

# Professional indemnity insurance - developments in the financial services industry

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by Mark Brookes, Partner

The current economic climate and poor performance of global financial markets has seen a marked increase in claims against financial advisors by investors who feel they may have received misleading or inappropriate advice. With this in mind we have taken a look at ASIC's objectives for professional indemnity insurance for the Australian Financial Services (AFS) industry in light of the recent update to Regulatory Guide 126 (RG 126).

## Background

RG 126 was first released on 27 November 2007 and was most recently updated on 26 October 2009. It provides guidance to AFS licensees and their authorised representatives on how ASIC will administer the compensation requirements under section 912B of the *Corporations Act 2001* (Cth) (the **Act**).

Section 912B of the Act provides that AFS licensees must have compensation arrangements for retail clients for losses suffered as a result of breaches of Chapter 7 of the Act.<sup>1</sup> The compensation arrangements include professional indemnity insurance cover that is adequate having regard to the nature of the licensee's business and its potential liability for compensation claims.<sup>2</sup>

## Insurance requirements

ASIC interprets adequate insurance as insurance that is fit for achieving the policy objective to:

*"reduce the risk that compensation claims to retail clients cannot be met by relevant licensees due to the lack of available financial resources".<sup>3</sup>*

RG 126 specifies that what is adequate will ultimately be determined by reference to a licensee's individual business and circumstances, however from 1 January 2010 (the end of the implementation period) the following minimum requirements must be included in an AFS

licensee's professional indemnity insurance to be considered adequate:

- cover must be provided by an APRA regulated insurer, or alternatively an insurer operating under an exemption in the *Insurance Act 1973* (Cth);
- a limit of indemnity of at least \$2 million for any one claim and in the aggregate for licensees with total revenue to retail clients of \$2 million or less, and minimum cover approximately equal to actual or expected revenue above \$2 million up to a limit of \$20 million;
- indemnity for all breaches of Chapter 7 of the Act by licensees and their representatives, including liability for fraud or dishonesty by directors, employees and other representatives of the licensee (except for sole traders) as well as liability arising out of EDR (external dispute resolution) award schemes;<sup>4</sup>
- no exclusions for claims arising out of EDR award schemes, fraud of directors, employees and other representatives (except for sole traders), claims for misrepresentations about services or notifications to ASIC;
- at least one automatic reinstatement;
- an excess that the licensee can confidently sustain as an uninsured loss taking into account available financial resources;
- coverage for claims involving legitimate switching where a client is being switched from a fund or product that is not on an approved list to another fund that is on an approved list; and
- coverage for defence costs in addition to the minimum level of cover.

## In brief

- § Strict requirements for professional indemnity insurance take effect on 1 January 2010, for AFS licensees.
- § There is some concern at the availability of cover to meet the requirements.

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## Insurance limitations

ASIC says it appreciates that the effectiveness of RG 126 is limited by the extent of cover provided in the professional indemnity market at any given time. This led to the implementation period to allow AFS licensees sufficient time to implement strategies to obtain cover that fulfils the stated objectives in RG 126.

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After industry feedback however, it has become apparent that the current professional indemnity market is unable to provide cover sufficient to meet all the proposed objectives. With the 26 October 2009 amendment ASIC has removed the requirement that policies include 12 months automatic run-off cover, because such a feature is not currently available in the market. ASIC have advised that they will continue to monitor the availability of automatic run-off cover into the future and reassess the requirement should conditions change.<sup>5</sup>

The latest version of RG126 also clarifies that sole trader licensees are not required to obtain fraud and dishonesty cover.

As far as we are aware there have been no other concessions however, and will continue to monitor developments.

**Implementation**

The implementation period is nearing its end and from 1 January 2010 all AFS licensees will be required to obtain professional indemnity insurance that meets the stated objectives of RG 126. AFS licensees should be mindful of their obligations when renewing their current professional indemnity policy and should seek the advice of a broker should they have concerns about meeting the standard of cover required.

- <sup>1</sup> Chapter 7 of the Act relates to financial services and markets.
- <sup>2</sup> Regulation 7.6.02AAA of the *Corporations Regulations 2001 (Cth)*
- <sup>3</sup> 'Regulatory Guide 126 – Compensation and Insurance Arrangements for AFS Licensees' October 2009, [www.asic.gov.au](http://www.asic.gov.au), p 9.
- <sup>4</sup> Pursuant to section 912A(2)(b) of the Act AFS licensees are required hold membership to at least one ASIC approved external dispute resolution scheme, for example the Financial Ombudsmen Service (FOS).
- <sup>5</sup> Above n. 3, p 12.

**Staff news...**

Carter Newell Lawyers welcomes **Dee Wood**, who has joined the Litigation & Dispute Resolution team as an Associate.

Dee has over ten years experience in commercial and professional indemnity litigation. Dee joins the Carter Newell team having spent the past five years working within a national firm in the insurance and corporate risk litigation team. She has previously practiced in London and was once a Judge's Associate in the Dust Diseases Tribunal of New South Wales.

Dee's main areas of practice includes commercial litigation, general insurance, reinsurance and professional indemnity where she has provided advice for brokers, valuers, certifiers, builders, project managers, veterinarians and other professionals.

Dee is admitted to practice in Queensland, New South Wales, England and Wales. She is a Director of the Australian Insurance Law Association (National Board), Committee Member of the Australian Insurance Law Association (Qld Chapter) and a member of the Australian Professional Indemnity Group.



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