Financial Planning Association of Australia Limited

"Compensation for Loss in the Financial Services Sector"

Response to Issues and Options Paper released September, 2001.

Index

2.2.1 Background

2.2.2 Opportunities
- (a) Commercial risk weighting
- (b) Risk Management Consciousness
- (c) Viability/Prudential Regulation

2.2.3 Weaknesses
- (a) Cost/Affordability
- (b) Accessibility
- (c) Sufficiency/Adequacy

2.3 Statutory Indemnity/Fidelity Fund

2.3.1 Background

2.3.2 Opportunities
- (a) Provision of Run-Off Cover
- (b) Certainty of Cover

2.3.3 Weaknesses
- (a) Competition Policy
- (b) Limited Risk Weighting
- (c) Risk Management Disincentive

2.3.4 Conclusions

2.4 Security Bond

2.4.1 Background

2.4.2 Opportunities
- (a) Accessibility
- (b) Familiarity

2.4.3 Weaknesses
- (a) Insufficiency
- (b) Administration Costs
- (c) No Deterrent Effect
- (d) Barrier to Entry

2.4.4 Conclusions

2.5 Alternative Options

2.5.1 The Financial Industry Complaints Service

Background

The Financial Planning Association of Australia Limited ("FPA") is the peak professional organisation for the financial services industry in Australia, with over 14,500 members servicing 5 million Australians with a combined investment value of $156 billion. The FPA promotes improved quality of financial advice for consumers and high standards of ethical and professional behaviour among its members.

In addition our members are looked to by a large percentage of the 300,000 plus self managed superannuation funds for investment and retirement advice. Of the 9 million working Australians participating in the $500 billion superannuation pool, a large proportion of these also rely on the retirement and estate planning skills of the FPA's members to achieve retirement independent of Government support.

The FPA is dedicated to promoting and protecting the financial interests of Australians generally, which interests are promoted through an efficiently functioning and competitive market for financial services and an accessible compensation arrangements mechanism which ensures the consumers of financial services are adequately protected against the wrongdoing of the providers of those services.

Over the past decade the financial planning industry has grown at almost twice the rate of the Australian economy. The numbers of Australians whose personal wealth is now under the management of financial planners has increased exponentially and the demographic of financial planning clientele has changed significantly.

Once perceived as available only to those with significant financial wealth, the industry has worked tirelessly to convince ordinary Australians of the importance of financial planning. The Government has acknowledged that the adoption of financial planning and investment strategies by all Australians is one of the keys to reducing reliance on the age pension in the longer term.

The adoption of industry wide standards on adequate compensation is vital to assure public confidence in the financial planning process and encourage ordinary Australians to invest to fund their future financial security.

Introduction

“adequate”

sufficient to satisfy a requirement or meet a need; proportionate; correspondent; fully sufficient;

“compensation”

that which constitutes, or is regarded as, an equivalent; that which makes good the lack or variation of something else; that which compensates for loss or privation;

“arrangements”

an orderly grouping of things.

Section 912B of the Corporations Act requires that if a financial services licensee provides a financial service to persons as retail clients, the licensee must have in place arrangements for compensating those persons for loss or damage suffered because of breaches of the relevant obligations under this Chapter by the licensee or its representatives.

This submission does not propose that the concept of “adequate compensation arrangements” necessitates a one size fits all approach to the issue. It is expected that there will be as many variations on the theme as there are groups making submissions on the issue.

The FPA favours an approach which recognises the needs of each of the various groups which can be classified as participants in the financial services industry. Each of those, often disparate groups, will recognise a different activities, different clientele, differing interests which warrant differing levels of protection and different approaches to the provision of that protection.

This submission addresses the various requirements of the FPA membership and its public, recognising that though the focus of compensation arrangements must be the protection of the consumer, it is essential that the system be appropriate to the needs of the industry to whom the arrangements will apply.

Sources of Liability

While this paper is not concerned with the sources of liability, it is founded on the supposition that the Corporations Act is far from the only, and indeed not even the major, source of liability of financial services licensees and their representatives to the investing public.

The very concept of compensation assumes the founding of liability and while this paper does not concern itself with issues of the determination or quantum of liability, it is important to recognise that certain tort law reforms will impact on the nature of the arrangements which are ultimately determined. Capping of liability, limitation periods and proportional liability are already under consideration in the context of professional indemnity cover, public liability and tort reform. These issues are not addressed in this submission save insofar as they impact on the relevant compensation options raised.

It is, however, important to understand relevant sources of liability in order to ensure compensation arrangements are properly targeted at the source of responsibility to ensure final arrangements encourage improved behaviour among practitioners.

The post FSR regime expressly makes Australian financial services licensees responsible for the conduct of their representatives and liable to the client in respect of loss or damage suffered by the client as a result of a representative's conduct.

In general, the responsibility of the representative has been substantially reduced. Direct obligations imposed on representatives in respect of clients are significantly fewer and in general provide defences enabling the representative to shift liability back to the licensee.

In addition to statutory liability, the laws of contract and tort also impose liability on licensees and representatives. Again, the post FSR environment has, at least in the case of contractual liability limited the liability of a representative by requiring the relationship between a licensee and its representatives to be one of principal and agent.

Though in the pre FSR regime it was possible for a proper authority holder to be constituted an agent of the Securities Dealer, in many cases, there was no agency relationship. Accordingly, it was possible for the client to have a contract with the dealer or with the adviser and potentially with both such that the right to sue in contract may have been against either or both of the dealer and the adviser.

In the post FSR environment, the Corporations Act effectively limits the ability of licensees and representatives to structure their relationship otherwise than as one of principal and agent. The result is that in almost all cases, the agent will be contracting with the client on behalf of its principal (the Corporations Act requirements generally mean the principal will be disclosed). Effectively therefore, privity of contract means that the client will have contractual rights only against the principal (licensee)

The Corporations Act previously imposed obligations directly on the proper authority holder (often in addition to the dealer) and as such granted the public a legislative right of compensation against both the dealer and the proper authority holder. The Corporations Act as amended by the FSRA, appears to have significantly reduced the obligations imposed directly on the representative. The Act instead (and likely intentionally) places the majority of obligations directly on the licensee. Where obligations are imposed on the representative they often have significant defences related to their capacity as an agent of the licensee which allows them to effectively escape liability. In addition, the Act specifically makes the licensee responsible for the conduct of its representatives and liable to the client in respect of loss or damage suffered by the client as a result of a representative's conduct.

There have long been calls for the reform of the law of solidary or joint and several liability Of particular concern in a financial services context is the fact that the financial services reforms to the Corporations Act have effectively removed the concurrent liability of a representative and laid responsibility wholly at the feet of the Australian financial services licensee. Rather than increasing the protection available to consumers, this has the effect of limiting recourse to one party and further limiting the rights of that party to claim contribution from third parties, for example, authorised representatives unless, for example, a contractual right of indemnity exists between the licensee and its representatives.

In the context of tort reform, Government is currently the replacement of the existing system of joint and several liability with liability which apportions fault among those responsible for the damage or loss.

In addition, CLERP 9 recommends proportionate liability in the market for audit services. It is suggested that uniformity of treatment demands a similar regime for all financial services industry participants.

Scope

This submission will address the following issues of particular relevance to the FPA, its membership and their clients:

1. the existing system and its practical limitations;
2. options for reform; and
3. coverage.

This submission recognises that the perception among the public of absolute protection may be unrealistic and unworkable. The only system which guarantees that consumers will receive 100% of their damages in the event of liability being found is a Government guarantees. Though this option is considered in this submission, it is unlikely that any such system would be either workable or affordable. "Adequacy" is a far more realistic goal.

The overriding concern of the FPA is that any compensation system should be holistic. Though the temptation may be to identify gaps in the existing system, plugging those gaps will inevitably lead to a fragmented system in which consumers will find it difficult to determine their rights.

Rather, it is submitted the process should identify the aims of an adequate compensation system and work toward a solution that addresses those aims.

The view of the FPA is that any system should:

- **perform a compensation function;**
- **encourage or legislate complete coverage of industry participants;**
- **perform a deterrence function;**
- **limit liability of professionals to reasonable levels having regard to the loss suffered by the consumer;**
- **encourage the adoption of good and secure business practices; and**
- **encourage access by all members of the public to financial planning services**

In addition, the system should be:

- **simple;**
- **clear;**
- **accessible and affordable both for consumers and participants; and**
- **robust.**

Other than as is relevant to the options for reform raised in this paper, the existing compensation arrangements for market licensees and reform options relevant to market licensees are not considered. The regulatory and licensing issues of relevance to market participants are beyond the scope of this submission. Rather, it is anticipated that the submissions made by those operators will be read in conjunction with this and other submissions focussed on discrete elements of the industry.

1. The Existing Compensation Regime/Operational Environment

A recent survey conducted by the FPA of its membership revealed that only 4% of respondents had in place formal compensation arrangements or proposed compensation arrangements for transition. It is possible that confusion in the industry about what constitutes a compensation arrangement accounts for the low figure. What is clear is that all respondents to the survey were members of the FPA and, accordingly required to hold professional indemnity insurance as a condition of their membership. It is apparent that practitioners regard compensation arrangements as a protection for themselves – a cost of doing business as opposed to a protective mechanism for their clients. This clearly indicates the need for guidelines on what constitutes adequate compensation arrangements

1.1 Open Market Professional Indemnity Insurance Cover

The commercial professional indemnity insurance market currently represents the major source compensatory funds in the industry. Presently however, cover is overpriced, inconsistent, and in many cases inadequate to meet the requirements of practitioners and accordingly, their clients.

In the absence of greater legislative and/or policy directives on arrangements which might meet the requirement under section 912B of the Corporations Act to have in place arrangements for compensating retail clients for loss or damage suffered because of breaches of the obligations of that Act by they or their representatives, financial industry professionals have sought to continue to hold professional indemnity cover to meet their obligations in this regard.

A professional standard imposed by the FPA requires all principal dealer members to hold professional indemnity insurance in order to qualify for membership of the Association. The FPA takes the view that this is a vital consumer protection initiative of particular relevance in a post reform environment. Currently however, the FPA is having to address whether that requirement is viable in an environment in which a number of principal dealer members are finding it difficult to obtain indemnity cover which meets the FPA requirements. While the Association appreciates the significant consumer detriment that would inevitably result from a waiver or watering down of the insurance requirement, it must also consider the interests of its members.

Of significant concern are comments received by the FPA to the effect that licensees have reduced their level of cover in order to keep premiums affordable:

"We reduced cover from $9million in the aggregate to $6million in the aggregate to reduce our premium"

"Reduced cover and increased excesses were negotiated in response to increased premiums"

"Overall cover was reduced to keep premiums affordable"[1]

It is clear that the only group to be disadvantaged by such reduced levels of cover are consumers for whom the risk of not recovering the full amount of their loss is increased.

In the absence of the availability of PI Insurance, there are currently few alternatives available for many licensees. Though larger dealer groups (commonly backed by financial institutions) may be able to self insure, it is unlikely that smaller groups or individual licensees will have sufficient financial resources to facilitate that option.

There is some suggestion that as a consequence, smaller dealers will flounder and possibly fail resulting in a significant hole at the smaller end of the market. This is clearly to the detriment of consumers for whom choice between large, medium and small dealers is vitally important.

While anecdotal evidence suggests premium increases ranging from minimal or no increase to more significant increases of between 30% and 1000%, it is difficult to attribute causative factors to the increases reported. As a fiercely guarded trade secret, it is impossible to obtain evidence of the basis on which underwriters price their premiums and make determinations as to whether to issue quotes.

Though some insurance brokers have advised their client dealers of significant exclusions, commonly for example in the case of margin lending and agribusiness, in at least two circumstances that exclusion did not flow through to the policy terms. It has also been possible in certain cases to negotiate in respect of those exclusions on individual policies.

Another significant exclusion, which highlights the confusion surrounding the assessment of risk, is in relation to rulings which are withdrawn by the Australian Taxation Office. It is difficult to understand how, at law, an adviser could be found negligent simply for advising consistently with a ruling issued by the Australian Taxation Office.

Insurers must be educated to assess risk in the context of risk management practices and not along product lines. The FPA is aware that agricultural based investment products are commonly excluded under current professional indemnity policies. In the view of the FPA an exclusion under a professional indemnity policy based on the nature of the product evidences a misunderstanding of the services and guidance that licensees and representatives provide to the investing public. A failure of an investment product is properly attributable to the product issuer, not the licensee or representative.

The above demonstrates a bias against certain financial investment products by professional indemnity insurers which, in the agricultural industry will likely result in a lower access to the Australian investment dollar. Whilst this issue does not directly affect an adequate compensation arrangement it is an issue that nevertheless needs immediate industry and government attention.

A failure to do so will only serve as a disincentive to practitioners implementing stringent risk management systems. The FPA's recent survey to members on professional indemnity insurance indicated that 50% of respondents had not been asked by their insurer for evidence of their risk management policies or procedures in assessing their proposals for insurance cover.

> ***"Yes we have those systems in place and offered them to the broker in order that they be delivered to the insurer – the insurer did not want them"***
>
> ***"Yes we have documented risk management procedures and no the insurer has not requested evidence of such procedures"***
>
> ***"We do have procedures but the insurer did not request copies"***
>
> ***"Yes we have implemented risk management procedures and no our insurer has not requested evidence of such procedures"[2]***

Anecdotal evidence also suggests increases in excesses of between 50% and 400%. It is to be noted that those reported increases appear to be from historically low bases and are largely comparable to other professional services indemnity excesses, however, it does seem that the calculation basis of these excesses is dissimilar. While lawyers and accountants are generally assessed for the calculation of excesses on the number of professionals within the organisation, the assessment in a financial planning context appears arbitrary and uninformed.

It is to be remembered that the requirement is not just to have compensation arrangements but **adequate** compensation arrangements. In circumstances where the only cover which licensees are able to obtain is at unaffordable premiums and with unworkable excesses, the consumer protection intent of the legislation is effectively meaningless.

The FPA does not disagree that excesses are an appropriate means of shifting a portion of risk to the insured in circumstances which warrant such a practice. Additionally, appropriate excesses have the advantage of discouraging smaller claims by effectively placing a floor on claims. It does not, however, appear that excesses are being utlilised in a standard or logical manner reflective of the potential benefits which may flow from effective excess structuring and application.

An adequate compensation arrangement that relies on the current Australian professional indemnity market should not be used as an instrument to exclude practitioners from the market. Care must be exercised to ensure that the current insurance and economic crisis does not result in a process of "natural selection". Rather the adequate compensation arrangement must compliment the regulatory and disciplinary system that is now entrenched in the Corporations Act to protect the public.

The question of whether commercial insurers will be prepared to offer run off cover is an increasingly concerning issue for industry participants as is the associated potential for the failure of an insurer during the run off period. This should be of significant concern to the public. To a certain extent it must be accepted that ensuring the longevity of insurers is the role of prudential regulation (likely to be tightened even further in the wake of the failure of HIH). Additionally both industry participants and consumers must accept that not every contingent risk can be addressed even in a carefully thought out compensation regime.

One criticism of the indemnity insurance system in general is that the spread of insurance has removed the effect common law negligence actions may have had as a deterrent to negligent conduct simply because insureds perceive there to be little risk to them where insurance cover saves them from what would otherwise be a crippling financial liability. On the other hand, it is argued that the common law action is still capable of performing a deterrence function for example by exposing risky practices and subjecting those who engage in risky practices or who have a poor claims history to higher premiums and excesses.

It is clear that commercial insurance has the capacity to encourage risk management and operational excellence, however, presently, a market which does not appear to be

appropriately applying risk weighting mechanisms or recognising best practice is failing in a role which is vital even to its own survival. Any adequate compensation arrangement should encourage both risk management and operational excellence as well.

Appendices “A” and “B” respectively set out some of the results of a survey conducted by the FPA on the professional indemnity experiences of its members and anecdotal evidence of the difficulties being experienced by members in obtaining adequate cover at acceptable rates.

Though the major driver of increases in liability premiums appears to be the numbers of claims and payouts, there are a number of underlying factors impacting on premium pricing.

World events including the September 11 terrorist attacks have had flow on effects to the Australian economy. Coupled with a reduction in investment returns and a protracted period of low interest rates which looks set to continue, insurers have been hardest hit. Additionally, there is evidence to suggest that insurers have for some years been discounting premiums and as a consequence the premium increases necessary to offset poor investment returns have been magnified by the cessation of that practice of discounting.

Over the past decade, the number of major insurers has decreased from over 20 to less than 10. Of particular concern was the fact that the HIH collapse effectively removed approximately 50% of the capacity in the local market for small and intermediate risks.

This decrease in overall competitive forces coupled with APRA’s higher capitalisation levels for insurers has placed considerable upward pressure on premiums.

Economic evidence suggests that there has been a steady increase over the past 5 years, not only in the number of claims, but also the quantum of payouts. The discounting practices of most insurers over the past decade is clearly at odds with this trend and has led to declining industry profitability with negative returns in the area of liability insurance, largely cross subsidised by other classes of business.

1.2 The Financial Industry Complaints Service

FICS is the complaint resolution body for the financial services industry in Australia. While FICS is a forum for determining and quantifying liability, of significant concern is the mismatch between the determination system and the compensation system. While members of the FPA are required to have an endorsement on their insurance policies to the effect that FICS determinations will be paid, there is no real basis on which liability for FICS determinations can be passed on to the insurer. This represents a significant gap in the system.

FICS offers both a conciliation service and arbitration service which may be conducted by an adjudicator or panel leading to a decision on the complaint. Both services are free of charge to the public.

Of concern is the presumption on the part of the public that FICS offers a free and simplified means of obtaining restitution for their loss. What they do not appreciate and what any compensation regime must address is that while the determination process may be simplified, that very process may deny the practitioner indemnity under their policy leaving the consumer without a source of funds to meet the determination in their favour.

Conciliation or determination of a complaint by FICS is predicated on the basis that the complainant has previously raised their complaint with the member and been unable to achieve resolution through the member's internal complaints resolution mechanisms.

FICS may only deal with complaints in respect of a policy of insurance dealing with lump sum risk or advice in relation to a lump sum product where the dollar value of the complaint is less than the regulated limit of $250,000 or in the case of an income stream risk product $6,000 per month.

In relation to complaints concerning financial services other than life insurance, the service may only determine claims not exceeding $100,000.

Of particular concern is the fact that while members are obliged to abide by an adjudicator's or panel's decision (and FICS may take any necessary action (including legal action) to enforce an adjudicator's decision), complainants may elect to pursue their rights in an alternate forum, including an appropriate Court of law.

While there is no system of review or appeal from a decision of the panel, members of the FPA are required to secure an endorsement on their professional indemnity insurance to the effect that the insurer will cover any determination made against them by FICS.

Of further concern to both the FPA and its members is that no underwriter is prepared to provide an endorsement in excess of the $100,000 general financial services jurisdictional limit. Effectively, members who provide life insurance services risks significant financial liability where a determination falls between the $100,000 endorsement and the $250,000 lump sum risk limit.

In addition, it is not uncommon in the current professional indemnity environment for policy excesses to approach and even exceed $100,000. The effect of an excess close to or at the $100,000 jurisdictional limit means members are effectively self insuring against determinations of the FICS service.

The intransigence of insurers in this regard may or may not be suggestive of a tacit refusal to provide the endorsement required by the FPA, but in any event, has the potential to nullify the consumer advantage intended to flow from the FICS dispute resolution system. Where members of the scheme are unable to meet either the excess or the differential between a determination and the limit of the professional indemnity endorsement, the potential for the consumer to be disadvantaged is very real.

The FPA is concerned that the current mismatched situation leaves consumers exposed to licensee failures as a result of their being unable to either satisfy a FICS determination or meet the excess under their professional indemnity insurance.

1.3 Licence Condition – Lodgement of Security

Pursuant to former section 786(2)(d) of the Corporations Law and Regulation 7.3.03, Securities Dealers were required to lodge and maintain a security bond with ASIC as a condition of their dealer's licence.

The FPA is of the view that while the security bond in its current form has become increasingly irrelevant, it still has a potential role to play in any compensation regime.

Regulation 10.2.45 extends the ability of ASIC to require the same condition of Licensees who carry on an activity which would have required them to lodge the security under section 786(2)(d) until the end of the transition period on 10 March, 2004, following which time it is presumed that the general power under section 914A would still operate to enable to impose a similar licence condition, although in respect of existing Australian financial services licenses, it would appear that ASIC needs to comply with the notification and hearing provisions of section 914A.

Presumably, it is intended that the new compensation arrangements be implemented to have effect following the end of the transition period.

The Issues and Options paper suggests that when a security bond is called up there is an average of 40 claimants to the bond. If all claims were equal, each claimant would receive an average of $500.

The law however, requires that where there is one claimant their loss be satisfied up to the value of the bond. Where there is more than one claimant, each should be proportionately entitled according to the value of their claim when brought. The practical effect is that one large claim could dilute all other claims so as to render them effectively worthless.

It is submitted that while the amount of the security bond, in fact, affords very little real security to any consumer, there is still capacity for the bond requirement to be restructured to offer potentially greater consumer benefits. This is discussed in greater detail below.

Subject to the reform options implemented, It is the FPA's position that existing security bonds be returned to practitioners.

2. Options for Reform

It is unlikely that one single option for reform will adequately meet the compensatory needs of the public. Each reform option is considered individually below for the sake of clarity, following which various combinations of policy initiatives are considered in the light of the consumer's and industry participant's requirements.

2.1 Professional Standards Model

2.1.1 Background

…the professional environment of today is one in which "….providers of professional services are the incidental underwriters of their client's risk."[3]

It is certainly the case that increasingly, consumers of professional services expect most, if not all risk relating to their consumption of those services to be borne by the service provider.

It has long been recognised that the viability of the professions such as accounting and law is essential and in the interests of the public. It is certain that the financial services professions can be included in this assumption.

An environment in which professionals feel constantly besieged by excessive risk works against an efficient, open, accessible and affordable system of service delivery. Professionals adopt defensive practices to minimise their exposure to risk which diverts resources away from the provision of the service, drives up costs and necessarily results in an inferior service.

The interests of consumers are best served by professions which are not unduly restrained by concern about the risks associated with the service they are providing. Consumers will inevitably receive the most relevant and comprehensive service where the service provider is free to be open in their dealings with the client.

The New South Wales and Western Australian Professional Standards Acts provide a mechanism for members of participating professional associations to limit certain aspects of their professional liability by registering a scheme with the Professional Standards Council.

The primary focus of the existing professional standards legislation is the importance of standards of professional conduct and best practice as risk management tools rather than risk protection.

The legislation specifically excludes death or personal injury, breach of trust, fraud or dishonesty, liability under Commonwealth Acts such as the Trade Practices Act or Corporations Act and liability arising outside of New South Wales or Western Australia respectively.

Schemes registered under the Acts are aimed at:

1. protection of consumers;
2. improvement to occupational standards of people working under the scheme; and
3. improvement of mechanisms to properly resolve consumer complaints.

Additionally, a person covered by a scheme is required to have insurance or business assets sufficient to pay for damages arising from occupational liability to the level of limitation applying to them.

The Professional Standards Council provides significant support, again aimed at supporting the consumer protection intent of the legislation by:

1. giving advice to associations regarding policies of insurance;
2. providing encouragement and assistance in the improvement of occupational standards for members of associations; and
3. assisting in development of self regulation of associations such as advice regarding:
    (a) codes of ethics;
    (b) codes of practice;
    (c) quality management;
    (d) risk management;
    (e) resolution of complaints by clients;
    (f) voluntary mediation services;
    (g) membership requirements;
    (h) disciplining of members; and
    (i) continuing occupational education.

Where schemes have been implemented, they are reported to have had a positive impact on controlling insurance costs. Engineers for example reported reduced premium costs of around 40%[4].

Of course the impact of professional standards limitation of liability schemes on policy premiums is in large part influenced by the geographic operations of the scheme participants. In an industry such as financial services where markets are becoming increasingly national, the jurisdictional limits of the regime are a significant concern and have the effect of reducing the impact of the limitations on overall business operations. Additionally, the fact that the operations of participants are largely governed by federal legislation provides a further limitation on the effectiveness of the legislation. Insurers recognise this impact when assessing premiums.

Clearly, the capacity of professional standards schemes to control insurance premium increases would be enhanced by a national regime which also encompassed federal legislative liability.

It is suggested that the underlying intent of the professional standards schemes may be replicated in some generally applicable, federally recognised scheme or regulated specifically in relation to the financial services licensing regime.

2.1.2 Opportunities

(a) Internal Risk Management/Improved Operational Standards

Risk management strategies such as monitoring and supervisory systems, disciplinary policies, internal complaints resolution systems and general operational policies and procedures are all prerequisites for scheme participation and registration. Necessarily these initiatives lead to a superior level of service to the client and improved consumer protection.

(b) Reduced Insurance Costs

Evidence suggests scheme participants are a more acceptable risk to insurers. This has led to significantly reduced premiums for participating professions.

Particularly in a climate of rising premiums and excesses and reduced competition in the professional indemnity insurance market, there is significant pressure to encourage insurers to return to the market and/or provide more attractive rates and terms to professions.

(c) Independent Regulation

Disintermediation and self regulation are a core focus of the financial services reforms. Accordingly, the embracing of an independent source of industry regulation through one or more participating associations would likely assist in that process and offer industry participants significant regulatory support.

2.1.3 Weaknesses

(a) Interpretive Limitations

Presently, schemes can only differentiate liability amounts by classes of persons, kinds of work and multiple of fees. In the financial services context, it is suggested that there are far more legitimate bases for differentiating liability, including along product lines and operational structures.

(b) Consumer Detriment

A capped system always gives rise to the argument that consumers necessarily suffer where their rights to seek redress are limited.

Recognising the real potential for that situation to arise, it is essential that any system involving capping of liability to balance the consumer's right to redress with the public interest that arises from professionals being able to operate with confidence in their ability to meet any liability as it arises.

In reality it is the case that the concept of complete compensation is illusory. Even where professional indemnity insurance is a feature of a compensation arrangements there is a risk that the insurer will avoid the policy for any number of reasons or that the insured will be unable to meet the excess thereby leaving the consumer exposed to a potentially impecunious defendant with little alternate recourse.

When the Professional Standards legislation was being debated in New South Wales, the then Attorney General John Hannaford QC noted that

"…..it (is) of no consolidated advantage to have an award of full compensation when there are insufficient assets to pay the awarded damages…."

Data collected over the life of the legislation indicates that risk for professional

services generally is well below the $500,000 threshold, however, the level of consumer's financial resources controlled by financial industry participants may warrant a higher threshold.

Capping is indeed a departure from the principle that the plaintiff should be entitled to be fully compensated for their loss. However, while the main criticism of capping is unfairness due to consumers' lack of ability to protect themselves from loss through either insurance or risk management, as previously discussed, this argument may be unwarranted where the concept of complete compensation is illusory or at the very least, uncertain. In addition, evidence suggests decreasing average claims values which is indicative of the majority of claims falling within the legislated cap in any event.[5]

A further argument against a capping regime is that in a system of joint and several liability, defendants who are not members of the scheme are exposed to a potentially greater liability than those whose liability is limited though it is submitted that this is not necessarily detrimental from an industry perspective and would encourage participation and the resulting consumer advantage which flows.

There is also considerable support for a limitation to any capping regime. It is considered inappropriate to cap liability for example where a professional fraudulently misappropriates funds, while a cap on damages suffered as a consequence of the professional's breach of the law sends an inappropriate message.

(c) Legislative Limitations

The capacity of the Trade Practices Act generally to undermine the effectiveness of the Professional Standards regime has long been a subject of controversy. While for other professions the Corporations Act has generally not been as significant a concern, for those in the financial services industry, it is at least as relevant as the potential for Trade Practices Act/Australian Securities and Investments Commission Act actions.

It must be accepted that the relevant exclusions in respect of the Trade Practices Act, ASIC Act and Corporations Act as well as the state wide jurisdictional limitations of the existing regime would significantly impact on the effectiveness of any scheme applicable to participants in the financial services industry and it would appear axiomatic that in its present form it would do little to either encourage insurers back

to the market or secure advantageous terms for participants.

2.1.4 Conclusion

The Professional Standards Acts can be likened to statutes that directly licence and regulate a particular profession.

The Professional Standards Council argues that licensing regulation is not an effective means of ensuring services are uniform, predictable and compliant with minimum standards, nor of encouraging and assisting continuous improvement.

It is submitted, however, that the licensing regime imposed by the Corporations Act, together with the associated Regulations and ASIC's regulatory guidance imposes a licensing regime which does in fact require significant ongoing development and improvement of internal policies and procedures. The Corporations Act regime creates a single regulatory and licensing regime for participants in the financial services market, but is focused clearly on consumer protection and aims to ensure the public receives services that are uniform, predictable and comply with minimum standards, duplicating to a large extent, the intent of the Professional Standards Acts.

PS 164 in particular focuses on the non financial organisational requirements for licensees including:

- monitoring and supervision of representatives;
- human resources;
- technological resources;
- risk management systems; and
- organisational expertise.

Importantly, licensees must satisfy ASIC that they will comply with the relevant requirements before ASIC will grant an Australian Financial Services Licence. In addition, ASIC has the power to require evidence of documented procedures and compliance measures.

The intention of such regulatory requirements are to ensure that the licensing regime does in fact impose uniform and predictable minimum standards.

Though there is scope for Professional Standards schemes to co-exist with legislative

licensing regimes, in the case of a licensing standard as detailed and progressive as that contained in the Corporations Act, it may well be appropriate to consider the incorporation of an industry appropriate cap into the Corporations Act regime or a federal initiative which operates in conjunction with the existing licensing requirements.

Where a cap is imposed merely in the Corporations Act, it leaves open alternate and additional uncapped causes of action which would need to be addressed either through amending legislation or a separate federal scheme which imposes caps on alternate legislative, contractual and tortious causes of action. The breadth of services offered by the financial services industry suggests that a broad discrete scheme linked to both the Corporations Act licensing requirements and the ethical and prudential requirements of the various industry associations, may have significant merit, though relevant constitutional considerations would inevitably be an issue which would require substantial consideration. It is unlikely that the existing referral of powers in connection with the Corporations Act would be sufficient to enable the implementation of the relevant legislative provisions.

If the constitutional issues affecting the ability to introduce a cap on claims is considered to be presently insurmountable the FPA suggests that the government strongly encourage the development of Professional Standards Council limitations in all States to properly supplement a limitation incorporated into the Corporations Act. Consistent with the present regimes currently present in New South Wales and Western Australia, such a scheme should only be available to industry participants that are members of an association that supports the Professional Standards criteria. The Professional Standards model that would evolve is likely to exceed that which has been created under financial services reforms. The existence of the limitation cap to industry participants will result in industry voluntarily adopting higher standards of professionalism that is currently recognised as part of the financial services reform.

The FPA also favours limitations on the capping regime such that the exclusions for fraud and breach of trust are maintained in the public interest.

2.2 Open Market Professional Indemnity Insurance Cover

2.2.1 Background

"The (professional indemnity) crisis now looms as one of the biggest threats ever to the financial planning industry, with few left in any doubt that it will force some financial advisers out of business."[6]

Over the past decade the financial planning industry has grown at almost twice the rate of the Australian economy. The numbers of Australians whose personal wealth is now under the management of financial planners has increased exponentially and the demographic of financial planning clientele has changed significantly.

A Consumer Sentiment Survey conducted for the Financial Planning Association by RMIT University in May 2002 found that an increasing number of Australians are turning to financial planners as a principal source of financial advice. More than a third of those surveyed said they had used a financial planner.

Once perceived as available only to those with significant financial wealth, the industry has worked tirelessly to convince ordinary Australians of the importance of planning their finances. The Government has acknowledged that the adoption of financial planning and investment strategies by all Australians is one of the keys to reducing reliance on the age pension in the longer term. Consequently however, the perceived risk is higher. Unsophisticated investors are perceived as less likely to be able to make informed judgments as to their financial interest and rely almost entirely on their financial planner to direct their investments. Often, clients have moved out of the accumulation phase and are reliant on the investment income generated by their assets to fund their retirement. Financial loss for those clients has potentially more devastating consequences and the risk profile of the industry clientele has increased in line with the changing demographic.

There must be some recognition on the part of insurers that financial planners are required by law to understand the risk profile of their clients and take account of that profile in the provision of financial services.

There must also be a concerted effort to encourage insurers back to the financial services professional indemnity market.

2.2.2 Opportunities

(a) Commercial risk weighting

While mutual funds and similar industry wide arrangements apply limited risk weighting to premiums, commercial insurers are best placed to calculate and apply full risk weighting. This ensures that good risks are not forced to fund bad risks through higher than commercial premium rates.

Touted as both an advantage and a disadvantage, professional indemnity insurance purchased in a free and competitive market has the potential to force unsatisfactory participants from the market (most often when insurance is compulsory). While many argue that the disciplinary process should perform that role as opposed to the insurance market, others suggest that insurers are merely responding to the disciplinary process rather than initiating the elimination itself.

Ultimately, commercial risk weighting is the economic force by which insurance premiums will be re-established at reasonable and commercially acceptable levels.

(b) Risk Management Consciousness

Experience suggests that deregulation of insurance markets leads to broader cover, cheaper premiums and a higher level of service. It also suggested that a deregulated market has the capacity to encourage consciousness of risk management because of the risk rating mechanisms applied in a competitive market. Presently, however, overriding disillusionment with the apparent lack of consistency with which such mechanisms are employed is a disincentive to the implementation of such systems.

(c) Viability/Prudential Regulation

Despite recent high profile and significant failures, history has proven commercial insurers to have greater long term stability. There is a perception, both among industry and the public that mutual funds and other pooled arrangements are susceptible to poor management and fraud leading to a higher potential for such arrangements to fail.

Commercial insurers are prudentially regulated and subject to a higher level of monitoring and scrutiny. Prudential standards such as:

- Liability Valuation – to ensure reliable and consistent valuation of insurance liabilities, and promote the provision of actuarial advice to management and

Boards;

- Capital Adequacy – to ensure insurers maintain a minimum level of capital commensurate with the risk profile of their businesses;
- Reinsurance Arrangements – to ensure that an insurer has in place sound and prudent reinsurance arrangements;
- Risk Management – to promote strong corporate governance, access to appropriate independent expertise and systems for identifying, managing and monitoring risks;
- Transfer and Amalgamation of Insurance Business – to provide details on the requirements necessary to facilitate the transfer of business between insurers; and
- Assets in Australia – to define 'assets inside Australia' for the purposes of meeting the requirements of the *Insurance Act 1973*;

ensure that as far as regulatory standards allow, the interests of insureds and, ultimately those who suffer loss as a consequence of the actions of insureds, are protected.

2.2.3 Weaknesses

(a) Cost/Affordability

> ***"In the last 4 years, premiums have gone from $1,500 to $3,700 to $8,700 to $20,300 without any claim being received in the history of the organisation"***[7]

The FPA's recent insurance survey revealed that the average premium has increased 120% from 2001 to 2002. In addition, excesses have increased 119% from 2001 to 2002.

For many dealers/ licensees, premiums and excesses far exceed those average figures. In the case of some practitioners, excesses exceed the limitations, for example which apply to FICS determinations.

Practitioners have expressed the view that they are effectively self insuring given the low likelihood of claims exceeding the excess amount. That view appears to be warranted.

The public stands to be significantly disadvantaged where practitioners either reduce

their levels of cover in response to increased premiums or are unable to afford cover at market premiums, or are unable to meet excesses under their policies.

(b) Accessibility

While there is a perception that availability of insurance is simply a function of price, current experience suggests otherwise. It is the experience of a number of members of the FPA that insurers are simply declining to quote on professional indemnity cover.

While in previous years, the refusal of two or even three underwriters to quote was inconvenient, in a shrinking insurance market the consequences can be devastating, leaving practitioners with no alternative than to hand in their licence or operate without professional indemnity insurance. Neither outcome can be in the interests of the client public.

(c) Sufficiency/Adequacy

Insurers' refusal to provide run off cover (and the potential for the failure of an insurer during the run off period) places both industry participants and the public at a distinct disadvantage.

One of the main features of professional indemnity insurance is its long tail. Notwithstanding relevant statutory limitations, several years can elapse between the cause of action and the date the claim is brought. Most, if not all, professional indemnity policies are "claims made" policies meaning that cover is denied unless the claim is notified within the period of currency of the policy. Generally, while ever practitioners remain covered by the one insurer, no issue arises. The problem however has come to a head in the current insurance environment. With a significant number of insurers abandoning the financial services market, practitioners have increasingly found it difficult to continue cover with their existing service provider and have had to move to alternate underwriters.

The result is that any run off cover is lost and the claims brought after the change to the new insurer are not covered. In addition, new claims in respect of past activities may not be covered.

2.3 Statutory Indemnity/Fidelity Fund

2.3.1 Background

It has been suggested that either a fully underwritten or mutual indemnity fund would offer significant advantages to participants in the financial services industry and greater compensatory certainty to the public.

Both solicitors and barristers are required to hold professional indemnity insurance approved by the Attorney General. The insurer is not specified by the Bar Council or Law Society, however, all solicitors are required to contribute to the Solicitor's Mutual Indemnity Fund (SMIF) established under the Legal Profession Act 1987 and managed by LawCover Pty Limited (a wholly owned subsidiary of the Law Society of New South Wales). Law Cover arranges indemnity with insurers, administers underwriting and policy issues and manages claims on behalf of insurers and the SMIF.

The purpose of the SMIF is to pay the difference between the indemnity provided by an insurer to an individual solicitor and the amount of a claim made against the solicitor.

SMIF was established in 1987 as a mutual fund because of difficulties encountered by solicitors in obtaining professional indemnity insurance. It has considerable reserves, which are beneficially owned by members of the Law Society.

As a pre-requisite to holding a practising certificate, solicitors must also pay a contribution to the Fidelity Fund intended to compensate a person who suffers loss as a result of a failure to account or a dishonest default. The primary motivation behind the requirement to hold fidelity cover is that solicitors hold large amounts of money on trust as part of their practice and therefore the risk of pecuniary loss is greater. It is apparent that this situation is anomalous to the financial services industry.

Relevantly, the SMIF provides run off cover to practitioners who have ceased to practice.

The SMIF addresses a number of issues which currently exist in the competitive insurance market. Though Law Cover applies limited risk weighting, it does not exclude practitioners from cover in the way that a competitive insurance market might if it were to apply full risk weighting but cover is guaranteed and members of the public are assured of at least some security. Though some argue that the refusal of insurers in a competitive market to insure bad risk would have the effect of protecting the public from unscrupulous practitioners, the

converse argument is that a disciplinary system exists to protect the public (akin to the protection intended to be achieved through financial services reform) and that insurance should not be an instrument of excluding practitioners from practice.

A 1999 review of the Legal Profession Act uncovered widespread support both within the industry and externally, for deregulation of the market for professional indemnity insurance for solicitors subject to appropriate protection for clients being addressed through minimum standards for policies, run off and indemnity.

The final report concluded that compulsory professional indemnity insurance on terms approved by the Attorney General was a necessary safeguard to legal practice and in the public interest. The majority of respondents also supported continuation of compulsory fidelity cover because solicitors hold money on behalf of clients. It is suggested that the same rationale would apply to the financial services industry.

The FPA take the view that provision of a statutory fidelity/indemnity fund may co-exist with a robust professional standards model and underpinned by professional indemnity insurance. This provision would provide for a cascading consumer protection structure which begins with the assets of any respective business, followed by insurance and with a fidelity/indemnity fund as back up. A statutory compensation scheme may resolve some of the difficulties encountered by licensees in securing insurance for such things as run-off and defalcation cover.

2.3.2 Opportunities

(a) Provision of Run-Off Cover

Where an indemnity fund assures run off cover, the advantage which flows to both participants in the industry and consumers cannot be underestimated. One of the most significant disadvantages of an open and competitive market for professional indemnity insurance is insurers' refusal to provide run off cover (and the potential for the failure of an insurer during the run off period) which places the public at a distinct disadvantage.

Many, argue that the failure of an insurer is not something compensation arrangements should attempt to protect against - this is the role of prudential regulation and not every contingent risk can be covered.

(b) Certainty of Cover

In a market where so many participants are struggling with difficulty obtaining cover, it is suggested that a fund that ensures coverage to all participants is of significant advantage to the industry. This advantage may, however come at the cost of increased premiums for many and decreased professional standards. This negative impact is considered in greater detail below.

2.3.3 Weaknesses

(a) Competition Policy

Where participation in an indemnity fund is legislated, competition policy issues arise. Guidelines for review of legislation are specified for compliance with the Competition Principles Agreement. This issue is addressed in greater detail below.

(b) Limited Risk Weighting

Though indemnity funds generally offer limited risk weighting based on claims history and/or the size of the organisation, the lack of truly tailored risk weighting is an indicator that good risks are being forced to cover poor risks which might otherwise be forced out of a competitive market.

(c) Risk Management Disincentive

It has been suggested that a consequence of there being only limited risk weighting is that participants in the fund are less likely to consider risk management policies important. In order to avoid this disincentive, it is essential that risk weighting take account of risk management strategies implemented by participants.

2.3.4 Conclusions

While at first glance, mandatory participation in a national mutual fund or any statutory indemnity fund might appear to resolve many of the problems which have recently plagued the commercial professional indemnity insurance market, the additional issues it raises are many, and would need to be addressed.

In the first instance, National Competition Policy issues must be addressed. Broadly, National Competition Policy and associated agreements provide that legislation should not restrict competition unless it can be shown that:

- the benefits of the restriction to the community as a whole outweigh the costs, and
- the objectives of the legislation can be achieved only by restricting competition.

Even if legislation does not restrict competition, consideration needs to be given to whether its objectives can be achieved by better means.

Perhaps the most relevant indication of how such a legislative restriction would be viewed is the recent National Competition Policy review of the Legal Profession Act which

recommended that a deregulated insurance market would provide adequate protection to the public provided that adequate safeguards were developed dealing with the minimum terms and standards, consistent with the policy being offered by LawCover.

While a fund maintained by a representative body would ensure cover. It would not necessarily ensure lower premiums.

It is essential that industry, consumer representatives and government set in place the scope for any such scheme. The provision of a statutory compensation fund will require the financial planning profession to devote a significant chunk of its resources to its application, hence the FPA takes the view that a process of in-depth and comprehensive analysis needs to take place. This process must provide answers and possibly determine:

- Its cost?
- Burdens?
- Who runs the statutory fund/scheme?
- How is it funded?
- Caps on compensation?
- Do responsible entities have to be members?
- What is acceptable loss?
- Does it cover advice failure?

The FPA recognises the importance of this layer of cover, however, before supporting such a proposal, there needs to be a comprehensive 'regulatory impact statement' which provides clarification to the points above. Likewise, we believe that there needs to be a thorough 'cost – benefit' analysis which investigates the provision from a consumer and industry point of view.

2.4 Security Bond

2.4.1 Background

Largely viewed as a leftover from prior regulatory regimes, in its current form and having regard to the insufficiency of the amount currently required to be lodged, it is clear that the growth of, and developments in, the financial services industry have rendered the security bond significantly less relevant to both consumers and industry participants.

2.4.2 Opportunities

(a) Accessibility

The bond is relatively easy for consumers to access and provides a certain source of funding of clients' loss.

(b) Familiarity

Practitioners are familiar with the requirement to provide the bond and

2.4.3 Weaknesses

(a) Insufficiency

The amount of the bond is not referrable to any objective measure of a client's potential loss or damage and at present the amount of the bond is insignificant when compared to the potential size and number of claims against practitioners.

(b) Administration Costs

The cost to ASIC of administering the lodgement and release of the bonds might be better utilised in connection with compensatory regimes which provide greater sufficiency of compensation to the public.

(c) No Deterrent Effect

The relatively insignificant amount of the bond and the prospect of having the bond attached does not provide a significant deterrent effect nor any real incentive to practitioners to implement stringent risk management systems given that the implementation of such systems does not have any impact on the amount practitioners are required to secure.

(d) Barrier to Entry

The implementation of a revised security bond will in affect act as a de facto 'capital

adequacy regime'. This will act as a mechanism which causes otherwise viable small businesses from either entering or forcing their exit from the market.

2.4.4 Conclusion

The current security bond requirement should be abandoned in favour of alternative arrangements which are likely to be of greater compensatory value to the consumer.

It is the view of the FPA that the value to the consumer of a modified security bond approach would be off-set by the cost to both industry and government in the administration and maintenance of it. It is recommended that the security bond be abandoned at the same time as the adoption of an adequate compensation arrangement.

2.5 Alternative Options

2.5.1 The Financial Industry Complaints Service

While the existence of an external dispute resolution scheme is considered to be an integral part of an efficient, professional and maturing financial services industry, there are some aspects of the operation of the service which must be addressed in the context of encouraging insurers to return to the market practitioner confidence in the service's operations.

There has been some suggestion that one of the options being reviewed in connection with the current reviews of FICS is an increase in the jurisdictional limits of the service. It is submitted that any increase in jurisdictional limits without reforming the rights of appeal from a determination of the service would discourage insurers from providing insurance to participants and/or from providing the relevant policy endorsement in respect of FICS determinations, thereby significantly undermining the very intent of an external dispute resolution system. If this were to occur, there would be no adequate compensation available to consumers from a complaint reviewed by FICS. The FPA submission to the Review of the Financial Industry Complaints Service is contained at Appendix "C".

It is suggested that the FICS rules be amended to allow a right of appeal by the practitioner from a determination. The experience of the Superannuation Complaints Tribunal is instructive. That Tribunal seeks to employ an ADJR approach to any superannuation complaint brought before it. FICS adopts a similar approach. Were the ADJR approach fails, the Superannuation Complaints Tribunal will rule upon the issue and the superannuation fund trustee is bound by the decision. However, human nature dictates that errors can occur. The appeal procedure from the Tribunal allows participants to be more confident in the result of any decision. The appeals also provide guidance to the Tribunal members on the various issues that are brought before them from time to time.

Similar to Superannuation Complaints Tribunal, the FPA would like to see rights of appeal on matters of law available to the consumer as well as industry participants from a FICS decision.

Adversarial proceedings provide an important check on the rights of participants in a dispute. Where participants in the resolution process are not represented by legal counsel and formal rules of evidence do not apply, the process is necessarily less sound and the decisions less defensible. These shortcomings are justified in the context of the cost savings and the other benefits which flow from such systems, however it appears at present that those advantages

are being eroded by a system which is becoming increasingly unsupportable and of increasingly less value to participants, particularly where determinations cannot be met by the respondent.

It is submitted that the informality of the external dispute resolution system does not support higher jurisdictional limits and that larger claims should be brought in an alternate forum such as a Court of law in which the adversarial process is more stringently regulated, open and subject to appropriate review.

Of significant concern is the presumption on the part of the public that FICS offers a free and simplified means of obtaining restitution for their loss. What the public does not appreciate and what any compensation regime must address is that while the determination process may be simplified, that very process may deny the practitioner indemnity under their policy leaving the consumer without a source of funds to meet the determination in their favour.

The primary aim must be to close the expanding gap between this system of determination of liability and the compensation mechanisms which underpin the industry.

2.5.2 Government Owned Insurance Companies

The establishment of Government owned and operated insurance companies would increase the capital in the insurance market, however would be inconsistent with the trend toward privatisation of Government owned instrumentalities and would be unlikely to receive widespread support.

2.5.3 Government Guarantees

It has been suggested that the Government guarantee the entitlements of the public in a manner similar to recent government guarantees of long service leave and superannuation entitlements following corporate collapses. It is suggested that a Government guarantee of statutory entitlements can be contrasted with guarantees in relation to the investment returns or even the capital of those investments.

It is not envisaged that this suggestion would receive widespread support.

2.5.4 Underwriting Pool for Particular Risks

If public policy indicates support for particular investment strategies which remain unattractive to commercial insurers, for example margin lending, Governments might

consider establishing an underwriting pool to cover losses resulting from participation in such strategies.

It is submitted that robust investment by the Australian public is vital to the existing. Government policy of reducing reliance on the old age pension and other government funded arrangements. In this context, Government support of otherwise unsustainable investment initiatives might be workable.

2.5.5 Legislative Amendment

The Government may consider supporting amendments to the Insurance Contracts Act to require insurance companies to charge premiums that take into account the prospective insured's risk management practices and claims history. Clarification that the duty of utmost good faith requires insurers to take appropriate care when pricing risks would encourage them to take account of such matters and reflect appropriate management practices in their premiums. This in turn provides appropriate incentives to insured's to implement good risk management strategies in their businesses.

2.5.6 Fidelity Levy

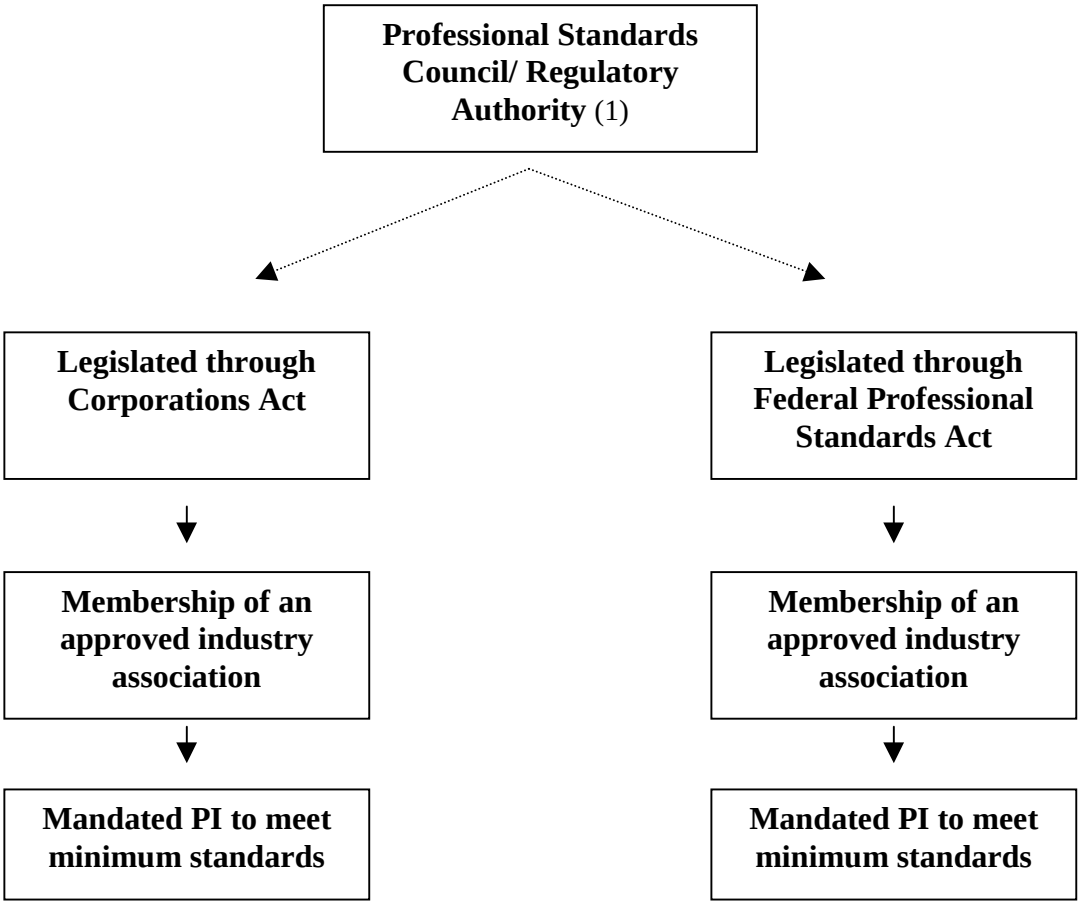
Currently the Superannuation (Financial Assistance Funding) Levy Act provides that if the Minister makes a determination under Part 23 of the *Superannuation Industry (Supervision) Act 1993* to grant financial assistance to a superannuation fund, the regulations may impose a levy or levies on each fund other than the first-mentioned fund or another fund in respect of which such a determination was made in the same financial year.

It may be advantageous to have included in the Corporations Act, a power vested in the Minister to impose a similar type of levy on licensees or classes of licensees in circumstances where the public interest arguments in favour of the imposition of such a levy are particularly persuasive.

If it is considered that this approach has merit, the FPA suggests that substantial research and further analysis will be needed before it could be incorporated in to any adequate compensation arrangement. Accordingly, the adoption of a fidelity levy should not be currently considered.

3. RECOMMENDATIONS

3.1 Professional Standards with Professional Indemnity Insurance (Basic Model)



(1) A body similar in approach and concept to the Professional Standards Council could be established to oversee, monitor and review industry participants in relation to their professional standards either under the auspices of ASIC, or independently, but recognised by ASIC.

The review of adequate compensation arrangements gives the financial planning community an opportunity to establish such a scheme purely for those operating under Chapter 7 of the Corporations Act, however, from a cost efficiency perspective, the govt could consider such a scheme for auditors (CLERP 9 review) and other professionals.

(2) In order to receive the benefit of the scheme, participants would have to demonstrate

membership of an approved industry association that was monitored by the Council/Regulatory Body.

The Corporations Act might contemplate the Regulations recording approval of relevant associations which would have to comply with certain minimum requirements including:

- that they have an approved Code of Ethics/Rules of Professional Conduct by which members are bound
- enforcement of that code through a disciplinary process;
- they have mechanisms in place to ensure member compliance with the code
- that members have effective IDR systems established
- that members were also members of an ADR scheme to which the industry is affiliated

Whilst it may be open for an organisation that can demonstrate that it satisfies minimum requirements to also come within the scheme, it is suggested that the scheme only operate through recognised associations to ensure a consistency of standards.

(3) Professional indemnity insurance satisfying minimum standards would be mandated under the relevant legislation but at a minimum should require:

- **minimum cover of $1 million for any one claim;**
- **$2 million in the aggregate, but not less than 50% of estimates gross income from financial planning and advising.**
- **maximum excess of 25% of current net tangible assets;**
- **run off cover for a minimum period of 3 years.**
- **coverage for:**
  - **loss of documents;**
  - **libel and slander;**
  - **fraud and dishonesty;**
  - **Trade Practices Act and Fair Trading Act breaches; and**
  - **FICS determinations up to the maximum jurisdictional limit**

The prescription of the above limits are based on the optimum coverage that the insurance market can deliver at an affordable price.

The FPA is mindful of the fact that the professional indemnity insurance market is currently enduring a so-called 'hard market', and what seems to be realistic now may not be so in the short to medium term future. As such, we stress that the FPA's minimum professional indemnity insurance standards are based on market tested standards which are efficient, realistic and affordable.

(4) ASIC policy statements and other legislative initiatives could be brought together under the professional standards umbrella as a part of this approach including:

- approval of industry codes;
- implementation of internal dispute resolution mechanisms within licensee organisations;
- membership and regulation of external ADR schemes; and
- licensing obligations.

In order for this model to work efficiently, insurers must be encouraged back to the market to facilitate stabilisation of premiums. This is one of the particular strengths of a professional standards model. As participants are required to adopt risk management and operational standards aimed at minimising systemic weaknesses in the financials services process, insurers may be more comfortable with the level of operational risk.

3.2 Alternative/Complementary Models

3.2.1 Professional Standards with Alternate Indemnity Sources (Statutory Indemnity/Fidelity Fund)

As an adjunct to the requirement to hold professional indemnity insurance in accordance with option 3.1, an indemnity fund or national guarantee fund, the operation of which is monitored by the Council as well as the industry body itself may offer alternate sources of indemnity proceeds. It is suggested that allowing some flexibility as to which mechanism is adopted will better satisfy the needs of a diverse and multidisciplinary industry.

However, the FPA is unable to conclude that we support this provision as we are yet to ascertain vital details including:

- Its cost?
- Burdens?

- Who runs the statutory fund/scheme?
- How is it funded?
- Caps on compensation?
- Do responsible entities have to be members?
- What is acceptable loss?
- Does it cover advice failure?

The FPA recognises the importance of this layer of cover, however, before supporting such as proposal, there needs to be a comprehensive 'regulatory impact statement' which provides clarification to the points above. Likewise, we believe that there needs to be a thorough 'cost – benefit' analysis which investigates the provision from a consumer and industry point of view.

The FPA suggest that a regulatory and financial impact statement be completed in line with ASIC Regulatory Impact Statement standards which includes identifying:

- Issue/problem
- Objectives/analysis of the problem
- Options/solutions
- Impacts analysis (costs and benefits) of each option
- Consultative process
- Implementation and review

The FPA will only be able to commit itself to a possible statutory scheme once the above has been provided for.

3.2.2 Security Bond Fidelity Extension

The FPA takes the view that the provision of a security bond fidelity extension is a blunt and ineffective compensatory tool. It will potentially prevent viable licensees from operating due to the large sums of money which they would be expected to set aside.

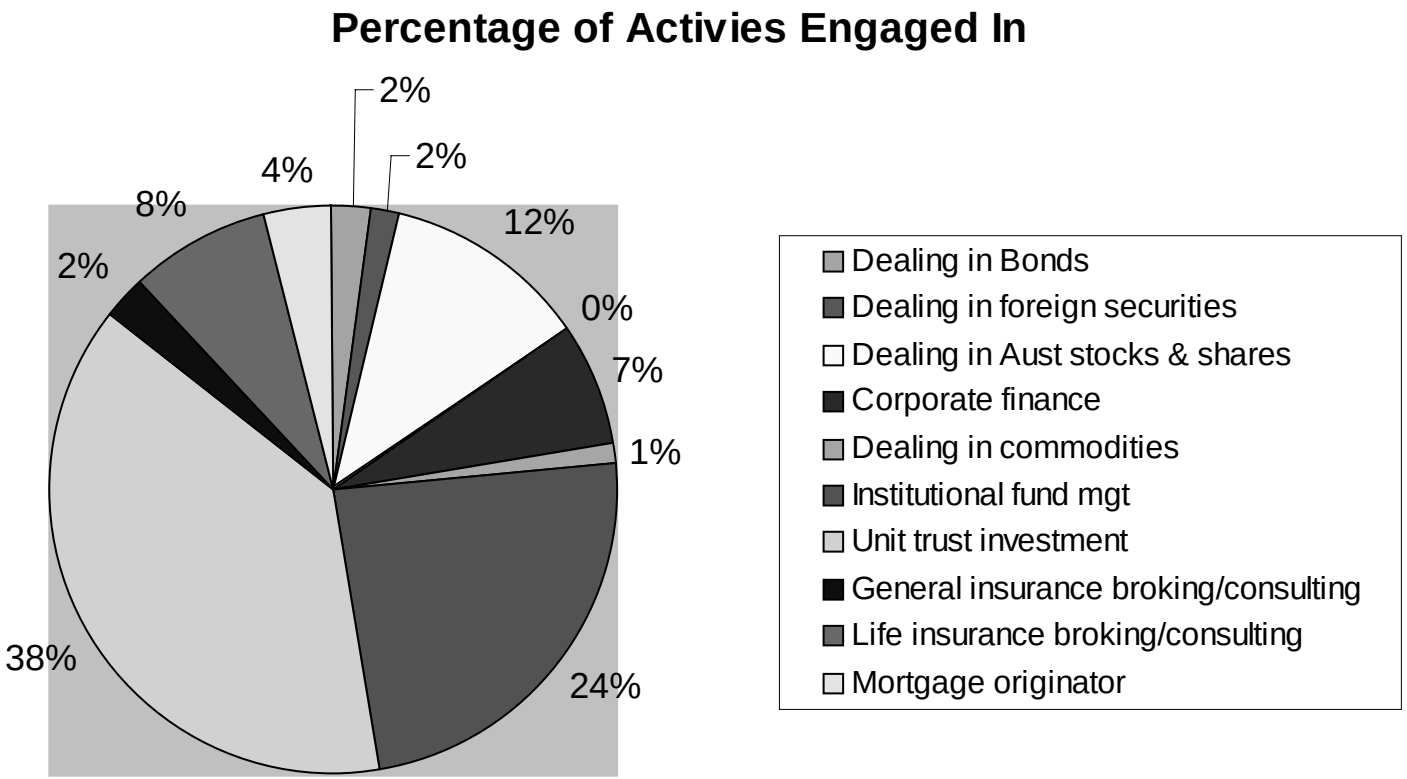
This measure will affectively act as a capital adequacy regime and hence placing ASIC in the position of prudential regulator.

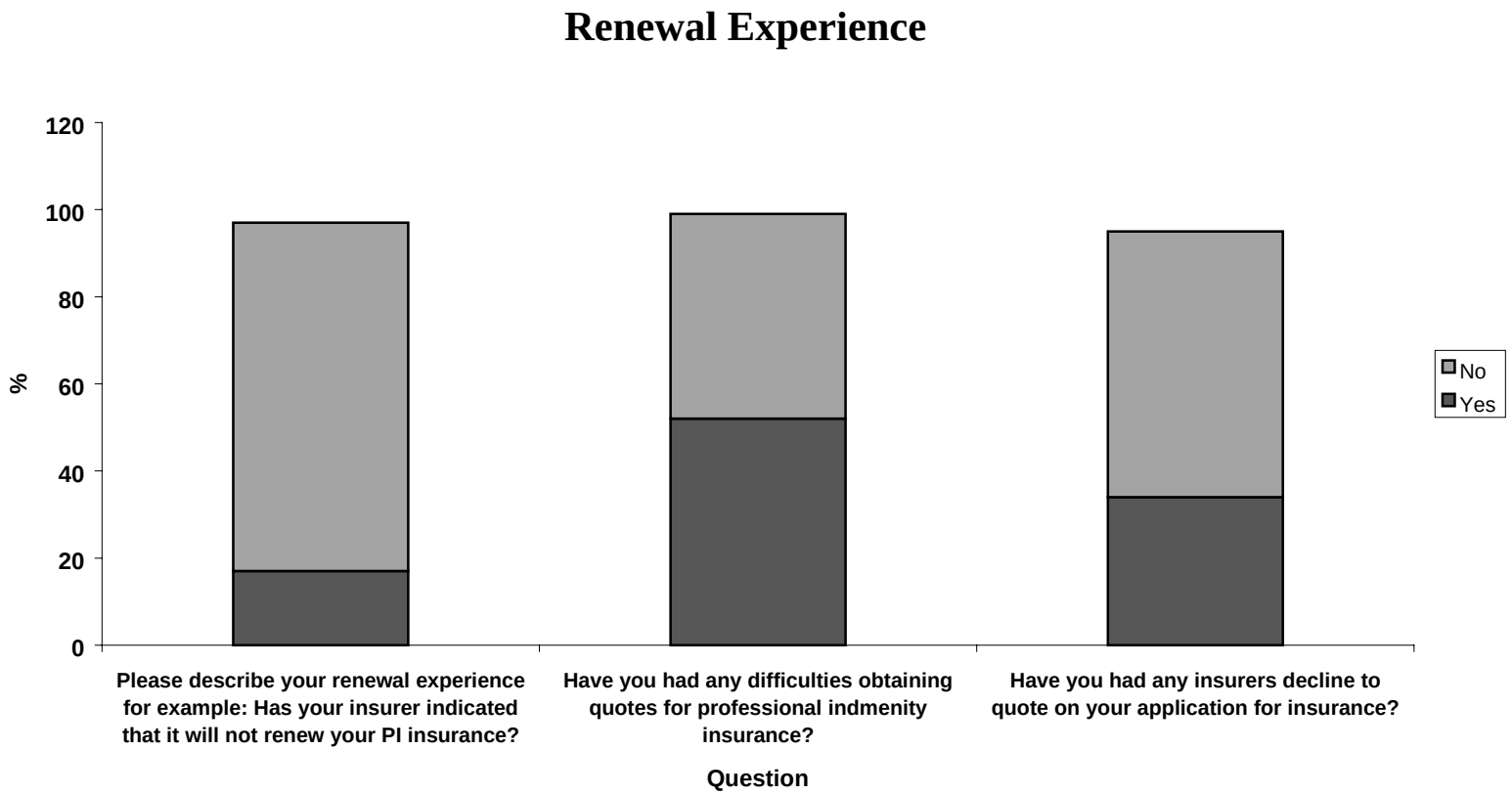
The FPA takes the view that the security bond provision should be all together scrapped once an adequate compensation arrangement mechanism has been put into place.

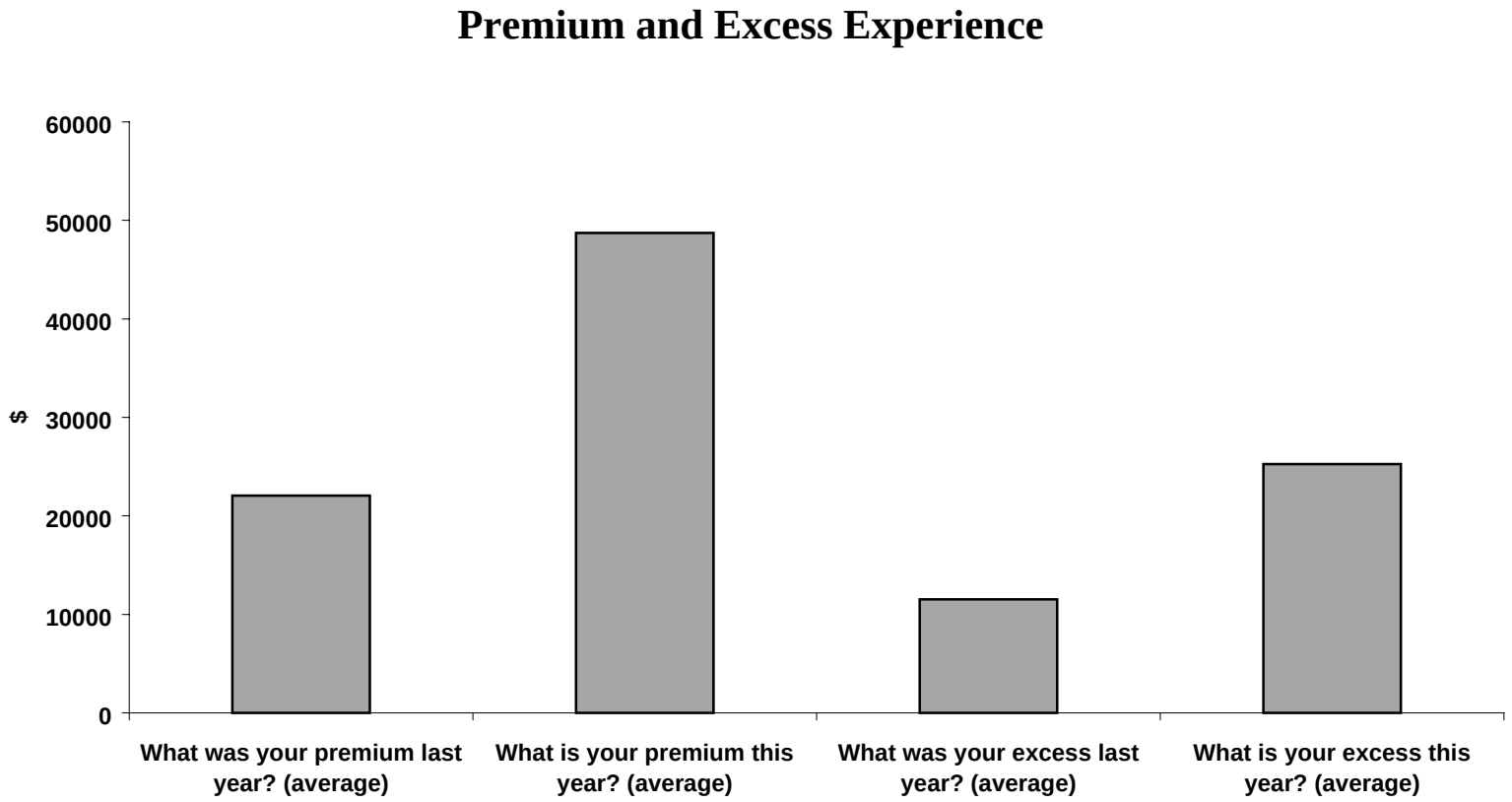
3.2.3 Fidelity Levy Extension

The FPA recognises that a power vested in the Minister to impose a levy on licensees or such classes of licensees as determined by the Minister, in circumstances where the public interest demands it may have some potential advantage to the investing public. However, the FPA does not believe that this is an efficient mechanism for an adequate compensation regime as its boundaries are undefined and too exposed to political discretion and judgement.

APPENIDIX "A" SURVEY RESULTS




Renewal Experience
120
100
80
60
40
20
0
%
No
Yes
Please describe your renewal experience for example: Has your insurer indicated that it will not renew your PI insurance?
Have you had any difficulties obtaining quotes for professional indmenity insurance?
Have you had any insurers decline to quote on your application for insurance?
Question


Premium and Excess Experience
60000
50000
40000
30000
20000
10000
0
$
What was your premium last year? (average)
What is your premium this year? (average)
What was your excess last year? (average)
What is your excess this year? (average)

APPENDIX "B" INDUSTRY EXPERIENCE

FPA SUBMISSION TO THE
SENATE ECONOMICS REFERENCES COMMITTEE ON

PROFESSIONAL INDEMNITY INSURANCE

14 May 2002

FPA submission for the

Senate Economics References Committee on

Professional Indemnity Insurance

13 May 2002

EXECUTIVE SUMMARY

- The Financial Planning Association of Australia Ltd (FPA) is the peak professional organisation for the financial planning industry in Australia with over 14, 500 members handling the financial affairs of over 5 million Australians with an investment value of more than $630 billion.
- Problems with Professional Indemnity (PI) insurance are a leading concern for the Financial Planning Industry, Financial Planning Association Members, the community and the economy.
- FPA principal members have recently experienced difficulties with obtaining PI cover.
- Current legislation requires members who have an Insurance Brokers License to obtain PI insurance. The Insurance Agents and Brokers Act 1984 requires Insurance brokers and agents of unauthorised foreign insurers to have insurance covering breach of their professional duty as an insurance intermediary. It is an offence to trade without PI insurance.
- The Financial Services Reform Act (FSRA) requires Australian Financial Services Licensee applicants to certify that they currently have, and will maintain compensation arrangements that will comply with FSRA. PI insurance is commonly used by dealers to satisfy this "adequate financial compensation" requirement.
- FPA Principal members have experienced steep rises in PI insurance premiums, some up to 1000%. The financial imposts these marked increases place on our members will see a significant number of small financial planning businesses go out of business or reduce the services they can provide to their clients.
- Members are continually being exposed to increased levels of commercial risk through increased policy exclusion clauses (ie. Exclusion of margin lending products, direct share advice, tax effective schemes, some superannuation funds)
- A survey of FPA Principal members in 2000/01 showed that there were 23 PI insurance underwriters. The number of underwriters in the market providing PI insurance has dropped to 8 insurers, of whom only four currently write financial planning business.
- Restriction of services, and specific product exclusion clauses leaves consumers with a limited range of financial products.
- Lack of protection against firms who continue to offer services but 'go bare' ie. Divest their assets and work uninsured.
- The FPA is happy to explore the contents of this submission with Committee members at any public hearings that they wish to convene.

1. INTRODUCTION

1.1 The FPA

The Financial Planning Association of Australia Ltd (FPA) is the peak professional organisation for the financial planning industry in Australia. With over 14,500 members through a network of 31 Chapters across Australia, and a state office in each capital city, the FPA is the only organisation, which represents qualified financial planners who mange the financial affairs of over five million Australians with an investment value of more than $630 billion. The FPA represents the views of the industry to key decision makers including government and media. Established in 1992, the FPA promotes improved quality of financial advice for consumers, and high standards of ethical and professional behaviour among its members.

The FPA's membership consists of companies and individuals who practise within or support the financial planning profession. The increase in size and stature of the FPA in recent years reflects the rapid growth of the international financial planning industry. FPA membership coverage is approximately 75% of the Financial Planning advisory community.

In addition to those who have trained and practised within the financial planning industry, many FPA members are specialist professionals such as accountants 14%, stockbrokers 12%, banking 5%, legal 2% and life insurance 56%. These members are now gaining qualifications as financial planners, and are reorienting their businesses to meet the growing market need for broadly based financial planning.

Principal Membership of the FPA is open to companies or individuals who hold a Securities Dealers or Investment Advisers licence issued by the Australian Securities and Investments Commission (ASIC), pass rigorous pre-admission standards, and agree to minimum educational standards for all those to whom they delegate the authority of their licence (known as Proper Authority Holders).
The FPA is concerned in particular about the impact professional indemnity insurance is having on small business, such as our Small and sole operator Principal Members. These businesses represent approximately 76% of Principal Membership of the FPA.

1.2 The Financial Planning Industry.

At the licence level, the size of businesses within the industry varies from the large players such as AMP, MLC & AXA and the four major banks, to the small boutique operator. There are approximately 1,500 licensees currently registered with ASIC and providing financial planning advice. Of these, 75% to 80% are classed as small businesses that employ less than 15 people.
At another level there are approximately 15,000 representatives whose conduct is the responsibility of the licensee, but who operate within their own independent business structures and who are sometimes required to obtain professional indemnity cover of their own. These representatives are scattered across Australia covering both metropolitan and regional areas.

2. THE LEGISLATIVE FRAMEWORK

The financial planning industry (refers to who currently hold a Securities Dealers or Investment Licence from ASIC and their Authorised Representative) has always played a leading role in ensuring its members maintain Professional indemnity insurance whether or not it has been a legislative requirement.

2.1 Insurance Agents and Brokers Act 1984

As previously indicated 56% of FPA Principal members provide life insurance products to clients.
The IABA requires Insurance brokers and agents of unauthorised foreign insurers to have insurance covering breach of their professional duty as an insurance intermediary. It is an offence to trade without Professional Indemnity insurance.

Registration cannot be granted or renewed unless satisfactory evidence of professional indemnity insurance is provided.

The level of cover that ASIC stipulates under the Insurance Agents and Brokers Act is A$1million, or 15% of Premium income in the previous financial year, whichever greater. The maximum required cover is A$5million.

2.2 Licensed Securities Dealers

During the early 1980's it was industry practice that the principal held a securities dealers licence and the representative held a 'dealers representative license'. It was also industry practice that both parties hold professional indemnity insurance cover, whereas now the onus is on the licensed dealer to hold the cover, although authorized representatives still actively carry their own personal cover as an arrangement or condition of their proper authority.

Despite these arrangements s817 of the Corporations law states that the principal is liable for the conduct of the representative 'in the same manner and to the same extent, as if the principal had engaged in that conduct itself'.

To date there is no statutory requirement for a securities dealer to carry professional indemnity insurance, unless ASIC insist on this as a condition of the licence.

2.3 Financial Services Reform Act (FSRA)

The FSR Bill is to replace a range of existing regulatory requirements including:

- Chapters 7 and 8 of the proposed Corporations Act
- The Insurance (Agents and Brokers) Act 1984
- Aspects of the Superannuation Industry (Supervision) Act 1993 and the Retirement Savings Account Act 1997 and regulations and the Insurance Act 1973
- Aspects of the Banking (Foreign Exchange) Regulations

Consequently the following classes of financial advisors will for the first time operate under a single licensing and disclosure regime:

- Security Dealers And Investment Advisors (Financial Planners);
- Futures brokers;
- Life and General insurance companies;
- Superannuation funds;
- Life and General Insurance brokers;
- Deposit taking institutions; and
- Their Agents and employees.

Under FSRA, holders of an Australian Financial Services Licence ("AFSL") are required to have adequate arrangements for compensating retail clients for loss or damage suffered by those clients because of breaches of the relevant obligations of the Licensee under the legislation. The adequate compensation arrangements must meet the requirements as specified in the Regulations to the FSRA and be approved in writing by ASIC (S.912B). It is not clear at this stage whether professional indemnity insurance will form part of these arrangements in relation to securities dealers. As at the date of this submission the FPA awaits the issues paper on "adequate compensation arrangements" from Treasury, which is due in June 2002.

However during the two-year transitional period prior to the full introduction of the FSRA, ASIC has stated that it will continue the existing requirement for responsible entities to maintain professional indemnity insurance as required by ASIC Policy Statement 131. Furthermore, under Regulation 10.2.44 the requirements of the IABA for persons carrying on business as an insurance broker or as a foreign insurance agent, to have adequate professional indemnity insurance will continue to apply during the two year transitional period to persons who hold an AFS licence authorising those activities.

ASIC has also released a list of Pro Forma licence conditions that may be endorsed upon an AFSL. One of the potential conditions which ASIC may impose in individual circumstances is that the holder of an AFSL when so required by ASIC in writing maintain a policy of professional indemnity insurance which conforms with the specifications set down by ASIC.

2.4 FPA Requirements for Members

The FPA has set minimum requirements for each principal member in relation to professional indemnity insurance cover. It is a condition of principal membership that these requirements be met for admission to membership. Rule 128 of the FPA's Code of Ethics and Rules of Professional Conduct states that a Principal Member shall effect and maintain professional indemnity insurance in accordance with the requirements. The FPA believes these minimum requirements provide comprehensive cover and protects Consumer in relation to redress against members.

Each Principal 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 the following minimum requirements as follows:
Minimum limit of indemnity:

- $1million for any one claim;
- $3million in the aggregate, but not less than 50%of estimated gross income from financial planning or advising
- A maximum deductible (excess) of not more than 25% of the current surplus liquid funds or net tangible assets as defined in the licence held by each member.

2.4.1 Policy Extensions:

- Loss of documents
- Libel and Slander
- Fraud and Dishonesty
- Trade Practices Act and Fair Trading legislation
- Retroactive cover
- Intellectual Property - for any breach of trust, breach of confidentiality, plagiarism or infringement of copyright, trademark or registered design or patent.
- Fidelity - against all monetary loss incurred through fraud or dishonesty
- Run Off Cover - to cover claims made after a planner has ceased to practice for whatever reason.

Principal Members are also required to have their policies endorsed in relation to cover for payments of awards and settlements under the Financial Industry Complaint Service, the approved external complaint resolution scheme for financial planners. That endorsement is to be in 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 the Financial Industry Complaint Service. 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."

Variations to the minimum requirements can be authorised by the Chief Executive Officer on written request and policies must be endorsed at least from the date of approval of Principal Membership.

The FPA will be submitting to both Treasury and ASIC that Professional Indemnity insurance should form part of the framework for adequate compensation arrangements under FSRA given it is a primary consumer protection mechanism. Irrespective of the future legislative requirements

placed on membership the FPA will continue to insist on Professional Indemnity cover as a condition of principal membership.

3. ISSUES

In particular, the FPA is concerned with the significant change in the PI insurance market. There has been reduced capacity and competition in the Australian market for the risk portfolio of professional indemnity cover for financial planners. The majority of insurers have exited the market in the last twelve to eighteen months, and those remaining are now seeking premium increases and applying policy restrictions. In the current market, premium increases and whether or not insurers will offer cover at all are among the biggest concerns.

3.1 Premium Increases

During the March 2002 renewal cycle FPA members experienced significant increases in professional indemnity quotes. These ranged anywhere from a 30% increase to a 1000% increase in premium.

A number of examples demonstrate the inconsistencies in pricing experienced in the current market even for dealer groups who have experienced no claims or change to their risk status from one premium year to the other.

One medium sized organisation with a premium of $20,790 in 2001, received renewal quotes of $59,300 and $74,000 from two different insurers in 2002. Another medium sized principal paid $6,000 in 2001 and received a renewal notice from the same underwriter for $66,000. That member was then able to find terms through another underwriter for $30,000.

Another example relating to small business concerns a member who paid $4,268 in 2001 and received initial renewal quotes of $10,500 and $14547 from one broker. Another small principal paid $4300 in 2001 and received terms from one broker of $15,413 and $20322.

Smaller dealer groups are even more premium sensitive given the impact on expenditure within a small business that a substantial premium increase can have.

3.2 Exclusions

There has been a major movement in the current underwriting market towards Restricted cover through revised or narrower policy wordings. Coverage is being increasingly restricted with respect to policy wordings and endorsements as well as the introduction of new exclusions. This is having a major impact on the ability of small business to effectively compete and may have greater implications for national savings as a whole, which will be explained in more detail later. Some of the more common exclusions are listed below, all of which were not in insurance policies of recent years.

Direct share advice and margin lending strategies.

Some policies are excluding claims relating to advice in direct shares or margin lending activities.

Product List Disclosure

Some Policies exclude any claim directly or indirectly related to, financial product and/or financial investment unless it is an Approved Product and/or Financial Investment which has been agreed and noted by the Insurer.

Tax Implications advice exclusion

Excludes liability for claims relating to the taxation implications of investments.

Superannuation Products

Excludes any claim and/or circumstances arsing from, or related to the collapse and/or liquidation of ANY Superannuation Fund.

Investment fluctuations exclusion

Excludes liability for claims arising from the depreciation of an investment, including securities, commodities, options and futures, as the result of any guarantee provided by the insured as to the performance of any such investments.

The main concerns include the sheer number and breadth of the exclusions. Further, as financial planners have claims made policies, these exclusions will have a retrospective effect in that they will exclude claims for advice already given in these areas.

One effect of these restrictions on cover will be that the choice and availability of service providers will become restricted, as firms increasingly restructure to accommodate the insurance policies terms and conditions and restrictions on their ability to give advice.

3.3 Impact in Specialist Areas of Service Provision

A range of specialist services offered by Financial Planning members, particularly from boutique type smaller businesses, which use 'innovative products classes' such as Tax effective schemes, negative gearing strategies, direct share investment; have attracted major difficulties regarding PI insurance.
These "product classes" are deemed to be 'high risk' by the insurance industry and have attracted high insurance premiums and excesses or encounter complete refusal of insurance cover.

Many financial planning firms using these 'product classes' will be forced to discontinue business or diversify into other lower risk and traditional 'product classes', leading to the loss of intellectual capital, specialist skills, product innovation, experience and services to Australian industry and the community.

Ultimately, the exclusion clauses are prescribing the investment strategies and product lists that financial planners will be using, and more importantly that consumers have access to.

3.4 Endorsements

FPA Principal Members are required to have their policies endorsed for payments of awards and settlements under the Financial Industry Complaint Service, the approved external complaint resolution scheme for financial planners. The role of the FICS scheme is to resolve complaints brought by consumers against members for amounts up to $100 000.

There are concerns that insurance premium increases together with exclusions will see the demise of such a facility. The FPA sees such an endorsement as fundamentally underpinning

the FPA's commitment to externally approved ADR schemes under ASIC policy. The lack of cover for such schemes, if that were to occur would lead to consumers being at risk of effectively being able to access redress.

3.5 Excesses

There is a push towards small business taking greater excesses to reduce the impact of premium increases. The effect of this is to leave small business more exposed to meeting claims made against the business. For example, one FPA member increased their insurance excess to $50,000 in order to make the insurance premium affordable. Whilst this is outside the FPA minimum requirements, it highlights the desperation of some to achieve affordable cover.

Anecdotally, the average excess has increased this renewal period from $2000 in 2001 to $10,000. The FPA is concerned that increased commercial risk coupled with increased Professional Indemnity insurance premiums will lead to the closure of small financial planning businesses
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3.6 Turn around of renewal notices and quotes by the insurance industry

The experience has been that renewal notices are not being served until one week to two days before cover expires. In addition, quotes in relation to renewal are then taking up to three weeks and sometimes longer. This leads to uncertainty, the need to negotiate short-term extensions at the last minute to ensure interim cover, and gaps in cover. This has compounded the stress placed on small business operators especially given the risks of claims exposure during these periods. Moreover, some members are forced to take out policies which are "pay by the month" to ensure that they have some type of coverage in place until they are able to find a suitable replacement policy.

3.7 Lack of a universal policy for Financial services participants

Underwriters continue to write policies based on product differentiation despite the fact that FSR has standardised products into service, being advice. Current standard policies do not look at business risk as a whole, despite the fact that under FSR a small business can be licensed to give advice in a broad range of areas and products. Small business can and often do structure their businesses to provide advice in a range of areas such as financial planning, accounting, life and insurance products. However currently, for example, an accounting practice that is also a licensed securities dealer and licensed life broker, may have to take out two, three and more policies just to cover all areas of their business.

The FPA believes there is scope in the professional indemnity insurance market for a policy that will cover AFSL recipients and pool risk differently in this respect.

3.8 Stamp duty

Stamp duty on increased premium is a windfall for State Governments. A reduction in stamp duty on professional indemnity insurance in the short-term small business some relief from the significant premium increases. This would be similar in intent to the hardship package relief granted by the Federal Government to small business last year with the HIH collapse.

4. OTHER IMPACTS ON INDUSTRY

a) It creates Barriers to entry to new licensees

b) It may force small business out of the industry due to the increased risks and costs associated with professional indemnity insurance, and the inability to offer traditional services due to restrictions on cover, or

c) A higher concentration of market providers

As smaller players leave the profession the consumers will be faced with less choice and required to seek advice from larger dealers, unlicensed operators or those prepared to wear the risk to access higher risk products. The impact is more likely to be a more highly concentrated industry accessing low risk product.

d) Is this in the public interest or to the public benefit?

Financial Planning advice does not merely redistribute wealth from one group of Australians to another. Quality financial planning advice acts to enrich the nation as a whole in the following ways:

Firstly, by shifting individuals from portfolios with less than optimal risk/return trade-off to portfolios closer to the optimal; Secondly, if the population as a whole is notably risk averse, good advice may also add to the national income by moving Australians along the risk/return trade-off in favour of greater returns.

A healthy financial planning sector benefits the Australian economy by raising the investment returns of the household sector. More broadly, a healthy financial planning sector boosts real wages, business investment, the Australian dollar and national savings, while easing the pressure on both interest rates and the current account deficit.

The marked increases in insurance premiums will also have to be covered by financial planners. In all likelihood, as with any business facing increased costs, these costs will be passed on to the consumer.

e) Consumer protection/redress issues

The Government has spent five years establishing the Financial Services Reform Act, which is fundamentally underpinned by consumer protection mechanisms. Those reforms could be undermined by the impact of the pressures on small business in relation to professional indemnity insurance.

The Australian community will suffer as consumers will have limited choice of financial planning providers. With decreased competition in the financial planning market , consumers may find the quality of advice they receive is reduced as services and access to a wide range of products becomes more restricted.

With increased pressure because of its role in the implementation of the Financial Services Reform Act, the current PI situation will only place a further burden on ASIC as it attempts to ensure licensees have adequate compensation arrangements.

ASIC's consumer protection unit is likely to experience increased activity as

consumers contact ASIC with grievances about reduced quality and availability of advice as competition is decreased.

The ACCC too is likely to be affected as consumers bear the brunt of the insurance premium increases. Both from a competition and consumer perspective, it is likely that the ACCC will also need an increase in resources.

f) The change in the balance between cost and risk in the insurance model and the need to return to equilibrium.

Currently small business is having to pay significant and increasing premium for professional indemnity insurance in circumstances where it is also being asked to take on more of the risk either through higher excesses or exclusions to cover. The FPA argues the balance between cost and risk needs to be returned.

g) The impact on national savings and creation of national wealth arguments

One significant consequence of the current situation is also that the Australian Economy is likely to suffer through a lower level of National Savings. This will occur because of a shift in the investment spectrum to low risk products. Higher risk products and investment strategies can be legitimately and effectively utilised by those who can absorb the risk. The exclusion of products such as margin lending will mean consumers are not gearing to returns. This reduces the overall return over a longer period and the capacity to grow wealth at both an individual and national level is reduced.

The following table devised for the FPA by Access Economics in a paper entitled "Assessment of the tax treatment of financial planners" in September 2000 demonstrates the impact more conservative investment strategies can have on the Australian economy.

Model results		**Long run impact**
Public Savings	% of GDP	-0.2%
of which:		
Cost of public pensions	%	4.7%
Private saving	% of GDP	-0.1%
National saving	% of GDP	-0.3%
Current account deficit	% of GDP	0.1%
of which:		
Net income deficit	% of GDP	0.2%
Private consumption	%	0.3%
Housing investment	%	-0.5%
Business investment	%	-0.3%
GDP	%	0.0%
Prices	%	0.5%
Wages	%	0.3%
Real Wages	%	-0.3%
90 day bank bills	%age points	0.4%
10 year bonds	%age points	0.2%
TWI of the $A	%	-0.1%

Assumptions:

1. An increase in conservation by the investing public, whereby the proportion of portfolios allocated to cash rose by 15 percentage points.
2. The long run impact refers to a nine-year time horizon.

5. SCHEMES AND ARRANGEMENTS OR REFORMS TO REDUCE THE COST OF INSURANCE OR BETTER ASSESS AND POOL RISK

All stakeholders need to work harder towards solutions.

5.1 The FPA

The good to come out of all of this is that it should cause industries to reflect on risk minimisation strategies.

The FPA has a good track record in relation to the establishment of such programs in recent years. For example, the implementation of a National Quality Assessment program, and a

National Disciplinary Scheme for members. Further, the FPA has recently submitted an industry submission to insurers and brokers who write cover for financial planners to raise awareness of both industry initiatives in this regard and the work of a financial planner (See attached Document Title Submission to Stakeholders in the Professional Indemnity Insurance Industry). In 2002/03 the FPA will also develop guidelines for members on the implementation an effective risk management model for the purposes of FSRA.

5.2 Brokers

The FPA believes the insurance broking industry can work harder in better understanding the financial planning small business hence being more effective in completing policy proposal documents. Brokers also need to work harder in seeking interim policy cover between premium years for financial planners.

5.3 Underwriters

Currently underwriters have a model where they assess risk universally across an industry and then apply to individuals. They need to work harder to establish models where risk can be assessed more effectively on an individual business basis. Our anecdotal evidence suggests that when they do that the premium quote is reduced.
Underwriters should also look to the establishment of models where policies cover all financial products and services, to be consistent with the new licensing regime and not financial product differentiation.

6. RECOMMENDATIONS

Solutions or relief to the range of adverse influences which are impacting negatively on the operation of the professional indemnity insurance industry must be sought across the spectrum in the long term best interests, not only of small businesses - but also of government, clients, the community and the economy.

Recommended directions for change include:

6.1 Federal And State Government Legislation

There must be change to legislation to restore fairness in matters of liability for damage in the delivery of Financial Planning services. Legislative changes may include

1. Caps on entitlements to compensation in professional indemnity matters
2. The introduction of proportional liability rather then joint and several liability in Trade practices, Fair trading and other relevant legislation.
3. A review of statutes of limitation and limitations on duration of liability.

6.2 Other Government initiatives may include:

4. A reduction in stamp duty on professional indemnity insurance in the short term to give small business some relief from the significant premium increases. This would be similar in intent to the hardship package relief granted by the Federal Government to small business last year with the HIH collapse.
5. Initiatives to review the costs and delays associated with claims for compensation within the judicial system
6. Hosting a national summit of industry associations, the insurance industry and other key stakeholders to identify the causes of the current change in market conditions for professional indemnity insurance and therefore develop and work towards long term structurally sound solutions.
7. Industry should also play its role in the solution. The FPA proposes the following initiatives:
8. Following the Summit, a national working party of Financial Services industry associations and the insurance industry should be convened to work on practical solutions to issues that may arise from the Summit. There are a number of projects the proposed working party may consider already including:
9. The development of Standard proposal forms across insurers for professional indemnity insurance
10. The establishment of more effective models of individual risk assessment and risk allocation
11. The development of a standard policy for Australian Financial services licensees

12. Guidelines to small business on how to obtain and renew professional indemnity insurance

13. All professions to establish internal dispute resolution mechanisms that accord to Australian Standards and have access nationally to externally approved alternative dispute resolution schemes. These schemes could be industry based and administered, such as those established for Securities Dealers/Australian Financial Services Licensees pursuant to the Corporations Law. Such schemes may lead to a reduction in the number of, and costs associated with, claims.

14. The FPA also looks forward to working with Treasury and ASIC on whether the definition of "adequate compensations arrangements" for Australian Financial Services Licensees under FSR will include professional indemnity insurance.

APPENDIX "C" FPA SUBMISSION TO REVIEW OF THE FINANCIAL INDUSTRY COMPLAINTS SERVICE

FPA SUBMISSION

REVIEW OF THE FINANCIAL INDUSTRY COMPLAINTS SERVICE 2002

25 OCTOBER 2002

CONTENTS

EXECUTIVE SUMMARY

1. The FPA encourages FICS to design mechanisms to allow for more transparency in its communications with the parties. For example, it would encourage a system where all documents relied on by the parties were exchanged at each stage of the process, including the complaint/response, negotiations and panel stages
2. The FPA would support the establishment by FICS of an early intervention strategy, where complaints are assessed up front upon receipt of initial information from the consumer and member
3. The FPA believes this proposal to actively manage files could be coupled to a strategy to at an earlier stage in a complaints:
    - set realistic expectations by both parties
    - provide them with an understanding of the types of FICS processes they are likely to be involved in
    - prepare the parties to consider the real issues in dispute and what they may want from a resolution
    - provide an understanding of the likely costs and outcome that will be imposed if they do not resolve the matter themselves.
4. There should be a greater emphasis on conciliation and settlement negotiations. The effective and early resolution of matters should be an objective of the scheme and there should be more emphasis on the use of settlement conferences, conciliation and mediation were appropriate to achieve that objective.
5. The FPA encourages FICS to remain true to its mission statement by establishing procedures that allow parties to resolve matters between themselves rather then having determinations imposed on them.
6. FICS should consider adopting a system of National circuits either to assist in the regular undertaking of settlement conferences, or as part of initiatives to handle backlogs.
7. The FPA and FICS to jointly develop a proforma generic submission document to overcome the imbalance in the quality of submissions lodged by members and to alleviate a significant cost hurdle for small dealers.
8. FICS to consider the appointment of consumer advocates to assist consumers in delineating their complaint and writing their submissions, instead of the use of case managers for this purpose as is its current practice.
9. That FICS implement systems to ensure there be greater, transparency, clarity, consistency and uniformity of decision making processes and procedure.
10. That FICS consider the interrelationship between the established IDR systems within its member group and how the ADR system adds value to build on that process rather then duplicating it.
11. That FICS seek advice on the merits of establishing an appeals mechanism in certain circumstances, and clarifying the right to rehear, review and reopen complaints already heard.
12. The FPA proposes that a series of guidelines be developed to more fully inform and assist members and consumers about FICS processes and decision making functions. This includes the development of a FICS charter of member and consumer rights.
13. It is suggested the Adjudicator/ Panel consider issuing practice notes or directions, for example on the standards of proof it would expect to see at arbitration and panel level in relation to complaints.
14. The FPA believes it has a role to play in jointly educating members on the benefits of IDR/ADR and their membership of the scheme as a whole.
15. The FPA encourages FICS to ensure its processes are accessible to members and consumers outside the Melbourne metropolitan area and in particular in other states and in regional areas that cross time zones.
16. The FPA suggests consideration be given to whether a nominal fee system should be established for consumers to access certain stages of the FICS process. Such fees could be rebated if the consumer was ultimately successful.
17. The FPA asks FICS to consider that small businesses make up 75% of the FPA principal

membership and that costs and fees associated with a complaint are a significant impost to small business. The FPA believes the member fee system could more accurately reflect an efficient user pays system, if changes to the case management systems were implemented and early intervention strategies were adopted.

18. The FPA is of the view that not all disputes lend themselves to resolution within the FICS framework. The FPA would be opposed to increase in the monetary limits as a result.
19. Further, the ability of some members to maintain and obtain insurance in the current professional indemnity insurance market has been severely restricted and this must be taken into account by FICS when determining jurisdiction limits and in relation to its reputational risks.
20. The FPA opposes any increase in the jurisdictional limits in relation to the FICS at this time due to the present professional indemnity insurance issues facing the industry, and the current debate and uncertainty in relation to what compensations arrangements a licensee must have in place going forward under the FSRA
21. The FPA recommends a joint initiative designed to raise awareness levels, not only of FICS processes but also of the value of membership.

1. INTRODUCTION

1.1 The FPA

The Financial Planning Association of Australia Ltd (FPA) is the peak professional organisation for the financial planning industry in Australia. With over 14,900 members through a network of 31 Chapters across Australia, and a state office in each capital city, the FPA represents qualified financial planners who manage the financial affairs of over five million Australians with an investment value of more than $630 billion. The FPA represents the views of the industry to key decision makers including government and media. Established in 1992, the FPA promotes improved quality of financial advice for consumers, and high standards of ethical and professional behaviour among its members.

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1.2 The Role of ADR

Although the precise figure is open to debate, there is a wide consensus that Australians are not good savers. The Financial Planning Association ("FPA") has commissioned research that shows that most Australians rely on homeownership and compulsory superannuation as their principal sources of saving and tend to avoid actively participating in the retail savings arena. The research shows that the lack of participation with retail savings products appears to be particularly acute amongst the less affluent, where insufficient levels of saving are likely to have a more serious impact.

A major reason for insufficient saving is the effective functioning of the financial services industry, including cheap and easy access to consumer protection mechanisms. The FPA believes that an effective ADR system reduces the barriers that may be inhibiting consumers, particularly the less well-off, from accessing retail savings products.

As a consequence, the FPA has been a strong advocate of the development of the Financial Industry Complaints Scheme (FICS).

1.3 The FPA's relationship with FICS

FPA Principal Members have been members of Financial Industry Complaints Service ("FICS") in Category E-Brokers, Financial and Securities Advisors, since the integration of that scheme with the Financial Services Complaint Resolution Scheme, (the FSCRS") in January 2000. It is a condition of FPA Principal Membership that the member also retains membership of FICS. In addition, under the Financial Services Reform Act ("FSRA"), the requirement to be a member of an approved external alternative dispute resolution scheme will become a licence condition.

Mr Wes McMaster represents FPA members on the FICS Board, Ms June Smith on the FICS Rules Committee, and three industry representatives have recently appointed to the FICS Panel, Mr John Hewison, Mr Peter Dunn and Mr Max Weston.

1.4 The Submission

The FPA welcomes the opportunity to lodge a written submission in relation to this review. FPA representatives have also been involved in the preliminary round of interviews and attended the forum sessions conducted by the consultants in Melbourne and Sydney.

There are numerous themes that the FPA will address in this submission, including whether the integration of financial planners has been successful, and the interaction between FICS and the industry bodies that represent its membership. However, the focus of the submission will be on the day to day operation of the scheme as it affects financial planners.

The FPA recognises that there are a number of benchmarks to an approved scheme including:

- Accessibility
- Independence
- Fairness
- Accountability
- Efficiency; and
- Effectiveness

The submission attempts to address each of these benchmarks in turn.

The FPA notes that ASIC Policy Statement 139 contains a number of edicts that currently influence the operations of FICS. Some of these are the subject of discussion in the submission, in particular the payment of fees and charges by consumers to access the Scheme.

During the course of the review the FPA has requested that its members provide comments and feedback on their experiences at FICS for the purpose of incorporation into this submission. The submission reflects that feedback where possible. FPA members have also been encouraged to submit individual submissions.

2. SATISFACTION AND ADR PROCESSES

2.1 Communication with the parties

The FPA believes the information bulletins sent by FICS to members each month and the recently revamped website, are of great value to members and an effective communication tool in relation to the scheme and its operations.

However, the communication with parties during the course of a complaint has been identified as one area for change, as it highlights some issues in relation to natural justice.

The FPA has received feedback from some of its members who have been the subject of a complaint, that they do not feel they have received all the information and documentation provided by a consumer to the scheme during the course of a complaint. The failure, or perception of failure, to exchange all relevant documentation leads to feelings of disenfranchisement from the process. It also results in members believing they have not been given the chance to be fully heard and to address all allegations raised against them, or all issues that may be taken into account by FICS in its decision making.

The FPA encourages FICS to design mechanisms to allow for more transparency in its communications with the parties. For example, it would encourage a system where all documents relied on by the parties were exchanged at each stage of the process, including the complaint/response, negotiations and panel stages.

FICS may already have such a process in place. If so, the FPA suggests that FICS document it as part of a guideline to the parties that it suggest be developed. The guideline should outline "The

obligations and responsibilities of parties during the course of a complaint", and should be distributed to parties at the commencement of a complaint. FICS should also develop member and consumer charters that outline its own obligations to parties and the process that will be undertaken during the course of a complaint.

2.2 Early intervention – Case streams

The Issues Paper suggests that FICS already undertakes a preliminary assessment of complaints to determine whether or not they fall within the jurisdictional limits outlined by the Rules. It is suggested that this could go further.

Given all complaints have already been through an internal disputes resolution mechanism prior to being lodged at FICS, the FPA would support the establishment by FICS of an early intervention strategy, where complaints are assessed up front upon receipt of initial information from the consumer and member on issues such as:

- Jurisdiction (for example, where it is alleged a complaint is clearly outside the rules).
- Vexatious or frivolous complaints.
- Where it is more likely then not that there is no case for the member to answer, (similar to a lacking in substance test).
- Whether the matter is capable of early settlement following an effective IDR process.
- Whether the complaint involves issue of complexity, the law, multi parties, etc.

Matters could then be distributed to case managers with instructions or directions including a strategy for how the matter should proceed.

Some complaints for example, where resolution has been tried and failed, where the matters are complex, or the amounts involved are high, could be streamed to go straight to the adjudicator/panel with the consent of both parties following investigation.

Where the matter is minor or there are only a few issues in dispute, and where formal attempts at resolution might succeed, the complaint could be streamed for immediate conference.

In this proposal, the investigation process could be used to determine substance, how a file may be streamlined in addition to providing evidence to the adjudicator or panel.

The FPA believes this proposal to actively manage files could be coupled to a strategy to at an earlier stage in a complaints:

- set realistic expectations by both parties
- provide them with an understanding of the types of FICS processes they are likely to be involved in
- prepare the parties to consider the real issues in dispute and what they may want from a resolution
- provide an understanding of the likely costs and outcome that will be imposed if they do not resolve the matter themselves.

The FPA suggests that the preliminary assessment should be undertaken by more senior officers, such as the CEO or a Panel member, who might then set directions for the files' progress, and periodically review the file's progress to its resolution or determination. It may also be that the preliminary assessment isolates the issues that seem to be in dispute for clarification by the parties.

In other words, the FPA proposes that instead of the CEO reviewing files at stage five in the process as outlined on page 19 of the Issues Paper, that review is completed at stage 2.

2.3 Vexatious/Frivolous complaints

The FPA encourages the establishment of processes to determine at an early stage those complaints which lack substance, or are frivolous or vexatious as outline in paragraph 2.2.

2.4 Use of face to face meetings and Conciliation/Arbitration

The FPA seeks to encourage the more effective use of conciliation/mediation or face to face settlement conferences in resolving disputes between members and consumers.

The FICS mission statement is to "encourage and assist consumers and members to reconcile any differences… and in such a manner as to retain a working relationship between the parties.

Whilst the FPA recognizes that FICS currently makes extensive use of what is described in the Issues Paper as "shuttle negotiation" or "facilitation", this process has some drawbacks. Feedback from members who have been through the process suggests that members often feel forced into settlement irrespective of merit due to the fees and other costs associated with a complaint and are left with little or no ownership of the outcome or process. They do not feel like they have restored their relationship with their client, often times they have not spoken to the consumer during this process, only the case manager. It does not seem to be a method of settlement that is conducive to delivering on the objectives of mission statement. Shuttle negotiation may have some value for complaints that are very close to settlement as a result of an effective IDR process. However it provides real no ability for the parties to retain their working relationship, no face to face communication between the parties where they hear first hand the issues of the other side, and no reconciliation of differences or isolation of issues.

There was general agreement at some forums that effective and early resolution of matters should be an objective of the scheme and that more emphasis on the use of settlement conferences, conciliation and mediation were appropriate to achieve that objective. Indeed more face to face communication per se with the parties, and between the parties, is required.

The FPA believes that the use of settlement conferences in whatever form have other benefits in relation to file management, even if the matter doesn't resolve at the conference, including:

- The parties get the opportunity to crystallize issues in dispute between them,
- they get to hear from and perhaps have a better understanding of the perception of the other,
- they have a chance to feel like they are being heard
- that they have some control of the resolution process,
- future submissions should be more focused as a result of the parties having a better understanding of what the issue in dispute really are, not wasting time on extraneous issues of no relevance.

<u>The Issue of Representation</u>

In relation to whether consumers should be represented at conferences because of a perceived or real power imbalance, the FPA believes one of the roles of the mediator is to ensure balance is maintained at conferences and that no party is forced into settlement, or does not understand the process.

The FPA does not believe representation is necessary in all situations, as the process should be kept informal and accessible without the additional costs associated with representation. The demographic suggested in the Issues Paper as being the category of consumer most likely to access FICS should not for example require representation. However, in some instances the FPA agrees that representative may be appropriate, for example for consumers of a non English speaking background, and consumers living with certain disabilities.

<u>The Conference Itself</u>

The FPA believes a conference should include reality testing. Accordingly, it would be appropriate in those circumstances for the mediator/conciliator to intervene and voice opinions on the strengths and

weaknesses of each case. The FPA does not agree with the view that a case manager should merely "facilitate the exchange of information" between the parties.

The FPA contends that the nature of complaints against planners lends itself to a conference process more because complaints stems from the provision of advice within a fiduciary relationship. The Issues paper suggests 79% of complaints against planners are categorized as advice, misrepresentation or standards of service.

The Issues Paper does suggest on page 28 that FICS is now conducting face to face conferences but it is unclear how files are identified as being appropriate for this process. On page 29 of the paper, no dispute appears to have been referred to a conference for example from the surveyed matters.

The FPA agrees that the test of a good ADR system includes whether the parties:

- participate in the process and the outcome
- feel control during the process
- feel ownership and control of the outcome
- understand the FICS process
- feel there has been resolution of the issues as well as an outcome

In our opinion the FICS process should also have specific objectives for members in addition to a resolution including:

- That the process raised awareness, understanding and empathy with the complainant's perspective
- That it educated the member on how to reduce the possibility of a similar dispute in future
- That the relationship with the client was retained or restored.

The FPA encourages FICS to establish strategies to achieve these objectives, including the early intervention strategies outlined.

The Issues paper suggests over half the member group surveyed believe there would be benefits in having face to face contact with complainants during the resolution process and suggested that such a move would increase satisfaction levels. This seems to re confirm the momentum for change in this area.

2.5 National Circuits

The FPA is conscious of the fact that early intervention and conference strategies should not impose undue costs/fees on members, particularly small dealers.

Accordingly, it suggests that these conferences could be undertaken in a number of different cost effective ways. For example by phone hookup or national circuit. The latter may involve extra costs to establish. However, hopefully an early intervention strategy will reduce the escalation of files to the panel stage, and therefore fees payable by members.

The FSCRS had approximately 20 mediators across Australia to conduct mediation across a wide geographical area – that scheme also used phone conferences. Not all mediators would have to be employed by FICS, but rather could be used on a contracting or session basis. It would be for FICS to determine the costs of using such settlement techniques, but the matter can always be put to a vote of members, or members asked if they wish to access these facilities during the course of a complaint.

National circuits do not have to be conducted all the time. For example, FICS could structure a system where regional and capital city circuits run for one week a quarter, with parties in each area being given prior notice of the circuit so they also could request the listing of matter if they choose to do so.

The FPA believes FICS should also consider the ABIO model outlined on page 29 of the Issues Paper where the Ombudsman undertakes "case conferences" with the parties – described as a simple meeting or teleconference chaired by the Ombudsman or a case manager. This seems like an effective mechanism for the early resolution of matters and one that should be cost effective.

2.6 Recording of outcomes

The FPA understands that currently any resolution of a complaint is recorded as "settled in favour of the complainant", even if a concession in the resolution has been very small. The FPA requests that FICS consider a different method of recording outcomes that more accurately describes the resolution between the parties.

2.7 Without prejudice negotiations

The FPA has previously voiced concerns about the panel having access to information concerning the settlement negotiations that have taken place between the parties. The FPA and FICS have previously agreed that without prejudice negotiations between the parties during the course of a complaint will not be made known to the panel.

The FPA believes this is an appropriate outcome because of the risk that parties will not negotiate in good faith for fear the panel will use that against them either in determining quantum, or in prejudging the matter.

3. FAIRNESS

3.1 Submissions and the exchange of information

As previously outlined in paragraph 2.1 of this submission, the FPA is concerned that parties have sufficient opportunity to consider, review and rebut material submitted by the other party to the dispute.

The FPA is aware that there seems to be an imbalance in the quality of submissions prepared by members. It suggests the FPA and FICS develop some proforma/generic submission documents to overcome this problem and to assist small business in particular in relation to the type of information that is expected of them. This should also help reduce the costs associated with the preparation of such material for small business, which is often undertaken for them by external providers.

The FPA was concerned to read in the Issues Paper that 97% of consumer submissions to the Panel are prepared by FICS staff. The FPA encourages FICS to provide as part of a series of proposed guidelines, information to members outlining the responsibilities and obligations of case managers in their preparation of submissions for the consumer to the panel, and the FICS mechanisms for ensuring objectivity?

The FPA believes that FICS should consider the appointment of consumer advocates to the service who could undertake these duties. The FPA believes members' perceptions that case managers are 'on the side of the complainant" may be associated with the performance of this type of task.

3.2 Procedural Fairness at the Panel stage

In its dealings with members who have been before the panel, the FPA has formed the view that members have a lack of understanding of why certain decisions are reached and the basis for them. FPA staff who have reviewed panel decisions have also confirmed that it is not always clear how the decision was reached or the reasons for it. Members are left to speculate, often negatively, about the evidence taken into account and the rationale for decision. Comments such as "they were always going to find for the consumer', or "they don't understand planning and investments" are common.

The FPA suggests that FICS consider whether:

- reasons for decision need to be more expansive in nature,
- parties should be given the opportunity to discuss findings with the Panel chair when a

decision is handed down, or
- the panel should have the parties present, perhaps by phone, to hand down their findings orally as well as in writing.

These suggestions may add to the transparency of the process.

As indicated in paragraph 3.1, the FICS/ FPA may have a role in developing a proforma submission that parties could use which outlines the major headings to be considered in any dispute between the parties, and that articulates the sort of evidence the panel is looking for in order to make a determination.

The FPA believes there are circumstances where the panel may also wish to consider hearing oral submissions from the parties to test the rigor of statements made and information relied on. For example, where cases are complex, involve multi parties, where financial loss is substantial or where a number of facts are in dispute.

The feedback received from FPA members suggests sometimes the submission process is confusing for the parties and that there is a perception that procedural fairness is not followed. As previously indicated, members do not always feel they have been given the opportunity to see all material placed before the panel by the complainant, nor given the chance to rebut contentious statements made. The chance to make oral submissions may reduce this type of criticism.

The FPA encourages the use of expert witnesses in panel hearings. We note this was agreed to by the FICS and FPA in April 2002 in relation to panels. We also concur with the views expressed on page 48 of the Issues Paper that case managers be able to seek expert advice on complex issues, or those issues beyond their level of expertise.

3.3 Skills and expertise of case managers

It is the FPA's view that complaints concerning financial planners should be handled by case managers who are not only expert in dispute resolution, but who also have specialist knowledge of the industry.

Feedback from FPA staff and members suggests that FICS case managers are perceived as having very limited knowledge of the legal, industry and ethical obligations of financial planners and that this is demonstrated in their assessments of files, and generates some of the frustration felt by members in their dealing with FICS.

The FPA recognizes that FICS has taken some recent steps to address this deficiency by employing staff who have a financial services background and in agreeing to quarterly meeting between FICS and FPA staff. These meetings not only raise the awareness of both organisations to the work of the other, but also expose FICS officers to the industry standards imposed on financial planners by the FPA.

The FPA contends that as FICS is presently structured, case managers can only give advice or make recommendations on settlement or the escalation of a dispute if they understand the issues, the industry in which the advice was given, and the legislative and ethical environment in which that advice was given. The FPA and other industry training can help in this regard and the FPA is willing to undertake further courses for FICS Staff in this area.

The Issues paper requests suggestions on other skill sets that case managers might need. These may include:
- ADR and conflict resolution
- Ethical behavior
- Communication skills

- Customer relations
- Negotiation skills

3.4 Standards of Proof

The FPA encourages the publication of practice notes by FICS on the standards of proof that it would expect at arbitration and panel level in relation to complaints. That is, what evidence would it expect to see from a consumer and from a member to defend a claim.

The FPA also encourages FICS to consider and articulate in those notes the role industry standards and legislative obligations play in the decision and assessment of claims.

Further, FICS may consider formulating guidelines that expand on:

- The rules in relation to jurisdiction that highlight the types of complaints that will be accepted in terms of the degree and seriousness of a complaint.
- What FICS expect of parties.
- What parties need to demonstrate for a file to progress or not through the system.
- How case managers will operate to ensure some consistency of decision making and a universal approach to file or case management.

3.5 Inconsistency in decision making

The FPA requests FICS consider clarifying by practice note or guideline some key decision making edicts in its case management, such as its interpretation of dealer liability for representatives who have left a business by the time a claim is made.

Again, clarity in relation to how case managers will operate to ensure some consistency of decision making and a universal approach to case management, may reduce some of the perception amongst members of inconsistency in decision making.

3.6 The Interrelationship with a member's IDR systems

The FPA's view is that FICS should consider and articulate how it will more effectively utilize and build on the work already undertaken by members in their IDR systems before a complaint reaches FICS. For example, details of the IDR process followed may be of use in determining an early intervention strategy for a file.

This may help reduce the perception that the FICS process leads to double up in relation to paperwork and correspondence, and a loss of any of the gains already made towards resolution, or the isolation of issues in dispute.

Financial Planning members are required to have an effective IDR system that meets the Australian standard on dispute resolution. The FPA has published guidelines outlining how to implement such a system. If FICS believes financial planning members are not using their IDR schemes effectively, the FPA may be able to assist with a joint awareness or education campaign in this area, perhaps with mediation or resolution experts, and/or in the form of some national workshops.

3.7 Review of FICS decisions and determinations

The FPA has previously raised its concerns about the Panel's understanding of the nature of investments when determining liability and quantum in financial planning matters. The FPA is also concerned that a consumer should not profit from a determination but that they be placed back in the position they would have been in but for the investment.

Some of these concerns have been met by the recent appointment to the Panel of three practicing planners. The FPA also recognizes the Panel Chairman's previous concession that quantum should be addressed in member submissions to the Panel, together with the other main issues in the complaint.

An appeals mechanism
The FPA is aware of circumstances where the Panel or Chairman has reconsidered, reopened or reviewed a decision made upon application by one or other party. It is also noted that there is confusion about a party's right to appeal a determination, and that this issue should be addressed and clarified.

One issue may be whether the contractual obligation each member has to abide by the decisions of the panel, would prohibit any proposed appeal or review mechanism. For example, does the contractual obligation override any access to review breaches of natural justice or appeals on a fundamental error in law?

Given this matter remains unresolved, the FPA encourages FICS to obtain legal advice on the right of parties to review or appeal decisions made, the right to appeal on fundamental errors of law, the circumstance in which this may occur and whether any changes to the Constitution or Rules are required as a result.

3.8 Proposed guidelines

The development of the following guidelines to assist stakeholders have been suggested within this submission:

- On what types of complaints consumers can contemplate taking to FICS
- On complaints that will be accepted – degree and seriousness
- Obligations and responsibilities of parties during the course of a complaint
- Charter of Members' Rights
- Charter of Consumers' Rights
- Guidelines outlining the FICS process that will be followed during the course of a complaint
- Proforma FPA/FICS generic submission document for use by financial planners
- Overlap in jurisdiction
- Responsibilities and obligations of case managers in preparing submissions for consumers and mechanisms for ensuring objectivity
- Practice Notes or Directions issued regularly by the CEO, Adjudicator or Panel

4. ACCESSIBILITY

4.1 Awareness of the scheme and its operations

The FPA is concerned at the level of awareness among principal members of the FICS process and the value of their membership in particular. The FPA believes it has a role to play in jointly educating members on the benefits of IDR/ADR and their membership of the scheme as a whole. Presentations by FICS officers at conferences are great as is the bulletin and the new website, but the development of the guidelines already proposed in this submission may also be of assistance. This should be done to address some of the negative perception that such schemes are simply imposed on members and that they have no control over process or outcome.

The FICS mission statement again becomes important in this context, a lack of ownership of the scheme and its outcomes has a negative impact on the perception of members to the scheme itself and the value it adds to a member's business.

4.2 Geographical isolation

The FPA encourages FICS to ensure its processes are accessible to members and consumers outside the Melbourne metropolitan area and in particular in other states and in regional areas that cross time zones.

Members in other states and regions do not always feel they are able to participate fully in the process and their contact with a case manager or FICS during the course of a complaint is sometimes minimal, and mostly in writing.

Members often feel disenfranchised by the process due to a number of factors including the reliance on a paper based system for conducting cases, time delays associated with that system, the lack of verbal communication and isolation from one on one contact with case managers.

Whilst the costs of such ventures must be considered, members in states such as Western Australia and Queensland must be given direct access to case managers, settlement negotiations and panel hearings without the need to travel to Melbourne.

4.3 Making the most of Existing obligations on informing/educating consumers

There are existing obligations on members to advise consumers of their rights to access FICS. These obligations are more effectively able to be met if members can articulate the benefits of the scheme for both parties. Accordingly, the FPA recommends FICS articulate those benefits in brochure form.

4.4 FICS Charters for members and consumers

The FPA supports the development of a FICS Charter for members and consumers as outlined in the Issues Paper.

5. FEES AND COSTS

5.1 Consumer fees

The FPA has received a great deal of member feedback in relation to the level of and payment of fees by members. That feedback is particularly directed at the lack of fees and costs to consumers to access the scheme. This would be one of the overwhelming areas of dissatisfaction with the scheme amongst FPA members.

The FPA recognizes that Policy Statement 139 states that an approved scheme should be accessible by all and that consumers should not have to pay a fee upfront to lodge a complaint.

However, the FPA suggests consideration be given to whether a nominal fee system should be established for consumers to access certain stages of the FICS process. Such fees could be rebated if the consumer was ultimately successful.

For example, the FPA suggests that a rebate able fee be imposed on consumers who seek to continue with their complaint in circumstances where a letter of advice is sent from the case manager to the complainant indicating that there is no case for the member to answer. Should the consumer wish to escalate the complaint to the panel or adjudicator stage in light of this advice a small fee would be payable. Indeed at any stage in the process where FICS advises the consumer that there is no case to answer a small fee should be imposed on the consumer to continue with their complaint.

Any consumer fees could be refunded should the consumer ultimately be successful in their claim. It is difficult to ascertain from the Issues Paper how many complainants who receive advice of no case to answer go on to appeal so it is difficult to know how many consumers this would affect, but it is estimated that it is the minority of complainants.

It is hoped that such a fee structure would reduce member frustration that they must wear all the cost burden of a complaint escalating at the consumer's request, irrespective of its merits.

5.2 Member fees

The FPA asks FICS to consider that small businesses make up 75% of the FPA principal membership and that costs and fees associated with a complaint are a significant impost to small business.

The FPA believes the member fee system could more accurately reflect an efficient user pays system, if changes to the case management systems were implemented and early intervention strategies were adopted.

6. JURISDICTION

6.1 Jurisdictional issues

The FPA is of the view that not all disputes lend themselves to resolution within the FICS framework. The FPA would be opposed to increase in the monetary limits as a result.
For example, some disputes which involve large monetary amounts or are complex in nature, or have multiple parties require more rigorous evidentiary and interrogatory processes, judicial direction or formal mediation. The FPA believes the FICS ADR framework is not equipped to effectively resolve those matters. The FPA would be apposed to increases in the monetary jurisdictional limits as a result.

6.2 Professional Indemnity Insurance

One of the critical elements to the reputation of FICS is the ability to obtain redress for consumers who have suffered financial loss. That is very much dependent on the ability of its members to pay.

At the present time all FPA Principal members must carry professional indemnity insurance that meets certain minimum requirements, including an endorsement that the insurer will meet all claims made to FICS to $100,000.

However, the ability of some members to maintain and obtain insurance in the current market has been severely restricted and this must be taken into account by FICS when determining jurisdiction limits and in relation to its reputational risks. Further there is no guarantee going forward that the endorsement can be retained. Many who have insurance also carry large excesses, some up to the jurisdictional limit.

There is also a current industry debate about what may constitute adequate compensation arrangements for an FSR licensee going forward. Access to professional indemnity insurance is not an existing license requirement for some of the FICS membership and may continue not to be going forward.

If jurisdictional limits are increased, in particular if there is no professional compulsion on small business and other industry participants to maintain professional indemnity insurance, small business may not have the capacity, or may refuse to pay compensation through the scheme. This may leave FICS with the scenario of attempting to enforce determinations on behalf of a third party via the courts, or in seeking the Regulator to revoke licences

The FPA opposes any increase in the monetary limits in relation to the FICS jurisdiction at this time due to the present professional indemnity insurance issues facing the industry, and the current debate and uncertainty in relation to what compensations arrangements a licensee must have in place going forward under the FSRA.

This opposition would include an extension of the current jurisdiction to allow consumers to lodge a complaint in relation to every product sold. The FPA is very much of the view that the jurisdiction of FICS in relation to complaints against financial planners stems from the advice given in a financial plan and the fiduciary relationship between the planner and the client, not each product sold as a result of that advice.

6.3 Overlap with other ADR schemes and jurisdictions

Some FPA Principal members find themselves in the position where they are subject to the jurisdiction of a number of externally approved and other schemes, for example FICS, the ABIO and

the Superannuation Complaints Tribunal.

The FPA encourages FICS and the Regulator to issue guidelines to members and consumers relating to the overlap in jurisdiction and the scheme that will assume conduct of a complaint in certain circumstances.

7. EFFICIENCY AND TIMELINES

7.1 Delays in case management

The FPA has received feedback from its members and consumers relating to delays suffered during the course of resolving a complaint.

For example, one member lodged a submission to the panel on 30 May 2002 and as of 24 September 2002 had not had a response from FICS as to the progress of the matter. Another involved a consumer who wrote to the FPA advising that he had not heard from FICS from the date he lodged his complaint in July 2001, to 5 July 2002.

Whilst these may not be indicative of the general operations of FICS, they do highlight a need for FICS to publicise their benchmarked timeframes and provide parties with the ability to take action if these timeframes are not met.

Streamlining cases into different categories as suggested in paragraph 2.2 may also assist with the management of timelines for each stage.

7.2 Issues for smaller dealers

The FPA is aware there are a range of issues that compound the ability of members to adhere to timeframes set by FICS.

The issue for members in adhering to timelines can often be a question of size. Smaller organizations and sole practitioner rely on external providers or themselves to prepare submissions and other material.

The FPA believes these sorts of issues should be taken into account if FICS is going to consider a system for penalising members who do not meet deadlines. The FPA is of the view that in fact members disadvantage themselves if they do not meet the timelines, because the file will progress to the next stage perhaps unnecessarily. So in effect timelines should be self regulating due to the imposition of further fees if the file is escalated for failure to comply with timelines. In addition, members could and should always utilize a request for an extension as a last resort.

However, smaller members may simply not have the resources to turn around requests for documentation within tight deadlines. Insurance companies and larger institutions often have dedicated staff to undertake this work. However, the FICS membership is quite diverse in relation to corporate size, their experience with the FICS process, and their capacity to respond to the demands of the scheme.

7.3 Liaising with representatives who have left the member's organisation.

The FPA confirms its current agreement with FICS, that a Principal member may liaise with the representative identified in the complaint as having provided the advice or service, prior to the preparation of a response, and that the principal member may invite the representative to any settlement conference.

However, some members have experienced difficulties with meeting timeframes in circumstances where the representative has left its organization.

7.4 Difficulties liaising with professional indemnity insurers

Expeditious reviews and an early intervention strategy would benefit both parties where compensation is to be paid out. However, where professional indemnity insurers are involved in a complaint there are often issues of whether the insurer will assume conduct of the matter before FICS. Even if the member retains conduct there are often issues about what settlement offers, if any, can be put, and responses to complaints must usually be written or approved by the insurer or their lawyers, before submission by the member.

8. ACCOUNTABILITY AND LIASON

8.1 Relationships with members

The FPA believes the information bulletins sent to members each month and the recently revamped website, are of great value to members and an effective communication tool in relation to the scheme and its operations.

However, the FPA is concerned at the level of awareness its members have of the processes at FICS. This in turn impedes their ability to assist consumers with their knowledge during and immediately following the IDR phase.

The FPA recommends a joint initiative designed to raise awareness levels, not only of FICS processes, but also of the value of membership.

8.2 Relationships with Industry bodies

As the Issues Paper points out, professional associations such as the FPA are the third highest referrer of consumers to FICS. Accordingly the interaction and communication between these organizations should be given priority.

This is in addition to the fact that the professional association can be the gatekeeper to the FICS membership in particular categories and represent the views of these members on its various committees and the Board.

The FPA confirms it recent agreement with FICS to implement the following reporting mechanisms:

1. Monthly file statistics
2. Quarterly meetings between officers of the two organisations
3. Quarterly meetings between the CEO'S
4. Individual reporting of cases where a serious breach of the Rules of professional conduct is identified, (at an early stage in the matter if other consumers may be at risk, or at the end of a matter if FICS determines that identification may interfere with the effective resolution of the consumer's complaint).
5. Reporting of systemic issues involving FPA members, after FICS attempts to resolve the matter directly with the member.

The FPA views these mechanisms as very important to the maintenance of the working relationship between the two organisations.

9. INDEPENDENCE AND FUTURE PLANNING

The FPA believes the changes recently made to the FICS Constitution and Rules in relation to the composition of the Board have been valuable and contributed to ensuring FICS stakeholders are adequately represented.

Further, the recent decision to appoint members to the Panels for three years, and the ability to appoint more than one person to represent any one industry, has been well received.

In relation to other matters raised in the Issues Paper, the FPA agrees that a code of conduct relating to FICS operations is a good idea in principle, but prefers that proposal of a Charter of Rights for members and consumers in conjunction with the development of a system of guidelines and practice notes.

In relation to future planning the FPA believes that following matters could arise:

- The issue of enforcing determinations made against members externally,
- Decisions in relation to the number of members to be taken on by FICS post FSRA which may well impact on resourcing,
- The likelihood that the scheme will have to operate in a more legalistic framework with more requests for legal representation, more threats to appeal and review decision making processes.

[1] All responses to the survey were anonymous.

[2] All responses to the survey were anonymous.

[3] Bernie Marden, Secretary of the Professional Standards Council on 26 June, 2001

[4] National Competition Policy Review of the Professional Standards Act 1994 Submission by the Professional Standards Council.

[5] HIH Claims History

[6] Money Management (George Liondis) "Crisis strikes at heart of industry" 1 August, 2002

[7] All responses to the survey were anonymous