



**ASIC**

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Australian Securities & Investments Commission

# **ASIC's Submission to the Senate Economic References Committee**

**Inquiry into the impact of  
public liability and professional  
indemnity insurance cost increases**

**May 2002**

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# Executive Summary

The Australian Securities and Investments Commission (ASIC) enforces company and financial services laws to protect consumers, investors and creditors.

ASIC regulates and informs the public about Australian companies, financial markets, financial services organisations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. In particular, ASIC regulates how companies deal with investors and creditors and how financial services organisations deal with consumers.

ASIC does not regulate the level of prices of financial services or products (ie competition regulation), and ASIC is not responsible for prudential regulation. As such, this submission does not address in detail the Inquiry's terms of reference, which address specific matters beyond ASIC's role and responsibilities.

## Introduction

This submission is in two parts:

- **Part A** sets out some general information about ASIC's role in the regulation of insurance; and
- **Part B** sets out some general information about some of the requirements to hold professional indemnity insurance that industry professionals that ASIC regulates are subject to, whether under statutory requirements, requirements of markets or industry bodies, or otherwise.

# Part A: ASIC's consumer protection role in regulating insurance

## Under the FSR regime

The *Financial Services Reform Act 2001* (FSR Act) and associated legislation amended the *Corporations Act 2001*, introducing a new licensing regime for financial service providers, and a new product disclosure regime. The FSR reforms commenced on 11 March 2002, with a 2-year transitional period.

The new licensing and product disclosure regimes are relevant to insurance companies, and to insurance intermediaries (agents and brokers). In general, general insurance policies are "financial products" within the meaning of the Corporations Act.

## Licensing

### When is an Australian financial services licence required?

In general, by the end of the transition period, insurance intermediaries (agents and brokers) will need to be appropriately authorised as representatives of an Australian financial services licensee, or they will need to hold an Australian financial services licence.

Under new Part 7.6 of the Corporations Act, an insurance company will need to hold an Australian financial services licence if they carry on a financial services business otherwise than as a representative of a licensee, unless an exemption applies under the Act or Regulations.

Generally, a person provides a financial service if they:

- (a) provide financial product advice;
- (b) deal in a financial product;
- (c) make a market in a financial product;
- (d) operate a registered scheme; or
- (e) provide a custodial or depositary service.

Some relevant exemptions that may apply to insurance companies include:

- **dealing by product issuers** – a licence is not required for dealing in a financial product by a product provider who issues, varies or disposes of a financial product pursuant to an arrangement with a licensee in specified circumstances where the licensee undertakes the distribution of the product (paragraph 911A(2)(b) of the Corporations Act);

- **APRA regulated body, financial service to wholesale (not retail) clients** – a licence is not required by a body regulated by the Australian Prudential Regulation Authority (APRA) if the service is one in relation to which APRA has regulatory or supervisory responsibilities and the service is provided only to wholesale clients and not to retail clients (paragraph 911A(2)(g) of the Corporations Act).

In general, for general insurance, a client will be a retail, and not a wholesale, client if:

- (a) the person is an individual or the product would be for use in connection with a small business; and
- (b) the general insurance product is of a kind specified in the legislation, such as a "motor vehicle insurance product" or a "home building insurance product" (as defined in the regulations).

In other cases, the client will be a wholesale client.

## **Obligations**

All Australian financial services licensees must comply with the licensee obligations set out in section s912A and 912B, which cover a range of matters such as competence to provide the financial services, compliance by representatives with financial services laws and compliance with licence conditions, and compensation arrangements where services are provided to retail clients (as described above).

Australian financial services licensees may also be subject to various obligations under the Corporations Act and various other financial services laws, including the obligations to provide a Financial Services Guide and a Statement of Advice to retail clients (as described above).

## **Product disclosure**

Part 7.9 of the Corporations Act contains a number of requirements relating to financial product disclosure and the issue and sale of financial products. The key requirement under Part 7.9 is that "regulated persons" are required to give a Product Disclosure Statement to retail clients in certain situations, including where personal advice recommending the acquisition of a particular product is given, or where a person offers to issue or arrange for the issue a financial product.

A PDS is to be prepared by or on behalf of the issuer or seller of the financial product (section 1013A). It must contain sufficient information so that a retail client (as described above) may make an informed decision about whether to purchase a financial product. A PDS includes information about fees payable in respect of a financial product, the risks and benefits of a financial product, and significant characteristics of a financial product. While a PDS must contain information about the cost of a financial product, ASIC is not responsible for monitoring or regulating the prices of financial products.

## **Pre-FSR**

Until industry participants complete their transition to the new FSR licensing and product disclosure regimes, they remain subject to their current regulatory regime.

In accordance with the *Insurance (Agents and Brokers) Act 1984*, ASIC regulates registered insurance brokers and registered foreign insurance agents, and ASIC also investigates and acts against misconduct by other insurance agents.

Under section 113 of the *Insurance Act 1973*, ASIC has responsibility for approving codes of conduct in relation to prescribed classes of insurance business and for regulating compliance with such codes. ASIC also has functions under the *Insurance Contracts Act 1984*.

# Part B: Requirements to hold professional indemnity insurance and industry feedback

Professional indemnity insurance plays an important consumer and investor protection role in the financial services regulatory framework, and in supporting business activities. Compensation is a particularly important issue in the finance sector, where consumers typically have larger amounts of money at stake than for most other services or products they deal with.

## PI insurance requirements

Registered insurance brokers and registered foreign insurance agents are required under the *Insurance (Agents and Brokers) Act 1984* to have in force an acceptable contract of PI insurance within the meaning of that Act (sections 19 and 31B). These requirements are continued during the 2-year transitional period for the FSR licensing regime by the transitional regulations (Corporations Regulation 10.2.44).

Operators of managed investment schemes are also generally required to maintain appropriate professional indemnity insurance by licence condition, unless the operator can demonstrate that such insurance is not reasonably available (Policy Statement 131 *Managed investments: Financial requirements* [PS 131]). To date, ASIC has received one application for an exemption from this requirement, and that application was later withdrawn. This requirement will continue to apply during the 2-year transitional period for the FSR licensing regime, under Policy Statement 167 *Licensing: Discretionary powers and transition* [PS 167]. A similar requirement is generally imposed on operators of an investor directed portfolio service under Policy Statement 148 *Investor directed portfolio services* [PS 148]. In accordance with Pro Forma 209 *Australian Financial Service Licence Conditions* [PF 209], in individual circumstances ASIC may impose a licence condition requiring PI insurance.

Under the Corporations Act, registered liquidators are required to lodge a security with ASIC. Under Policy Statement 33 *Security Deposits* [PS 33], as an alternative to a security deposit, ASIC will accept an undertaking from registered liquidators who hold practising certificates from the Institute of Chartered Accountants in Australia (ICAA) or the Australian Society of Certified Practising Accountants (now called CPA Australia (CPAA)) to maintain professional indemnity insurance in accordance with some minimum requirements and the requirements of the ICAA or CPAA.

Other entities regulated by ASIC are also subject to requirements to hold professional indemnity insurance imposed by other bodies. Some examples include:

- Approved Superannuation Trustees – APRA requires approved trustees to maintain adequate insurance against liabilities incurred as a result of a breach of

the trustee's professional duty as a trustee (Instrument of Approval under the *Superannuation Industry (Supervision) Act 1993*);

- ASX Participating Organisations - the Australian Stock Exchange requires all ASX Participating Organisations to have adequate professional indemnity insurance (Business Rule 5.9);
- Participants in the Sydney Futures Exchange (SFE) - the SFE requires participants to maintain appropriate professional indemnity insurance (General By-Laws G.3.16(j) (full participants), G.4.16(j) (associate participants) and G.5.18(e) (local participants)); and
- Financial Planners - the Financial Planning Association is currently reviewing its minimum requirements of professional indemnity insurance that it requires its Principal Members to have as a condition of membership.

PI insurance arrangements are also designed, in some cases, to cover payments that may arise out of the decisions of alternative dispute resolution schemes, which play an important consumer protection role in the financial services sector. The complaints before these schemes typically have a monetary cap (eg \$100,000 for complaints concerning financial advice).

## **Under the FSRA regime**

As is clear from the above list, there has not been a single consistent requirement for PI insurance across the finance sector. However, the new FSR regime provides a more coherent framework for any such requirements. Holders of an Australian financial services licence who provide financial services to retail clients are required to have arrangements for compensating those persons for loss or damage suffered because of breaches of the relevant obligations under Chapter 7 of the Corporations Act by the licensee or its representatives (section 912B). Under the regulations, this requirement does not apply during the 2-year transitional period, and provision is made for existing arrangements to continue during that period.

The Parliamentary Secretary to the Treasury, Senator the Hon Ian Campbell, announced on 28 February 2002 that he intended to release an issues paper for industry consultation on a framework for compensation arrangements in the financial services sector. This issues paper may provide a vehicle for considering requirements for PI cover in the financial services sector.

## **Industry feedback**

At present, and where relevant, ASIC has continued to require entities to hold professional indemnity insurance, in recognition of the important role such cover plays in consumer and investor protection. ASIC's primary regulatory focus in this context is to ensure that financial services providers obtain appropriate types and

levels of cover to meet consumer protection objectives, rather than focusing primarily on cost issues.

Some finance sector intermediaries and industry associations have indicated to ASIC informally that they are experiencing difficulties with their professional indemnity insurance, and particularly that they are encountering:

- significant premium increases; and/or
- reductions in cover – for example, that professional indemnity insurance is being offered with new exclusions relating to particular types of products, such as agricultural schemes, that the intermediary advises on or deals in.

As ASIC does not monitor price levels we have not collected data on PI premiums for this sector.

Some industry participants have informally conveyed the view to ASIC that they will be better placed if they can ensure PI insurance providers have a sound understanding of their businesses and the regulatory environment in which they operate. As noted, industry may have the opportunity to comment on these issues as part of the consultation on FSRA compensation requirements.

ASIC does not have a final view on the implications of current market conditions for the framework for compensation arrangements in the financial services sector under the Corporations Act, as this is the subject of the forthcoming issues paper. However, ASIC considers that the final compensation arrangements regime, including any PI requirements, should result in effective protection for consumers across the financial services sector.