National Insurance Brokers Association.

NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA (NIBA)

COMPENSATION ARRANGEMENTS FOR CONSUMERS OF FINANCIAL SERVICES

FUTURE OF FINANCIAL ADVICE

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 500 member firms and over 2000 individual Qualified Practising Insurance Brokers (QPIBS) throughout Australia.

Brokers handle almost 90% of the commercial insurance transacted in Australia, and play a major role in insurance distribution, handling an estimated $16 billion in premiums annually and placing around half of Australia's total insurance business. Insurance brokers also place substantial insurance business into overseas markets for large and special risks.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 500 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on Risk Insurance products.

NIBA appreciates the opportunity to be able to provide further feedback on the latest proposals in relation to compensation arrangements for consumers of financial services.

ABOUT INSURANCE BROKERS

The role of insurance brokers

The traditional role of insurance brokers is to:

- assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under the insurance.

In doing the above the insurance broker acts on behalf of the customer as their agent. Insurance brokers offer many benefits to customers and consumers:

- assistance with selecting and arranging appropriate, tailored insurance policies and packages

- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market;
- assistance in interpreting, arranging and completing insurance documentation;
- experience in predicting, managing and reducing risks; and
- assistance with claims and a higher success rate with settlements (about 10 per cent higher than claims made without a broker).

In limited cases insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.

EXECUTIVE SUMMARY

Generally NIBA supports the recommendations in the report but notes that:

- further consultation will be required on any proposed changes to the existing arrangements "to assess the regulatory and financial impact of changes on licensees. Such a process would aim to reach an appropriate balance between protecting consumers and implementing financial requirements that provide a buffer without being overly burdensome on licensees. The consultation process would also be expected to explore an appropriate timeframe for implementation of new measures to allow licensees where necessary to build up their capital over a period." (see paragraph 4.62 of the report)

- a one size fits all approach is inappropriate. NIBA is pleased to note that the report acknowledges that there is a real difference between the experiences of consumers with insurance brokers as opposed to financial advisers that justifies a different approach. See paragraph 4.61 of the report.

NIBA sets out its response below in *italics* on each of the proposed recommendations.

Last resort scheme

Recommendation 1: Last resort scheme

It would be inappropriate and possibly counter-productive to introduce a last resort compensation scheme at this stage.

NIBA response - *NIBA supports this recommendation for the reasons specified in the report and in NIBA's original submission.*

Strengthen current compensation arrangements

In any move to strengthen the regime for the protection of consumers the initial focus, in conjunction with the Future of Financial Advice reforms and other efforts to raise industry standards, should be on developing a more robust and effective system to make licensees responsible for the consequences of their own conduct.

NIBA response – *NIBA supports this approach in principle but notes that changes should only be made in relation to licensees where there is established evidence of a problem. A one size fits all approach is inappropriate. NIBA is pleased to note that the report acknowledges that there is a real difference between the experiences of consumers with insurance brokers as opposed to financial advisers that justifies a different approach. See paragraph 4.61 of the report.*

Recommendations for changes to strengthen the current compensation arrangements are summarised below.

Reference is also made in Chapter 4 to initiatives by industry bodies, brokers and insurers to develop insurance solutions that better cater for the specific obligations on licensees to hold adequate professional indemnity insurance.

Initiatives of this kind are acknowledged and should be encouraged.

NIBA response – *NIBA agrees that there is an opportunity for industry bodies and brokers and insurers to develop insurance solutions that better cater for the specific obligations on licensees to hold adequate professional indemnity insurance and intends to progress consideration of such opportunities with its members as appropriate.*

Overall, it seems that retail clients are able to recover compensation awarded to them in most cases. In some cases however there is a shortfall and retail clients remain uncompensated.

Recommendation 2.1: Licensees to demonstrate adequacy of their insurance

Require licensees to provide ASIC with additional assurance that their professional indemnity insurance cover is current and is adequate to their business needs.

The report notes that the aim would not be to increase the regulatory burden on licensees overall, but to enable a tighter approach to be taken to licensees who present more of a risk.

The proposals were that licensees who have to hold such cover should be required:

- to submit to ASIC an annual certificate of currency for their policy including such relevant factual information as ASIC requires about the policy;
- to provide an annual declaration, signed by senior management, that in the process of renewing their insurance cover they have satisfied themselves that it meets established standards of adequacy;

- to include in their annual report to ASIC a statement by their auditor that it has reviewed and signed-off on the currency of the insurance policy and its adequacy in covering the risks of the licensee's business.

It should also be a requirement of a compliant policy that the insurer will advise ASIC if a policy is downgraded or cancelled during the course of its term and if a policy is exhausted by claims and is not reinstated. Consideration should also be given to requiring the nomination of ASIC as an interested party in any compliant insurance policy.

Further, the notification requirement should be designed to elicit whether there is any gap between the products and services covered by the policy and those provided by the licensee.

The annual certification requirement would be an extension of the licensee's obligation to provide audited financial statements to ASIC. It would be more efficient and cost effective for both licensees and ASIC for all required information to be submitted at the same time.

NIBA response *- Further consultation is required on what level of assurance will be appropriate and practical or not. NIBA agrees with paragraph 4.62 of the report which states "There would need to be a consultation process to assess the regulatory and financial impact of changes on licensees. Such a process would aim to reach an appropriate balance between protecting consumers and implementing financial requirements that provide a buffer without being overly burdensome on licensees. The consultation process would also be expected to explore an appropriate timeframe for implementation of new measures to allow licensees where necessary to build up their capital over a period."*

NIBA believes that given the lack of evidence of any insurance broker related issues, the requirements applicable to insurance brokers should be different to those of financial advisers, to which most risk examples in the report relate.

Recommendation 2.2: Licensees to hold appropriate capital resources

More attention should be given, on a risk targeted basis and in conjunction with the level of their insurance cover, to the adequacy of licensees' financial resources to enable better management of risks and unexpected costs such as compensation liabilities.

NIBA response *- Further consultation is required on the proposals. NIBA believes that given the lack of evidence of any insurance broker related issues, the requirements applicable to insurance brokers should be different to those of financial advisers, to which most examples in the report relate.*

NIBA notes that paragraph 4.61 of the report states " It is envisaged that ASIC, in reviewing the capital adequacy requirements of licensees beyond those being addressed in its current reviews, would adopt a tailored approach that takes into account the nature of the services and products *provided. This might have regard to the relative riskiness of the financial services or products offered by a licensee, for example the complexity or otherwise of financial products issued or advised on. Little if any change may be called for in the requirements for categories of licensees, such as insurance brokers, who incur limited claims for compensation from retail clients."*

Recommendation 2.3: A more pro-active stance by ASIC

ASIC should take a more pro-active approach in monitoring licensee compliance with the requirement to hold adequate professional indemnity insurance cover and any new requirement in regard to financial resources, and in targeting licensees who are most at risk.

NIBA response *- Further consultation would be required on any proposed change that incorporates ASIC regulatory guidance into the law. NIBA believes that given the lack of evidence of any insurance broker related issues, any requirements applicable to insurance brokers should be different to those of financial advisers, to which most risk examples in the report relate.*

Recommendation 2.4: Policing the licensing system in regards to compensation

To assist ASIC in playing a more pro-active role in administering the licensing regime with respect to compensation arrangements, consideration should be do not comply through:

- powers to deal with phoenix activity, both through licensees establishing new entities or by former directors who re-emerge in the industry as authorised representatives;
- ability to deal with disreputable industry participants; and
- access to an infringement notice regime.

ASIC for its part should be prepared to take action in appropriate cases to enforce its published views of what is required by the licensing conditions on insurance cover or financial resources. In the event that it becomes apparent that the current legal framework provides insufficient basis for effective enforcement action, consideration should be given to clearer legislative backing for regulatory standards on the adequacy of insurance or financial resources.

NIBA response *– NIBA supports the above in principle but further consultation is required on the actual proposals. NIBA believes that given the lack of evidence of any insurance broker related issues, the requirements applicable to insurance brokers should be different to those of financial advisers, to which most risk examples in the report relate.*

Other matters

The following issues relevant to the provision and operation of compensation arrangements and the protection of consumers, referred to in Chapter 4, should be addressed.

Recommendation 2.5.1: Compensation where licensees cease to trade

In dealing with licensees who give up their licence or reduce the scope of their licensed activities, ASIC should seek where possible to secure ongoing protection for retail clients including by imposing appropriate conditions in relation to the termination of a licence or the amalgamation or takeover of a licensed business.

NIBA response *– NIBA supports this recommendation in principle but further consultation is required on the actual proposals. NIBA believes that given the lack of evidence of any insurance broker related issues, the requirements applicable to insurance brokers should be different to those of financial advisers, to which most risk examples in the report relate.*

Recommendation 2.5.2: Protection from unlicensed providers

There are risks to consumers where they deal with financial services providers that:

- have a licence, but operate beyond the scope of that licence because they provide products or services that are not covered by the licence; or

- should be licensed under the Corporations Act but are not, and accordingly have limited or no compensation arrangements.

While acknowledging the difficulties in identifying outlaw activity, the importance of concerted enforcement effort by ASIC to police the boundaries of licensed financial service activities is emphasised. In its approach to the handling of complaints about outlaw activities ASIC should be transparent and provide as much feedback to complainants as possible in order to encourage further assistance.

NIBA response *– NIBA supports this recommendation.*

Recommendation 2.5.3: Third party rights under licensee's insurance policy

(a) Where a licensee (or its administrator or liquidator) does not respond to claims from a consumer or the licensee cannot be contacted after reasonable inquiry, ASIC should be able to provide the consumer with information it has about the insurance policy including the name of the insurer and the policy number. This would assist the consumer to decide whether there is a prospect of recovering compensation should the claim proceed and be successful.

NIBA response *– NIBA supports this recommendation in principle but further consultation is required on the actual proposals.*

(b) The third party rights provisions of the Insurance Contracts Act 1984 should be extended, as was proposed by a review of that Act in 2004, to apply where a consumer cannot recover compensation awarded against the insured and there is capacity to meet that liability from the insured licensee's professional indemnity insurance policy.

***NIBA response** – NIBA supports this recommendation.*

Recommendation 2.5.4: Defence costs

ASIC should give further consideration, in its approach to the adequacy of professional indemnity insurance cover, to the treatment of defence costs with a view to striking a reasonable balance between the interests of licensees and insurers on the one hand, and consumers on the other.

***NIBA response** – NIBA supports this recommendation in principle but further consultation is required on the actual proposals to ensure they are reasonable and practical.*

Recommendation 2.5.5: External Dispute Resolution scheme processes

Given their key role in the regime for the protection of consumers of financial services, and marked increases in their jurisdiction, External Dispute Resolution schemes and ASIC should give more attention to the adequacy of the EDR scheme processes as those schemes grow beyond their origins as forums for small claims.

Issues for consideration include: rights of review; transparency; capacity of a member to join in a proceeding other members that might be liable; cost contribution by complainants; liability standards; relevance of regulatory guidance and other operational issues discussed in Chapter 2.

***NIBA response** – NIBA supports this recommendation in principle but further consultation is required on the actual proposals.*

Rebalance responsibilities of licensees

Having regard to an apparent imbalance in the responsibilities of product issuers and financial advisers towards retail clients, and the fact that most cases of serious consumer loss relate to the failure of financial products, consideration should be given to measures to enhance the responsibilities of product issuers and the protection offered to retail clients. This would pave the way for possible compensation claims against issuers where their obligations are breached.

***NIBA response** – NIBA supports this recommendation in principle but notes that it was focussed on non insurance products.*

Recommendation 3.1: Review regulation of product issuers

As a matter of strategic approach, it would be timely to review the present relatively light-handed regulation of certain product issuers, in particular managed investment schemes, including the possible need, in accord with developments at the international level, to move to a somewhat more interventionist approach.

It would be appropriate also, in the course of any such review, to direct more attention to the responsibilities of licensees who provide financial products for retail clients. While the review has not had an opportunity to test these proposals, a first step might be to consider measures along the following lines by which product issuers would be expected to assume more responsibility for the protection of consumers of their products:

(a) Subject product issuers to more positive obligations in regard to the suitability of their product for retail clients. Such obligations might be applied in particular to managed investment schemes in issuing products to the retail market, and would apply at each stage of a product's life cycle including its distribution and marketing. Amongst other things, the product issuer might be required to state the particular classes of consumers for whom the product is suitable and for whom the product is unsuitable, and the potential risks of investing in the product.

A stronger approach by managed investment schemes to the management of risk of fraud, particularly by employees or representatives, might also be sought.

(b) Consider the development of standardised product labelling so that financial products, particularly managed investment schemes, are described on a consistent and more meaningful basis.

This might apply to such terms as capital guaranteed, capital protected, conservative, balanced, diversified, growth, defensive, fixed interest, or hedged, as well as other like descriptors.

(c) While the review has not looked into these matters in any depth, the significance of the role of gatekeepers, such as research houses, should be kept in mind in any strategic consideration of consumer protection in the financial services sector.

NIBA response *– NIBA supports this recommendation in principle but notes that it is directed to non insurance products and services.*

Recommendation 3.2: Responsibility of product issuers through EDR schemes

Some rebalancing of responsibilities of product issuers and financial advisers towards retail clients could be addressed through changes to the operation of EDR schemes by resolving the inability of EDR schemes to apportion responsibility for misconduct amongst responsible licensees. The operating rules of EDRs should be changed to enable them to make awards that recognise the proportionate liability of product issuers, financial advisers or other licensees.

Further, consideration should be given to the clarification of clause 5.1(i) of the terms of reference of FOS which excludes consideration of disputes about the 'management of the fund or scheme as a whole'. The aim would be to remove any doubt about the ability of FOS to deal with consumer disputes in respect of misleading product disclosure statements or other practices of issuers in marketing their products.

NIBA response *– NIBA supports this recommendation in principle but notes that it is directed to non insurance products and services*

If you would like to discuss any aspect of this matter further do not hesitate to contact us.

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National Insurance Brokers' Association of Australia