

# Financial Planners Professional Indemnity & RG 126

An interview with Richard Midgley of Moray & Agnew

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Transitioning to the new regime for financial planners has proven to be an onerous exercise. ProEx (JLT's specialist PI insurance division) interviewed Richard Midgley at Moray & Agnew (one of Australia's leading insurance law firms), about the key aspects of RG 126 as they relate to Financial Planners PI Insurance. ProEx is delighted to publish Richard's comments on this subject.

**JLT: Recently the Australian Securities and Investments Commission ('ASIC') introduced a regulatory guide (RG 126) relating to the obligations of financial planners to obtain professional indemnity insurance. What are the current obligations on financial planners?**

M&A: The key obligation on financial planners is set out in section 912B of the Corporations Act 2001. This provides that financial planners must have in place arrangements for compensating retail clients for losses if they occurred as a consequence of a breach of Chapter 7 of the Corporations Act by either the licensee or a representative. Chapter 7 prescribes certain conduct affecting financial planners, for example, the need to provide statements of advice and to have a reasonable basis for that advice etc.

The Corporations Regulations 2001 outline necessary arrangements for the provision of compensation. These require the financial planner to have in place either 'adequate' PI insurance or approval from ASIC of an acceptable alternative arrangement to enable the payment of compensation.

The recent ASIC regulatory guide, RG 126, provides ASIC's view on the content of the necessary compensation arrangements and provides certain timeframes for the implementation of those arrangements.

**JLT: As the PI insurance has to be 'adequate', what type of matters should financial planners take into account in order to assess whether their PI insurance is 'adequate'?**

M&A: The question of whether the planner's PI insurance is adequate will depend on the circumstances of each particular planner. ASIC interprets 'adequate' to mean fit for achieving the policy objective of reducing the risk that licensees cannot meet claims for compensation due to insufficient financial resources. The responsibility for determining what is adequate is placed upon licensees.

The types of matters licensees will therefore have to take into account include:

- The nature of their business and the extent to which the business has retail clients.
- The licensee's realistic potential liability for claims brought through the Financial Ombudsman Service.
- The volume of business e.g. turnover.
- The number and kind of clients.
- The kind or kinds of business and its complexity.
- The number of representatives which the licensee has and their geographical spread; and
- Importantly, the terms and conditions of their PI insurance, e.g. the amount of cover, the scope of cover and the levels of the deductible under the policy.

The above matters are relevant to the risks facing the business and the financial protection through PI insurance which the planner has in place to cover those risks.

**JLT: In RG 126, what is meant by the 'minimum PI insurance requirements'?**

M&A: As noted above, there remains a legal obligation on the licensee to obtain 'adequate insurance' and what is adequate will depend upon an assessment of each particular financial planning business. ASIC has set out minimum standards which the PI policy should meet before the policy may be considered adequate. However, even if the minimum terms are met, it does not necessarily follow that the insurance obtained is adequate for that particular business. So minimum PI insurance requirements means the minimum level of cover which ASIC considers all financial planners must meet, although even then the cover may not be sufficient as this will depend on the nature and extent of the financial planner's business.

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**JLT: What do the minimum standards say about the amount of cover required in the PI policy?**

M&A: The 'minimum' amount of cover required for all financial planners is:

- a \$2 million aggregate claim limit if the planner's total annual revenue is \$2 million or less;
- otherwise, the policy limit should be no less than the actual expected annual revenue from retail clients, subject to a cap of \$20 million.

These amounts will be higher if the policy does not contain an automatic reinstatement provision.

**JLT: Will the costs of defending any claim affect the amount of cover available?**

M&A: This depends on the wording of the policy. Ideally, the policy should provide for the payment of the costs of defending any claim 'in addition' to the limit of cover specified under the policy. If this is not the case then the policy limit should be sufficiently increased to allow for a potential reduction in the amount of cover available by reason of costs incurred in defending a claim. Depending on the complexity of the matter, the costs of defending a claim can be significant.

**JLT: Will a decision at FOS be covered by PI insurance?**

M&A: Again this will depend on the terms of the policy. However, RG 126 requires the policy to cover awards made by bodies such as FOS. The policy should also be checked to see if any lower sub-limits or specific aggregation provisions apply to FOS determinations.

**JLT: Once a PI policy is in place following the initial assessment, will the planner need to review the ongoing adequacy of the policy?**

M&A: Yes. Generally PI policies are renewed each 12 months. If in the interim period there are significant changes to the business, for example the provision of new services or the engagement of more representatives, then a review of whether the PI insurance arrangements remain adequate should be undertaken. Additionally, each year when the PI policy is being renewed the adequacy of cover should be reviewed as a matter of course. It is advisable to keep records of the reviews undertaken and the determination of adequacy.

**JLT: When will financial planners need to comply with RG 126?**

M&A: The requirement to have adequate compensation arrangements in place is already in force. With effect from 1 January 2008, new licensees have been required to meet the minimum standards set out in section D of RG 126.

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For existing licensees, the requirements came into effect from 1 July 2008, although where they held an existing policy which had not come up for renewal before 1 July 2008 they needed to ensure compliance upon renewal and, in any event, prior to 31 December 2008.

Additionally, by 1 January 2010, ASIC requires financial planners to have in place a higher standard PI policy which provides even wider coverage and as set out in section C of RG 126. The reason for the additional period is that such coverage may not yet be practically available in the insurance market.

**JLT: If a claim is made against a financial planner will they be able to apportion liability if other parties are involved and so reduce their own exposure?**

M&A: Whilst the ability to apportion loss to others depends on the nature of the claim made, it is likely claims would be made under those provisions of the Corporations Act which do not permit liability to be apportioned. Therefore, the financial planner may still be liable to the claimant for the full amount of the loss even if some other person is also legally responsible. Although rights may exist to pursue that other person for a contribution to the loss such rights will be of little comfort if that other person is insolvent or becomes insolvent. Equally, if claims are made through FOS contribution claims are unlikely to be available in that forum. The potential absence of apportionment of liability should be borne in mind when considering the amount of cover purchased.

**JLT: What is your general advice to financial planners in order to ensure their compliance requirements of RG 126?**

M&A: The financial planner should consider the size and nature of their business, claims history and the potential for claims to arise. It should be borne in mind that in the current economic climate claims are more likely. They should read the policy wording to understand what is covered and consult with their insurance broker.

**Moray & Agnew is a leading insurance law firm. Enquiries in relation to Moray & Agnew's experience in professional indemnity matters can be directed to:**

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