cover should be obtained for:

(a) work performed in a previous firm where the registered liquidator now works in a new firm that was formed by the merger of two or more firms or by one firm acquiring another;

(b) work carried out in another firm before joining the current firm (if such insurance is not maintained by the other firm); and

(c) the situation where a partner or officer has left the insured firm.

See Proposal G1 and paragraphs 81–83 of CP 96.

46 Most submissions received agreed with proposal (a). However, one respondent who disagreed stated that it did not reflect commercial practice because when partners leave a firm and join another, it is their former firm that holds run-off cover. Another submission suggested that our policy should provide for the situation where predecessor firms have obtained separate run-off cover that is still current.

47 Most respondents strongly disagreed with proposal (b), stating that:

- it seems too broad and cannot be adequately mitigated by the current firm: the current firm should not be held liable for claims made against registered liquidators resulting from their conduct in the previous business;
- it does not reflect commercial practice because when partners leave a firm and join another it is their former firm that holds run-off cover; and
- it would be difficult or impossible to comply with where the previous firm was an international firm, or where such a firm had a particularly adverse claims history: it is neither fair nor reasonable to expect an insured firm to cover liabilities incurred by a completely unrelated firm.

48 Most submissions agreed with (c) although one respondent felt that it was too broad.

> *ASIC's response*
>
> We have decided to include in our final policy the following requirements:
>
> - regarding mergers and acquisitions of corporate insolvency services firms: PI and fidelity insurance should be held by the newly merged or acquiring firm in respect of claims made in relation to the work performed in the previous firms by the staff of the new firm for a reasonable, commercially available period of time, e.g. up to a total of seven years after the merger or acquisition (unless the predecessor firms obtained separate run-off cover for the total of seven years after the merger or acquisition);
> - regarding staff who have left a previous firm: if the previous firm is still in operation, cover for former principals and staff should be obtained for a reasonable, commercially available period of time; and
> - regarding staff who have left a previous firm: if the previous firm is insolvent or otherwise no longer operating, the registered liquidator must obtain insurance in respect of such work for a reasonable, commercially available period of time.

Reinstatements

49 We consulted on proposals that:

(a) it would be good industry practice for a registered liquidator to negotiate an unlimited reinstatement of the limit of indemnity; and

(b) if it is not reasonably commercially feasible to obtain an unlimited reinstatement clause, a registered liquidator should, in any event, ensure that their insurance policy provides for at least one reinstatement.

See Proposals G2, G3 and paragraph 84 of CP 96.

50 Most submissions agreed with the proposals. It was pointed out, however, that:

- it is difficult to obtain a single reinstatement with respect to fidelity cover, even in the current soft market;
- in a hardening market, multiple reinstatements may not be available for PI insurance;
- assessing whether obtaining an unlimited reinstatement clause is reasonably commercially feasible is problematic.

51 One respondent also stated that, as the market hardens, a number of changes should be expected, such as:

- unlimited reinstatement may move back to only one or several reinstatements;
- costs will be applied to reinstatements; and
- high deductibles will be applied to the limits of liability that are triggered in a reinstatement.

52 The ICA suggested that the final policy should refer to 'multiple' rather than 'unlimited' reinstatements because the availability of unlimited reinstatements is subject to market conditions and insurers find it difficult to obtain reinsurance that provides complete protection for unlimited reinstatements.

ASIC's response

We have decided simply to require at least one automatic reinstatement in the PI insurance policy. The requirement will be limited in its application to PI insurance (instead of applying to fidelity insurance as well).

Alternatively, registered liquidators or their firms may obtain insurance with an aggregate limit of indemnity twice the amount of the minimum insured amount (or a higher sum).

This approach acknowledges that the number of available reinstatements is likely to be affected by changes in insurance market conditions, but sets a practical base level of ongoing cover in the event that a large claim, or series of claims, exceeds the initial minimum aggregate amount insured. It also provides flexibility as to how registered liquidators or their firms may wish to access that additional cover.

The rule does not apply to fidelity insurance because we understand reinstatements are unlikely to be available for fidelity cover, whatever the market conditions.

Run-off cover

53 We consulted on proposals for:

(a) stand-alone run-off cover to be held for a minimum of seven years for PI insurance and three years for fidelity insurance;

(b) registered liquidators to use their best endeavours to obtain automatic run-off PI and fidelity cover for as long as reasonably practicable or at least one year; and

(c) registered liquidators to ensure that an event of insolvency does not terminate the insurance policy.

See Proposals G4–G6 and paragraphs 85–88.

54 In relation to multi-year stand-alone run-off cover, responses were mixed. One respondent suggested that both PI and fidelity should have run-off cover for a minimum of seven years, as it was unusual to specify different run-off periods for each type of cover. Other respondents stated that run-off cover is not a component of PI insurance but only available as stand-alone cover on an annual renewal basis. Reinsurance structures typically prevent retail insurers from writing multi-year policies. Accordingly, there is no guarantee from year to year that cover will be available.

55 There were divergent views about the availability of automatic run-off cover, with some stating it was available and others stating that it was not available at an affordable cost in any market conditions, or only available on highly conditional terms. There were also mixed responses in relation to whether automatic run-off cover would cause additional costs.

56 In respect of the question as to whether it would be viable to have insurance policies permitting creditors and other claimants to deal directly with insurers, most comments received were negative. It was suggested that the proposal left no means of defence for the liquidator against vexatious claims. Another respondent indicated that PI insurance is a liability insurance designed to protect the insured, not third parties.

ASIC's response

Because most negligence claims are 'long tail' (i.e. claims arise some years after the negligent act), there is a risk that the registered liquidator might have retired or their firm been wound up, and the period for notifying claims to the insurer might have passed, before the claimant realises they have suffered a loss. Accordingly, where a firm is wound up and the PI and fidelity insurance policy period ends, run-off cover is necessary to meet claims made after this time. As the insurance industry is not intending to write 'claims occurring' PI insurance policies, there is no alternative to viable run-off cover.

Our final policy requires:

- automatic run-off cover to be obtained for at least one year after the expiry of the policy period, triggered by the cessation of the registered liquidator's business or an event of insolvency (but an implementation period of two years will be provided); and
- stand-alone run-off cover to be obtained each year for a reasonable, commercially available period (such as seven years for PI insurance), instead of a multi-year run-off requirement.

This approach provides a level of flexibility should this type of insurance be commercially unavailable. It also allows for a two-year period during which the insurance market can respond to these new requirements by developing products that incorporate at least one year of automatic run-off cover. At the same time, it affords a degree of protection for creditors and other claimants where the registered liquidator ceases business.

H No-action positions

Key points

A majority of submissions supported our proposal to provide no-action positions in relation to certain registered liquidators who pose no risk to creditors or possible claimants in Australia.

We have decided to reflect most of these no-action positions in our final policy.

57 We consulted on taking no-action positions (on certain conditions) in relation to registered liquidators who do not hold any PI or fidelity insurance because they:

(a) no longer take on any appointments or perform work in connection with the external administration of bodies corporate (see Proposal H1(a) of CP 96);

(b) reside and work only overseas (see Proposal H1(b) of CP 96);

(c) are employees of state, territory or Commonwealth government departments or agencies where a statutory immunity or indemnity applies (see Proposal H2(a) of CP 96); and

(d) are retired registered liquidators that act as expert witnesses in court proceedings (see Proposal H2(b) of CP 96).

58 A majority of respondents supported the no-action proposals. However, we received certain comments, including:

- that limitation periods should be applied when the insolvency practitioner's previous firm continues to maintain adequate and appropriate PI and fidelity insurance, because insurance should not need to be maintained indefinitely; and
- questions as to what the position will be if run-off cover is not commercially available in a hard insurance market and the requirement cannot be met.

ASIC's response

We have decided broadly to retain the policy proposed in Proposals H1 and H2 of CP 96 because it is not necessary for these liquidators to maintain PI and fidelity insurance in order to meet the policy objective of s1284.

However, we have deleted the separate category of employees of state, territory or Commonwealth government departments or agencies on the basis that these registered liquidators will fit within the first category, i.e. those who no longer take on any appointments or perform work in connection with the external administration of bodies corporate.

We will also limit the period during which adequate and appropriate PI and fidelity insurance should be held in respect of the work performed while at a firm or as a sole practitioner in connection with the external administration of bodies corporate in Australia, to a minimum period of seven years (or as long as it is commercially practicable to obtain run-off cover) after the registered liquidator ceased working at that firm or as a sole practitioner or moved overseas.

Requiring compliance with the new insurance requirements for longer than this period of time would impose costs on these categories of registered liquidators which would be out of proportion to any related benefit to creditors and other claimants.

Appendix: List of non-confidential respondents

- Insolvency Practitioners Association of Australia (IPA)
- The Institute of Chartered Accountants of Australia (ICAA) and CPA Australia Ltd (CPAA) (joint submission)
- Insurance Council of Australia (ICA)

