

## Chapter 2: Current compensation arrangements

This chapter describes in more detail the approach under the Corporations Act to the protection of retail clients who deal with providers of financial services. It covers the compensation arrangements required of licensed providers of financial services, the place of professional indemnity insurance in those arrangements, the administration of the compensation arrangements, the grounds for compensation claims, the avenues for consumer redress, and the more concrete compensation arrangements available in particular segments of the financial services sector:

- Compensation arrangements required of licensees are intended to reduce the risk that claims by retail clients cannot be met by licensees due to their lack of available financial resources.
- A retail client who suffers loss or damage because of a breach of a licensee's statutory obligations in regard to conduct or the disclosure of information may claim compensation from that licensee.
- Retail clients may seek such redress by legal action through the courts or by using the dispute resolution process a licensee has to make available.
- The compensation arrangement required of most licensees is to hold professional indemnity insurance. Certain licensees are exempted from this requirement on the basis of their relative financial strength.
- Professional indemnity insurance is an indirect means for compensating clients. Where a licensee's policy responds to a claim it assists the licensee to pay any compensation awarded to a client. Where this is not the case, the client's prospects of recovering will depend on the available financial resources of the licensee.
- Separate more direct statutory compensation arrangements cover some critical elements of the financial services sector. These include:
  - the National Guarantee Fund (and similar arrangements) to protect clients of stockbrokers;
  - the Financial Claims Scheme covering loss by depositors or policyholders due to insolvency of an authorised deposit-taking institution or general insurer; and
  - a scheme of financial assistance to compensate for loss incurred by a superannuation fund trustee from fraud or theft.

## Arrangements under s912B of the Corporations Act

2.1 Licensed providers of financial services who deal with retail clients are required to have in place:

- a dispute resolution system that meets specified standards (s912A); and
- arrangements for compensating clients for loss or damage suffered because of a breach by the licensee of its statutory obligations (s912B).

2.2 The policy intent of s912B was to 'reduce the risk that compensation claims to retail clients cannot be met by the relevant licensees due to the lack of available financial resources'.<sup>1</sup> The rationale was described as follows in a Treasury paper:<sup>2</sup>

Retail clients of financial services licensees are exposed to the risk of suffering losses arising from misconduct of the licensee or its representatives. This can result in claims for compensation against licensees. There is a risk that some financial services licensees could be faced with a situation in which they are unable to meet all such claims against them, unless some arrangements were made in advance ... the losses under consideration do not include losses arising from sources such as market fluctuations or the collapse of an issuer of a financial product.

2.3 Section 912B declares that a licensee who has retail clients must have arrangements for compensating those clients for loss or damage suffered because of a breach by the licensee of its relevant statutory obligations. It provides as follows:

912B(1) If a financial services licensee provides a financial service to persons as retail clients, the licensee must have 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 representative. The arrangements must meet the requirements of subsection (2).

912B(2) The arrangements must:

- (a) if the regulations specify requirements that are applicable to all arrangements, or to arrangements of that kind satisfy those requirements; or
- (b) be approved in writing by ASIC.

912B(3) Before approving arrangements under paragraph (2)(b), ASIC must have regard to:

- (a) the financial services covered by the licence; and
- (b) whether the arrangements will continue to cover persons after the licensee ceases carrying on the business of providing financial services, and the length of time for which that cover will continue; and
- (c) any other matters that are prescribed by regulation made for the purposes of this paragraph.

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1 *Compensation Arrangements for Financial Services Licensees*, Regulation Impact Statement, April 2007

2 Commentary released with draft regulations: *Compensation Arrangements if Financial Services are provided to Retail Client under section 912B of the Corporations Act*, *Commentary on Draft Regulations*, the Treasury, 2006. Available at [http://www.treasury.gov.au/documents/1181/RTF/Explanatory\\_commentary\\_Compensation\\_arrangements.rtf](http://www.treasury.gov.au/documents/1181/RTF/Explanatory_commentary_Compensation_arrangements.rtf).

912B(4) Regulations made for the purposes of paragraph (3)(c) may, in particular, prescribe additional details in relation to the matters to which ASIC must have regard under paragraphs (3)(a) and (b).

2.4 Although s912B commenced on 11 March 2002, its practical operation was deferred until 2008 to allow for consultation to be undertaken on the content of the required arrangements.<sup>3</sup> In the intervening period, regulations and an ASIC class order allowed licensees to continue to comply with the pre-existing requirements for compensation:

- for securities dealers and advisers — a \$20,000 security bond provided to ASIC to compensate a person who suffered a pecuniary loss due to failure to carry on the business adequately and properly; and
- for insurance brokers, operators of managed investment schemes and of investor directed portfolio services — professional indemnity insurance and in certain cases insurance against fraud.

2.5 Following consultation the then Government expressed a preference for compensation arrangements to be based on professional indemnity insurance.<sup>4</sup> The use of professional indemnity insurance as the default arrangement for compensation is embodied in the regulations. Corporations Regulation 7.6.02AA requires a licensee to hold professional indemnity insurance which is adequate having regard to specified considerations that relate to the licensee's business, clients and exposure to claims. These considerations include:

- (a) the licensee's membership of a scheme (or schemes) mentioned in paragraph 912A(2)(b) of the Act, taking account of the maximum liability that has, realistically, some potential to arise in connection with:
  - (i) any particular claim against the licensee; and
  - (ii) all claims in respect of which the licensee could be found to have liability; and
- (b) relevant considerations in relation to the financial services business carried on by the licensee, including
  - (i) the volume of business; and
  - (ii) the number and kind of clients; and
  - (iii) the kind, or kinds, of business; and
  - (iv) the number of representatives of the licensee.

2.6 Attachment A sets out the relevant regulation in full as well as the regulation covering the disclosure of information on compensation arrangements by a licensee.

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3 Regulation 7.6.02AA made on 28 June 2007 imposed obligations under s912B for new licensees from 1 January 2008 and for existing licensees from 1 July 2008.

4 *Compensation for Loss in the Financial Services Sector*, Position Paper, December 2003. This followed an Issues Paper of the same name issued in September 2002. These papers are available at [www.treasury.gov.au](http://www.treasury.gov.au).

## **Exemptions from compensation arrangements**

2.7 The regulation provides an exemption from the need for compensation arrangements for a licensee who is:<sup>5</sup>

- an 'exempt licensee' — a general insurance company, life insurance company and ADI regulated by APRA;
- a 'related licensee' — a licensee related to an exempt licensee and which holds a guarantee from the exempt licensee that is approved by ASIC.

2.8 The apparent rationale for the exemption of a licensee who is also regulated by APRA is that those licensees have to meet APRA's capital adequacy and other prudential requirements. The expectation is that prudential oversight of these entities means they are less likely to fail and more likely to have the financial capacity to meet claims for compensation from their own funds.<sup>6</sup> Such licensees are effectively able to self insure against the risk of compensation claims that might arise from their clients.

2.9 An entity that is related to an APRA regulated entity may be able to secure a guarantee that ensures payment of its obligations for compensation of retail clients. As such a guarantee would have capital implications for the APRA-regulated entity there have been only a few arrangements of this type to date.

## **Alternative arrangements**

2.10 ASIC is empowered by s912B(2)(b) to approve in writing compensation arrangements other than professional indemnity insurance. In approving alternative arrangements, ASIC is required to have regard to a number of factors prescribed in s912B(3)(c) and by regulation. The regulation requires ASIC to have regard to whether those alternative compensation arrangements provide coverage that is adequate having regard to matters of the kind referred to in regulation 7.6.02AA(1). That is, the adequacy of the compensation arrangements must have regard to the licensee's volume of business, the number of clients, the kinds of business undertaken and the number of representatives.

## **Coverage of representatives**

2.11 A licensee's insurance policy is expected to cover possible breaches committed by its representatives as well as breaches by the licensee itself.<sup>7</sup> A representative includes:<sup>8</sup>

- an employee or director of the licensee;
- an employee or director of a related body corporate of the licensee;
- an authorised representative appointed in writing by the licensee;<sup>9</sup> or
- any other person who acts on the licensee's behalf.

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5 Corporations Regulation 7.6.02AAA(4).

6 *Compensation Arrangements for Financial Services Licensees*, Regulation Impact Statement, April 2007.

7 Part 7.6, Division 6.

8 Section 910A.

9 Sections 916A or 916B.

Authorised representatives are not required to have separate compensation arrangements of their own because they are covered by their licensee's compensation arrangements.

### ***Disclosure of compensation arrangements***

2.12 The regulations require licensees to include in the FSG they provide to their clients a statement about the kind of compensation arrangements they have in place and whether those arrangements satisfy the requirements under s912B.<sup>10</sup> For licensees who hold professional indemnity insurance, ASIC requires a statement that they have such insurance in place and whether it will cover claims in relation to the conduct of employees and authorised representatives who no longer work for them.<sup>11</sup> Other licensees have to state that they have alternative arrangements approved by ASIC or that they are exempt from the requirement for compensation arrangements.

### **Insurance as a basis for compensation**

2.13 Professional indemnity insurance is a commercial product available to financial services providers to protect them against liabilities incurred in the course of operating their business. It has been described as:

a product that indemnifies professional people ... for their legal liability to their clients and others who relied on their advice or services. It provides indemnity cover if a client suffers a loss, material, financial or physical, that is directly attributed to negligent acts of the professional.<sup>12</sup>

A licensee's liabilities in this context would include compensation awarded to a retail client for loss or damage incurred as a result of the licensee's breach of statutory obligations.

2.14 Professional indemnity insurance is not itself a compensation mechanism for retail clients. It plays an indirect role in facilitating the payment of compensation to a client. Where a retail client is awarded compensation for a loss arising from the licensee's breach of a statutory obligation, the licensee may be able to claim against the insurance policy to help meet the costs of the award.

2.15 In this way a licensee's professional indemnity insurance cover reduces the risk to a client that the licensee will not have the financial resources to meet an award of compensation. However, it does not guarantee that a retail client will in fact be compensated (see Chapter 3).

2.16 ASIC's approach to the administration of the compensation arrangements for licensees is set out in Regulatory Guide (RG) 126 *Compensation and insurance arrangements for AFS licensees*. The Guide says ASIC's objective in administering the compensation requirements is to:

reduce the risk that a retail client's losses (due to breaches of Chapter 7) for which a licensee is responsible) cannot be compensated by a licensee because of a lack of financial resources.<sup>13</sup>

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<sup>10</sup> Regulation 7.7.03.

<sup>11</sup> ASIC RG 126: Compensation and insurance arrangements for AFS licensees, October 2009, Part G – Disclosure in FSGs.

<sup>12</sup> *Available and affordable – Improvements in liability insurance following tort law reform in Australia*, the Treasury, December 2006.

2.17 The Guide adds that ASIC will ‘aim to raise the standard of available professional indemnity insurance cover for licensees’ but notes that ‘professional indemnity insurance is not a guarantee that compensation will be paid if there is a claim’.

2.18 The Guide also indicates that:

- licensees are responsible for assessing what is adequate cover in their circumstances;
- in determining whether an insurance policy is adequate it must be fit for providing compensation to retail clients and practically available.

2.19 The Guide sets out ASIC’s view on the features a professional indemnity insurance policy should have in order for it to be ‘adequate’ in terms of:

- minimum requirements and features of the insurance policy; and
- factors that licensees should consider when determining what is adequate for them including the nature, scale and complexity of the business and the licensee’s financial resources, as well as the maximum liability that might be incurred.

2.20 ASIC took a staged approach in introducing its administrative requirements for compensation arrangements.

- In the transitional period (1 January 2008 to 31 December 2009), licensees were to hold professional indemnity insurance that met the minimum policy features that were regarded as being commercially available in the insurance market:
  - a limit of indemnity of at least \$2 million and up to \$20 million depending on the licensee’s annual revenue from financial services provided to retail clients;
  - cover for breaches of obligations under Chapter 7 including liability:
    - : under external dispute resolution (EDR) scheme awards;
    - : for fraud or dishonesty by directors, employees or representatives;
  - no exclusions for EDR scheme awards, losses caused by the conduct of representatives generally, fraud and dishonesty by directors, employees or representatives, claims for misrepresentation about services or for claims arising from incidents notified to ASIC;
  - inclusion of defence costs in addition to the minimum limit or an increased level of cover to take defence costs into account;
  - inclusion of an automatic reinstatement clause (if the limit of the policy is exhausted before the end of the policy period, the limit of indemnity is reinstated for the balance of the period to cover any new claims that arise);<sup>14</sup>

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13 ASIC RG 126, para 5.

14 This is not necessary where the limit is at least twice the minimum amount of cover.

- inclusion of retroactive cover if the licensee had an immediately previous professional indemnity insurance policy (a retroactive clause is designed to cover past unknown claims); and
  - excess amounts to be met by the licensee limited to a level that the licensee can confidently sustain as an uninsured loss.
- Since 1 January 2010, ASIC expects the licensee’s policy to cover legitimate switching from funds or products that are not on an approved product list to another fund or product on the approved product list. Licensees are also expected to consider a more detailed list of factors in determining the level of indemnity that is adequate for their business and individual circumstances.

### ***Run-off cover***

2.21 In introducing its administrative guidance, ASIC initially proposed to require professional indemnity insurance to provide automatic run-off cover. Run-off cover is cover for claims made after an insurance policy has ended but which have arisen from acts or omissions of the insured during the period the policy was in force. However, following consultation with industry, ASIC concluded that insurers were generally not willing to provide this risk feature for licensees. ASIC did not proceed with the proposed requirement for run-off cover but has indicated that it will continue to monitor the availability of automatic run-off cover and may reassess its position in the future.

### ***Insurance provider***

2.22 ASIC generally calls for licensees to obtain insurance cover from an insurer regulated by APRA or operating under an exemption under the *Insurance Act 1973*.

## **ASIC administration of insurance requirement**

2.23 ASIC’s general approach is to look to licensees to self-assess the adequacy of their professional indemnity cover, taking account of the guidance in RG 126. ASIC regards the requirements as self-executing with the onus on a licensee to comply as part of its overall risk management processes. ASIC does not vet the terms of a licensee’s insurance cover. It is up to the licensee to form the view that its policy is adequate.

2.24 An applicant for a licence is not required to provide ASIC with a copy of its insurance policy but has to provide information about its insurance cover and a certificate of currency of that insurance. This information is generally sought on a ‘yes/no’ basis and includes:

- name of the insurer;
- period of the policy;
- amount of cover;
- provision for defence costs;

- amount of excess and whether it is at a level that the licensee can confidently sustain as an uninsured loss;
- number of reinstatements allowed;
- indication of whether individual or group cover is provided;
- indication that cover is provided for all financial services and products that the licensee seeks to offer;
- indication that cover is available for breaches of Chapter 7 by both the licensee and the authorised representative;
- indication that the policy covers EDR scheme awards;
- indication that the policy covers fraud by representatives, employees and agents;
- indication that retroactive cover is provided;
- indication of exclusions in the policy; and
- estimated gross revenue for next financial year.

In addition, the licensee must confirm in writing to ASIC that the policy covers standard margin lending.

2.25 ASIC does conduct some risk-based surveillance of licensees through which it can check whether a licensee is complying with a range of statutory obligations including the adequacy of its professional indemnity insurance. It does not however conduct systematic or periodic compliance checks on the insurance held by a licensee.

2.26 Once a licence is granted it is not subject to annual or other periodic renewal. However, a licensee is expected to notify ASIC if it is unable to meet its licence obligations, including the requirement to have adequate professional indemnity insurance.

2.27 If ASIC becomes aware that a licensee does not have professional indemnity insurance, it could take action to suspend or ultimately cancel the licence.

## **Grounds for compensation claims**

2.28 The compensation arrangements in s912B are directed to support the recovery of compensation awarded to a retail client who suffers loss or damage because a licensee has breached its obligations under Chapter 7. The licensee's relevant statutory obligations can be categorised as requirements directed to its conduct towards retail clients and to the information disclosed to clients.

2.29 A licensee will be in breach of the conduct rules if it engages in any of the following conduct, or fails to exhibit the professional conduct required under Chapter 7:



- fails to comply with the principal duties of a licensee (for example, to carry on a financial services business efficiently, honestly and fairly and comply with the financial services laws);
- provides personal advice without:
  - making reasonable inquiries into the client’s personal circumstances and having a reasonable basis for the advice (advice that takes into account the person’s needs, objectives or financial situation); or
  - warning the client if the advice is based on incomplete or inaccurate information;<sup>15</sup>
- provides general advice but fails to warn the client that it does not take account of the client’s objectives, financial situation or needs;<sup>16</sup>
- fails to assess the client’s suitability before issuing or increasing the limit on a margin loan;
- refuses to comply with a client’s right to return a product in accordance with ‘cooling off’ provisions; or
- fails to deal as required with money provided by the client for the purchase of a financial product or service (for example, by payment into a specified account).

2.30 A licensee will also be in breach of the conduct rules if it engages in conduct that is prohibited under Chapter 7. This includes unconscionable, misleading or deceptive conduct, such as the making of false and misleading statements, market manipulation, false trading, or inducing people to deal using false or misleading information.<sup>17</sup>

2.31 A licensee will be in breach of the disclosure rules if it:

- does not provide a relevant disclosure document (a Statement of Advice, Financial Services Guide or Product Disclosure Statement) within the required timeframe; or
- provides documents which are defective (for example, contain a misleading or deceptive statement or omit material that is specifically required, such as information on remuneration and commissions).<sup>18</sup>

2.32 A licensee is also required to comply with the financial services laws.<sup>19</sup> These are defined in s761A to include, apart from specified provisions of the corporations law, other Commonwealth, State or Territory laws dealing with conduct in the provision of financial services, certain parts of the ASIC Act, and for a licensed trustee company, rules of common law or equity relevant to trustee company services.

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15 Sections 945A and 945B.

16 Section 949A.

17 Section 1041I.

18 Sections 953B.

19 Section 912A(1)(c).

2.33 A recent study provides some insights into the most common forms of inappropriate advice by a financial adviser.<sup>20</sup> The study shows that the most common form of inappropriate advice is a 'misleading statement as to performance, product features or security, business reputations' (around 15 per cent of cases in the review), followed closely by 'using client funds for own purposes' (13 per cent) and the provision of 'advice [which] did not meet client objectives or circumstances and had no reasonable basis' (12 per cent). The study also found problems in the disclosure of information by the financial adviser to the consumer, with failures both to disclose 'remuneration benefits and conflicts of interest' and 'information relevant to client decision'. Consumer complaints in the period studied were also based on dissatisfaction with the advice provided, in terms of the adequacy or tailoring of the written advice received or the adequacy of the explanation and examination of the risks associated with the investment or financial product.

## **Avenues for consumer redress**

2.34 A client of a financial services licensee who suffers a loss or damage arising from misconduct can seek redress through private legal action:

- by pursuing an action for a breach of contract or in tort, or through class action with other clients who have had similar experiences with the licensee;
- by utilising avenues for redress available under the Corporations Act which enable a court to make an order for compensation for damage:
  - that results from the licensee's contravention of a financial services civil penalty provision;<sup>21</sup>
  - that follows from the licensee's failure to provide a disclosure document;<sup>22</sup> or
  - that is consequential upon a breach of a provision relating to false and misleading statements, inducing a person to deal, dishonest conduct or misleading or deceptive conduct.<sup>23</sup> and
- by utilising the power of the courts to make orders relating to the payment of money.<sup>24</sup>

2.35 ASIC is also able to take action on behalf of investors who have suffered a loss if it appears to be in the public interest to do so. ASIC can take action under s50 of the *Australian Securities and Investment Commission Act 2001* to recover:

- damages for fraud, negligence, default, breach of duty, or other misconduct committed in connection with a matter which ASIC is investigating; or
- property on behalf of investors.

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20 *Ethics and Financial Advice: The Final Frontier*, Dr June Smith, 2010 which is available at <http://www.businessandlaw.vu.edu.au/>The study was based on a review of 225 consumer complaints of inappropriate financial advice determined by the courts, FOS and ASIC between 2006 and 2007.

21 Section 1317HA.

22 Section 953B or 1022B.

23 Section 1041I.

24 Section 983E.

ASIC has succeeded in obtaining compensation for retail clients in a number of cases (see Chapter 3).

2.36 Compensation may also be secured as an outcome of an ASIC investigation of a licensee's conduct. In a recent investigation ASIC concluded that a financial adviser potentially breached various sections of the Corporations Act by providing inappropriate financial advice to a large number of clients. According to ASIC, the financial adviser subsequently agreed to identify those affected, assess liability and provide appropriate compensation.

### ***Alternative dispute resolution mechanisms***

2.37 It is also open to retail clients to seek redress through the less formal alternative dispute resolution processes that licensees are required to have in place under the Corporations Act. As these processes are the conduit through which many of the claims for compensation by retail clients flow they are outlined below.

#### *The dispute resolution system*

2.38 A licensee is required, under s912A(2), to have in place a dispute resolution system that consists of:

- an internal dispute resolution (IDR) procedure that meets ASIC's approved standards and requirements; and
- membership of at least one external dispute resolution (EDR) scheme that is approved by ASIC and covers complaints relating to the types of financial services provided by the licensee;
  - a licensee who only deals with superannuation products and services does not need to join an EDR scheme if all complaints can be handled by the Superannuation Complaints Tribunal.<sup>25</sup>

2.39 ASIC provides regulatory guidance on the standards for its approval of a dispute resolution system.<sup>26</sup>

2.40 The aim is to encourage the direct resolution of disputes between retail clients and financial service providers and to provide a less costly and more expeditious alternative to formal court processes.

2.41 In most cases, retail clients first seek to resolve their complaint directly with the licensee through its IDR process. If the complaint remains unresolved it may then be taken to the licensee's EDR scheme.

2.42 In deciding whether to approve an EDR scheme, ASIC has regard to the principles of accessibility, independence, fairness, accountability, efficiency, effectiveness and any other matter it considers relevant.<sup>27</sup> In practice, ASIC looks to an EDR scheme to provide free access for consumers, to actively promote its

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25 Established under the *Superannuation (Resolution of Complaints) Act 1993*.

26 ASIC RG 165: *Licensing: internal and external dispute resolution* and RG 139: *Approval and oversight of external dispute resolution schemes*.

27 ASIC RG 139 in particular section B: Guidelines for initial and ongoing approval. The Corporations Regulations and the National Credit Regulations state that ASIC must take those principles into account when considering whether to approve an EDR scheme.

services, to be independent of its members and overseen by an independent body, and to apply principles of natural justice.

2.43 Under its guidelines ASIC has regard to the following matters in considering the approval of an EDR scheme:

- the adequacy of the scheme's coverage in terms of the types of complaints and complainants who may access the scheme;
- its ability to handle claims up to the value of \$500,000 (consistent with a test for 'retail client' in the Corporations Act) and to make non-monetary orders, such as releasing a complainant from a contract;<sup>28</sup>
- its ability to award compensation up to a specified capped amount;
  - from 1 January 2010 to 31 December 2011, the upper limit of an award will be the limit each scheme used to operate in the immediately prior period;<sup>29</sup>
  - from 1 January 2012, the upper limit of an award will be \$150,000 if made for a claim against a general insurance broker and \$280,000 for other claims, and these caps will be subject to indexation;
- its ability to award interest on a loss;<sup>30</sup>
- the means by which the scheme will ensure compliance with its decisions; and
- the types of complaints a scheme can legitimately exclude from jurisdiction under its terms of reference, including those which were not brought in time.<sup>31</sup>

2.44 Following a recent change to the regulatory requirements, EDR schemes have a discretion to handle complaints against a member that has ceased to carry on business or ceased to have a licence.<sup>32</sup> Previously a scheme was not able to handle such complaints owing to the expulsion of a member from the scheme once it ceased to carry on business or lost its licence.

#### *Approved EDRs*

2.45 ASIC has approved eight EDR schemes for financial services over the years and, following amalgamations, two of these remain in operation:

- Financial Ombudsman Service Limited (FOS);
  - formed on 1 July 2008 by the merger of three EDR schemes previously approved by ASIC — the Banking and Financial Ombudsman Service, the Insurance Ombudsman Service and the Financial Industry Complaints Service.

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28 ASIC is currently consulting on whether a higher compensation cap should apply to beneficiaries of traditional trustee services complaints - ASIC Consultation Paper 138 *Dispute resolution requirements for trustee companies providing traditional services* (September 2010).

29 See para 2.45 which sets out the current caps for each EDR scheme.

30 An interest-inclusive award may exceed the capped amount by the amount of that interest.

31 Generally, a claim must be lodged by the earlier of six years from the date the complainant becomes aware of the loss or two years from the date a final response is given by an IDR scheme.

32 ASIC RG139, paras 139.196 to 200, para 3.10 of the FOS Constitution and para 10.1 of the COSL Constitution.

The Credit Union Dispute Resolution Centre Pty Limited and the Insurance Brokers Dispute Resolution Limited joined on 1 January 2009;

- had almost 5,400 members at the end of 2009-10;
  - has a compensation cap of \$150,000 for awards in investment related complaints (claims against a stockbroker, financial planner, managed investment scheme or in relation to securities and derivatives), \$100,000 for awards in insurance broking complaints and \$280,000 for awards in all other complaints (general insurance, deposit taking and credit); and
  - received 23,790 new complaints and more than 200,000 inquiries in 2009-10.<sup>33</sup>
- Credit Ombudsman Services Limited (COSL);
    - had more than 12,700 members at the end of 2009-2010;
    - members are generally loan writers and mortgage brokers, and some financial planners;<sup>34</sup>
    - has a compensation cap of \$250,000 for all complaints; and
    - received 1,153 new complaints and 19,147 inquiries in 2009-10.<sup>35</sup>

#### *Financial Ombudsman Service*

2.46 FOS is the largest provider of dispute resolution services for disputes with financial advisers and its operations are dealt with in more detail below.

2.47 A retail client can seek redress through FOS if a dispute is within its terms of reference. There is no cost to the applicant to use the dispute resolution service provided by FOS.

2.48 The cost of providing the service is borne by the member licensees. FOS is funded by an annual membership base levy for which the maximum charge is \$10,000 and the minimum is \$250. There is also an annual user charge based on the number and complexity of disputes and the stage in the process at which they were closed in the previous year. A licensee who had no more than one dispute in the previous year does not pay the user charge. In addition member licensees are charged case fees which are charged at the closure of a dispute and depend on the complexity of the dispute and the stage in the process at which it is closed. The fees are payable by the licensee irrespective of the outcome of the dispute.

2.49 Where FOS finds in favour of a consumer it makes an award that reflects the loss incurred up to the compensation cap. Where the amount in dispute is higher than the cap the complainant can either:

- waive the excess and accept the scheme outcome in full and final settlement; or
- reject the scheme outcome and pursue the complaint in a court.

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33 FOS Annual Review 2009-10.

34 COSL Annual Report on Operations 2008-2009.

35 COSL Annual Review of Operations 2009-10.

2.50 A member of FOS (the licensee) is contractually bound to honour a decision in favour of its client if accepted by the applicant in full and final settlement of the dispute<sup>36</sup>. The licensee is required to pay the amount of compensation awarded and comply with any term of a decision, such as a variation of its contract with the client.

2.51 While a licensee is contractually bound to honour an award it does not follow in practice that it will always have the financial capacity to do so. A licensee who fails to comply with a FOS determination could be reported to ASIC for serious misconduct and as a result ASIC could take steps to cancel its licence or impose conditions on the licence.

#### *Grounds for EDR scheme awards*

2.52 As noted in paragraph 2.42, in approving an EDR scheme ASIC looks to the scheme to reflect the principles of accessibility, independence, fairness, accountability, efficiency and effectiveness. In regard to fairness, ASIC says it believes a scheme's dispute handling should accord with the principles of natural justice. ASIC does not otherwise seek to limit the scope of the standard by which disputes may be resolved.<sup>37</sup>

2.53 In practice EDR schemes are not limited to handling disputes involving a breach of a licensee's obligations under Chapter 7. An EDR scheme may have jurisdiction to award compensation on grounds that go beyond breaches of Chapter 7.

2.54 ASIC's regulatory guidance also calls for EDR schemes to offer remedies that are 'consistent with the remedies available under the relevant laws that apply to the arrangements between the scheme member and its customers'.<sup>38</sup> In determining the extent of loss or damage suffered by a complainant, the scheme should have regard not only to the relevant legal principles but also to the concept of fairness and to industry best practice.

2.55 FOS, for example, in dealing with a dispute '... must do what in its opinion is appropriate with a view to resolving disputes in a cooperative efficient, timely and fair manner' and in resolving a dispute it will 'do what in its opinion is fair in all the circumstances, having regard to ...legal principles; applicable industry codes or guidance as to practice; good industry practice; and previous relevant decisions of FOS or a predecessor ...'. The types of disputes that can be considered by FOS are those '... that arise from a contract or obligation arising under Australian law' where it relates to the provision of a financial service.<sup>39</sup>

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36 *Financial Industry Complaints Service Ltd v Deakin Financial Services Pty Ltd* [2006] FCA 1805.

37 ASIC RG139, paras 102 to 107.

38 ASIC RG, para 211.

39 FOS Terms of Reference, clauses 1.2, 8.2 and 4.2.

### Complaints regarding investment services

2.56 Only a small proportion of the total disputes received by FOS in 2009-10 were investment disputes (1,639 of the 23,790 complaints received). In its Annual Review, FOS says that the:

bulk of investment disputes were about problems ... with a financial service provider's (FSP) advice (38 per cent), disclosure (18 per cent) or service (17 per cent). Advice-related complaints included claims that an FSP gave inappropriate advice or failed to provide advice. Disclosure related complaints included claims that an FSP provided insufficient, misleading or incorrect information about a product or service.<sup>40</sup>

FOS also says that 'more than half (58 per cent) of the investment disputes it handled were about products or services provided by financial advisers or planners'.<sup>41</sup>

2.57 The proportion of claims regarding investment services which were decided in favour of claimants was around 16 per cent and in favour of members was 11 per cent.<sup>42</sup>

2.58 The apparently low proportion of claims resolved in favour of the consumer may be attributable in part to:

- settlement of claims by the parties before a determination is made;
- resolution of claims by members outside of FOS; and
- claims that fall outside FOS's jurisdiction (for example, claims that exceed the monetary cap), are inappropriate and dismissed by FOS or are withdrawn by the claimant.

2.59 Table 2.1 shows the composition of claims against members that offer investment services, the aggregate amounts claimed and the amounts awarded. The average amount awarded was 12 per cent of the total amount claimed.<sup>43</sup>

**Table 2.1: Claims against FOS members who provide investment services — 2006 to 2009**

Activity	Aggregate claims	Aggregate outcomes
	\$million	\$million
Financial planning	124.4	17.8
Managed investments	37.1	1.3
Stockbroking	22.9	2.4
Other Claims	5.4	0.4
<b>Total</b>	<b>189.9</b>	<b>21.9</b>
<b>Average proportion awarded</b>		<b>12 per cent</b>

Source: FOS data

40 FOS Annual Review 2009-10, section on Investment Disputes.

41 Ibid.

42 FOS data provided to the review relating to the four year period to December 2009.

43 FOS may not record the outcome amount for some claims so the value of claims settled in favour of the claimant may be understated.

2.60 Awards made in favour of a claimant are commonly for an amount less than the amount claimed. This may occur because FOS was not persuaded that the claimant was entitled to the full amount claimed.

2.61 In assessing the amount payable as a result of a breach, FOS indicates that it 'may consider whether there was any contributory negligence ...' by the applicant, but it will not consider the liability of financial service providers other than the licensee member against whom the claim has been made.<sup>44</sup> In the case of *Wealthcare Financial Planning Pty Ltd v Financial Industry Complaints Service Ltd [2009] VSC*, the Supreme Court of Victoria concluded, on several grounds, that FICS was not obliged to, and in many cases was not able to apply the principle of proportional liability by considering the liability of parties other than the financial adviser in question, such as the contribution to that loss of the finance company, directors, the product provider, auditors or the investment research firm. It was also noted that some of these parties would not have been subject to an EDR scheme's jurisdiction.

2.62 The effect is that the consumer can obtain an award of compensation from a member licensee with whom the consumer has dealt. The licensee in such circumstances might have a legal right to seek proportional recovery from other responsible parties.

### ***EDR scheme awards and professional indemnity insurance***

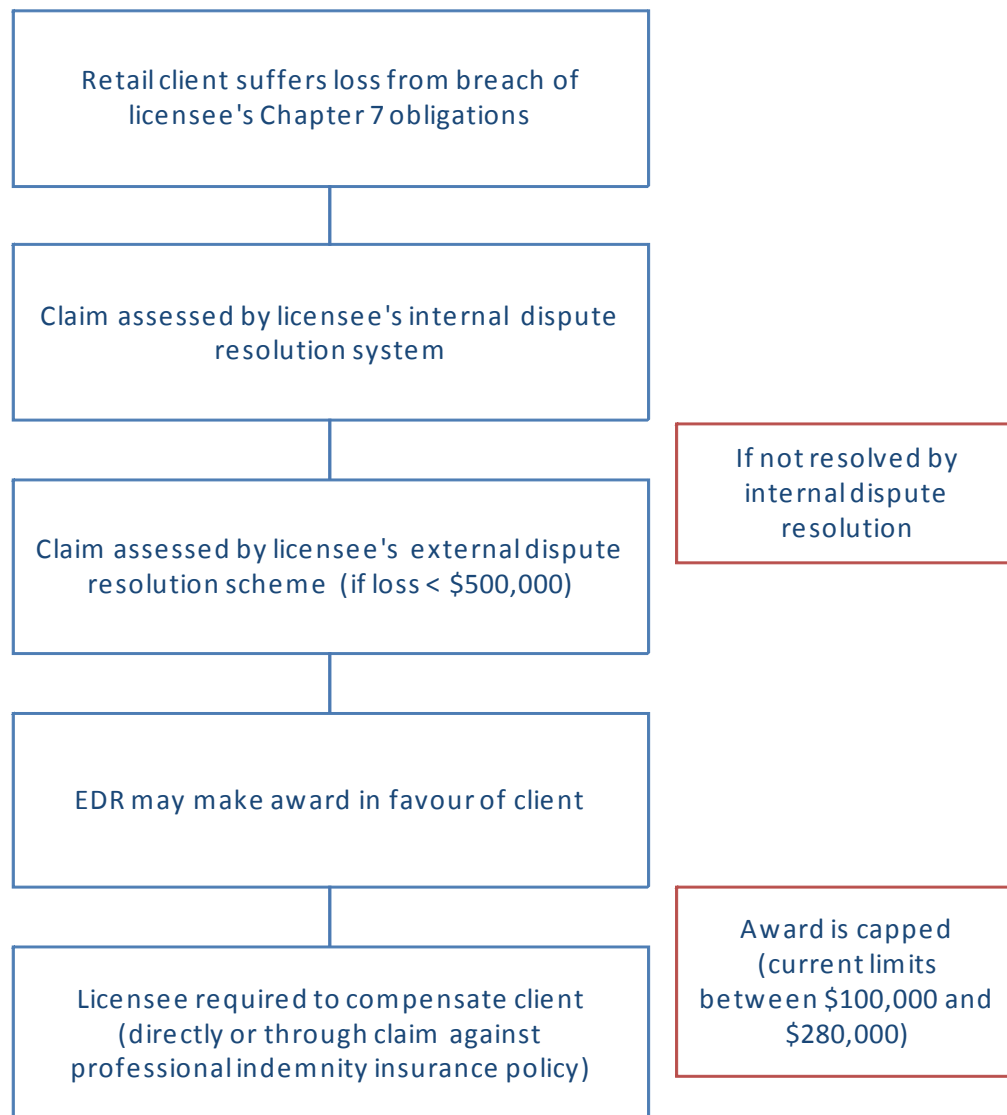
2.63 A licensee is contractually bound to honour an award of an EDR scheme made in favour of its client and could be expected to look to its professional indemnity insurer to meet this liability. The interaction between an EDR scheme award and professional indemnity insurance is shown in Diagram 2.1.

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44 FOS Circular, 4 December 2010.



**Diagram 2.1 — Interaction of EDRs and professional indemnity insurance**



2.64 Licensees are expected by ASIC to have insurance that covers liability arising under an award made by an EDR scheme. ASIC states that the insurance policy 'must have the effect of providing cover for breaches of the relevant obligations under Chapter 7 and EDR scheme awards and that that policy must be a contract of professional indemnity insurance (meaning) ...it must cover negligence, fraud and other misconduct (relating to retail clients) ordinarily covered by a contract of professional indemnity insurance'.<sup>45</sup> It is noted that ASIC in this regard goes beyond requiring a licensee to have insurance covering breaches of Chapter 7.

2.65 In practice, a licensee's claim for payment of such an award under its professional indemnity insurance policy may not be straightforward. The insurer is likely to look at the basis for the award and whether the specific circumstances are covered, and not excluded, by the policy. The fact that an EDR scheme has made an award in favour of a retail client may not be enough to satisfy the insurer in this regard.

<sup>45</sup> ASC RG 126, para 54, *Scope of cover*, Notes 1 and 2, p 17.

2.66 Difficulties may arise where an EDR scheme has based an award on a notion of fairness or breach of an industry code of practice or legal obligation other than those arising from Chapter 7. An example might be an EDR scheme award based on a breach of the licensee's contractual obligations to a client, or on its negligent conduct in breach of a common law duty of care to the client or on a licensee's breach of the broad principle of fairness and good practice.

2.67 A licensee who is not covered for such a liability under its insurance policy will have to meet it from its own financial resources. In some circumstances a licensee might also decide to meet the liability itself where it is less costly to do so than to pay an amount of excess required under the policy.

## **Other financial sector compensation arrangements**

2.68 Apart from the s912B arrangements, separate statutory compensation arrangements are already in place covering significant segments of the financial services sector. These arrangements have developed over the years in a somewhat piecemeal fashion.

### ***Compensation regime for financial markets***

2.69 The Corporations Act regulates the operation of financial markets such as securities and futures markets. Under Chapter 7 a person licensed to operate a market is generally required to establish a compensation regime if its participants provide financial services for retail clients that involve the participants holding money or property on behalf of those clients.<sup>46</sup>

2.70 The purpose of these compensation arrangements is to promote confidence for retail investors in the handling of money or property provided to intermediaries for investment purposes. When the NGF was established, it was hoped that it would instil confidence and encourage participation in the share market, given the low level of participation at that time.<sup>47</sup>

2.71 Providers of financial markets are required to comply with one of two compensation regimes established respectively in Part 7.5. Members of the Securities Exchange Guarantee Corporation (SEGC) must comply with the compensation arrangements in Division 4 of Part 7.5. Other providers of financial markets must comply with the compensation arrangements in Division 3 of Part 7.5 of the Corporations Act.

2.72 In addition to the requirement that market operators establish compensation arrangements, participants in those markets, such as stockbrokers and futures traders, are required to have the financial capacity to meet claims for compensation from their clients. Under ASX operating rules, participants are required to meet capital adequacy requirements and core liquid asset ratios. Stockbrokers and other participants are required to hold professional indemnity insurance against a breach of

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<sup>46</sup> Section 881A.

<sup>47</sup> *Australian Stock Exchange and National Guarantee Fund Bill 1987*, Second reading speech to the House of Representatives, Hansard, 18 February 1987.

duty owed in a professional capacity, whether in contract or at law.<sup>48</sup> Failure to meet the obligation to have insurance attracts a maximum penalty of \$100,000.

2.73 In practice it is understood that stockbrokers take out professional indemnity insurance that meets their dual obligations as financial service licensees and as participants in the securities market. The latter requirement is broader in respect to cover 'against a breach of duty the market participant owes in a professional capacity whether owed in contract or otherwise at law'. Another distinction is that the market participant must advise ASIC within 10 business days of the renewal of its insurance policy, including the amount and nature of cover, and to advise ASIC immediately of any notification to its insurer of a claim.<sup>49</sup> Failure to meet these obligations attracts a maximum penalty of \$20,000.

### *National Guarantee Fund*

2.74 SEGC administers the NGF as the compensation regime for the ASX which currently is its only member.

2.75 NGF was established in 1987 from the amalgamation of state and territory fidelity funds following a long history of stock exchanges operating their own fidelity funds.<sup>50</sup>

2.76 NGF provides compensation for clients who incur a loss in their dealings with stockbrokers on the ASX in the following circumstances:<sup>51</sup>

- where a stockbroker has failed to complete a sale or purchase of securities entered into on the ASX's equities and debt market and where those transactions are required to be reported to the ASX by the stockbroker (that is, a contract guarantee);
- where a stockbroker makes an unauthorised transfer of securities;
- where a stockbroker cancels or fails to cancel a certificate of title to quoted securities contrary to the operating rules of the Australian Securities Exchange Settlement and Transfer Corporation Pty Limited; and
- where a person has entrusted property to a stockbroker who subsequently becomes insolvent and cannot meet its obligations to that person.

2.77 In the first three of those circumstances, there is no cap on the amount that can be claimed under NGF. In respect to a loss arising from a stockbroker's insolvency,

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48 ASIC Market Integrity Rules (ASX Market) 2010, February 2011, rule 2.2.1.

49 *ibid*, rules 2.2.3 and 2.2.4.

50 NGF was established by *the Australian Stock Exchange and National Guarantee Fund Act 1987*. The Sydney Stock Exchange established a fund in 1937, and funds were subsequently established by the Perth Stock Exchange in 1968, by the Melbourne Stock Exchange in 1970 and by the Brisbane Stock Exchange in 1971. The *Securities Industry Act 1980* required all stock exchanges to establish and keep a fidelity fund and required a contribution to the fund of at least \$500 from all members, with additional levies imposed if the fund became insufficient.

51 Part 7.5, Division 4 of the Corporations Regulations, subdivisions 4.4, 4.7, 4.8 and 4.9.

compensation is limited to 15 per cent of the minimum size of NGF — which is currently required to be a minimum of \$80 million.<sup>52</sup>

2.78 While only required by law to provide compensation for retail clients, NGF in practice covers claims by wholesale clients as well.

2.79 Compensation is not available from NGF:

- for a loss arising from investment decisions or from relying on investment advice given by a participant;
- for a loss if a participant fails to act on instructions to buy or sell;
- for money lent to a participant which has not been repaid;
- in respect of conduct by an entity other than the specific entity which is the participant; and
- in respect of alleged unauthorised withdrawal or misappropriation by the participant of money in a client's account or held on a client's behalf (unless covered by one of the four circumstances noted above).

2.80 SEGC may impose a levy on operators or participants in their market if the amount in NGF falls below the minimum prescribed. SEGC has not found it necessary to impose any levies to date given the availability of assets rolled over from the pre-existing funds and subsequent investment earnings. NGF had \$111 million in assets as at June 2010.

2.81 Where a retail client of a stockbroker is unable to receive compensation through NGF the client could still bring a claim under the broker's s912B compensation arrangements if the broker failed to meet its obligations under Chapter 7. An example might be where a client relied on a broker's investment advice and the broker did not have a reasonable basis for the advice provided.

#### *Compensation regimes for other market operators*

2.82 Market licensees who are not members of SEGC must obtain approval from the Minister for compensation arrangements to deal with losses in the following circumstances:<sup>53</sup>

- where a retail client gives money or other property to a participant in connection with a transaction covered by the operating rules of that market and there is a defalcation or fraudulent misuse of that money or property by the participant; or
- where the retail client gives the participant authority over the property and the participant fraudulently misuses that authority.

2.83 The market operator must have 'an adequate source of funds available to cover claims' which arise from the losses described above.<sup>54</sup> Examples of arrangements that have been accepted include a fidelity fund, insurance arrangements, an

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<sup>52</sup> Section 889I.

<sup>53</sup> Sections 881B, 882A and 885C, and Corporations Regulation 7.5.15.

<sup>54</sup> Section 885H.

irrevocable letter of credit or a combination of these.<sup>55</sup> The following market licensees have established compensation arrangements:

- SIM Venture Securities Exchange and the National Stock Exchange of Australia;
- Asia Pacific Exchange (formerly the Australia Pacific Exchange) — which has a fidelity fund with minimum cover of \$750,000;
- IMB — which has an irrevocable undertaking by an ADI with minimum cover of \$1 million;
- Australian Securities Exchange Supplemental Compensation Fund; and
- Sydney Futures Exchange Fidelity Fund.

### ***Financial Claims Scheme for depositors and policyholders***

2.84 FCS was established in October 2008 to provide depositors of ADIs and general insurance policyholders with timely access to funds in the event of the failure of such a financial institution.<sup>56</sup> In December 2010, FCS was confirmed as a permanent feature of the financial system.<sup>57</sup>

2.85 The introduction of FCS follows consideration by the Council of Financial Regulators dating from 2005, and also follows recommendations made by the HIH Royal Commission in 2003 and the global Financial Stability Forum in 2008. The Council of Financial Regulators, which includes the heads of APRA, ASIC, the Reserve Bank of Australia and the Treasury, examined Australia's crisis management arrangements and found there was a strong case for introducing a mechanism to provide both depositors in an ADI and policyholders in an APRA regulated general insurer with access to some of their funds or funds due to them in a timely manner should a financial institution fail.

2.86 The *Banking Act 1959* provides a mechanism for making payments to depositors under the Government's guarantee of deposits to ADIs up to a nominated cap (currently \$1 million per depositor per institution).<sup>58</sup>

2.87 The *Insurance Act 1973* protects certain policyholders and other claimants who make valid claims on a general insurance company where the insurer is insolvent.

2.88 FCS is administered by APRA with its day to day costs met through the APRA levy on prudentially regulated financial institutions.

2.89 In the event of a payout to depositors or policyholders, the Government meets the cost of the payments in the first place, but recovers these costs when the failed ADI or general insurer is wound up. Should the available assets be insufficient, the Government can levy ADIs or general insurers as the case may be to recover the remainder.

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55 Notes to s885H.

56 *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008*.

57 *A Competitive and Sustainable Banking System*, Media Release by Deputy Prime Minister and Treasurer, the Hon Wayne Swan MP, 12 December 2010.

58 The *Banking Act 1959* and the *Insurance Act 1973* were amended by the *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008*.

### **Compensation arrangements for superannuation funds**

2.90 The superannuation industry is subject to a prudential regulatory system. APRA supervises trustees of superannuation funds but allows trustees a degree of freedom to operate their funds. This regulatory approach aims to minimise rather than prevent failure of the superannuation funds.

2.91 In 1993, the then Government introduced legislation which aimed to strengthen the security of superannuation savings and protect the rights of superannuation fund members.<sup>59</sup> The Explanatory Memorandum stated that one of the most important elements of this package of measures was ‘for financial assistance to be provided to funds that have suffered a loss due to fraudulent conduct or theft’.<sup>60</sup> This policy intent was the basis for Part 23 of the *Superannuation Industry (Supervision) Act 1993*.

2.92 Under Part 23 of that Act a trustee of an APRA-regulated superannuation fund (or approved deposit fund) can apply to the Minister for a grant of financial assistance if the superannuation fund incurs a loss as result of fraudulent conduct or theft.<sup>61</sup> The Minister is required to seek advice from APRA and must be satisfied that the loss has caused a substantial diminution of the fund leading to difficulties in the payment of benefits, and that the public interest requires a grant to be made.

2.93 The Minister has discretion over the payment of financial assistance and the amount of that assistance.

2.94 The financial assistance granted in this way is funded initially from the Consolidated Revenue Fund and then recouped through an industry levy on APRA-regulated superannuation funds and approved deposit funds.<sup>62</sup> The effect is that a loss in one superannuation fund is borne by the members of other funds that contribute to the levy. Levies are based primarily on the asset size of the contributing fund.

2.95 The Minister has a discretion to impose conditions on the grant of financial assistance and has used this discretion to impose a requirement that any monies recovered from the perpetrator of the fraud or theft against the superannuation fund be refunded to the Commonwealth up to the amount of the grant.

2.96 Part 23 specifically excludes self-managed superannuation funds (SMSF) from being able to apply for financial assistance under Part 23. This is on the basis that SMSF members, as trustees of their SMSF, have direct control over their superannuation savings and are in a position to protect their own interests. The trustees of an SMSF, in circumstances where they qualify as retail clients under the Corporations Act, will have rights to compensation on a par with other retail clients.

### **Compensation arrangements for credit providers**

2.97 A provider of consumer credit and credit-related brokering services and advice must hold an Australian Credit License under the *National Consumer Credit*

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59 *Superannuation Industry (Supervision) Act 1993*.

60 *Superannuation Industry (Supervision) Bill 1993, Explanatory Memorandum*.

61 Part 23 applies to a regulated superannuation fund or an approved deposit fund but not a self managed superannuation fund.

62 *Superannuation (Financial Assistance Funding) Levy Act 1993 and the Superannuation (Financial Assistance Funding) Levy and Collection Regulations 2005*.

*Protection Act 2009*.<sup>63</sup> In some instances, an Australian Financial Services Licensee may also hold a credit licence. A financial planner who also advises on mortgages, for example, will be subject to a dual regulatory regime, including compensation arrangements imposed under both the financial services and credit regimes (see Table 2.2).

2.98 Credit providers are required to have an IDR process, to be a member of an EDR scheme and to have adequate compensation arrangements for loss or damage to the consumer as a result of a breach of an obligation of the credit licensee, such as the obligation to ensure they do not provide a credit contract that is unsuitable for the consumer. These consumer protection mechanisms are broadly similar to those that apply to Australian Financial Services Licensees.

2.99 Under the regulations for credit providers, the obligation of the licensee to have compensation arrangements can be met by holding professional indemnity insurance cover that is adequate.<sup>64</sup> Licensees who are APRA-regulated insurers or ADIs are exempt from the requirement to hold professional indemnity insurance. In assessing the adequacy of the cover, the licensee is to have regard to:

- the maximum claim likely to be made against the licensee should a dispute be taken to an EDR scheme; and
- the credit activity undertaken by the licensee.

2.100 An overview of the compensation arrangements that apply to financial services licensees is provided in Table 2.2.

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63 Generally commenced on 1 July 2010, or 1 January 2011 for ADIs and Registered Financial Corporations.

64 *National Consumer Credit Protection Regulations 2010*.

**Table 2.2: Compensation arrangements applicable to financial services licensees**

<b>Financial services licensees</b>								
<b>Financial services providers requiring a License</b>	<b>Financial advisers</b>	<b>Insurance brokerage</b>	<b>Securities, futures or derivatives brokers</b>	<b>Superannuation funds</b>	<b>Provision of managed investments</b>	<b>Provision of banking services</b>	<b>Provision of credit</b>	
<b>Default compensation requirements</b>	<b>Section 912B compensation requirements apply to all licensees</b>						<b>Additional requirement for compensation under the National Consumer Credit Protection Act 2009</b>	
<b>Nature of compensation arrangements</b>	<b>Professional indemnity insurance (or alternative approved by ASIC)</b>						<b>Self insurance (as prudentially regulated entities)</b>	<b>Professional indemnity insurance, self insurance (for prudentially regulated entities) or alternative approved by ASIC</b>
<b>Grounds for and resolution of claims</b>	<b>Breach of conduct and disclosure requirements</b>						<b>Determined by court, internal dispute resolution or external dispute resolution processes</b>	<b>Additional grounds under National credit code for breach of responsible credit conduct</b>
<b>Other arrangements</b>	National guarantee fund and other regimes set up by providers of financial markets		Ministerial grant of financial assistance to superannuation fund trustee for loss from fraud or theft			Financial Claims Scheme for loss by depositors or policyholders due to insolvency of ADI or general insurer		



## Issues of interest

### Insurance market

ASIC concluded, on the basis of research in 2006, that the market for professional indemnity insurance was well supplied and competitive on price at that time. There appears to have been a tightening in this market in more recent years, in particular in the availability and cost of cover for financial advisers. Information and comment are sought on the current conditions in and prospects for the market in the supply of professional indemnity insurance to licensees. In particular, the following aspects are of interest:

2.1 The capacity of the insurance market to supply licensees with professional indemnity insurance cover that is adequate to the needs of licensees considering the specific features ASIC requires the licensee to take into account such as minimum levels of cover, excess amounts the licensee can confidently sustain, and coverage of EDR scheme awards.

2.2 The circumstances in which the market has been able to supply run-off cover to a financial services licensee.

2.3 The conditions, in terms of access and price, for reinsuring the risk of professional indemnity insurance provided to financial service licensees.

2.4 Changes in the availability of professional indemnity insurance for licensees since 2008 when s912B arrangements came into full operation, in terms of premiums, excess amounts, cost of including specific policy features, factors that have impacted on pricing this product, and the impact on licensees of any changes, particularly on those who provide financial advice.

2.5 The longer term outlook for the insurance market in terms of the supply, cost and coverage of professional indemnity insurance for financial service licensees in accordance with the requirements of s912B, associated regulations and guidance from ASIC.

2.6 The circumstances in which licensees have found it difficult to acquire professional indemnity insurance cover that meets their needs.

## **ASIC requirements for professional indemnity insurance**

In administering the requirement that licensees who deal with retail clients have in place compensation arrangements, ASIC provides formal guidance on the factors to be taken into account by licensees in assessing the adequacy of their professional indemnity insurance. ASIC is able to approve in writing compensation arrangements other than professional indemnity insurance. Information and comment are sought on the experience of insurers, licensees and consumers with this approach. In particular, the following aspects are of interest:

2.7 The utility and effectiveness of the guidance provided by ASIC to licensees in enabling them to assess the adequacy of their professional indemnity insurance.

2.8 The adequacy of the current administrative approach in providing assurance that licensees meet their requirements to have adequate insurance cover.

2.9 The appropriateness of the current exemptions from the need to hold professional indemnity insurance cover.

2.10 The scope for a licensee in practice to make alternative compensation arrangements with the approval of ASIC.

## **Process for claiming compensation**

Information and comment are sought on the experience of respective parties with the process for claiming and recovering compensation for loss or damage arising from a breach of a statutory obligation by a licensee. In particular, the following aspects are of interest:

2.11 Awareness by retail clients of the available dispute resolution schemes and compensation arrangements, and the degree of clarity to consumers about using those processes.

2.12 Any issues arising from the existence of separate compensation schemes and arrangements in various segments of the financial services sector (for example, NGF and FCS).

2.13 The possible scope for bringing together some of these schemes and arrangements or moving towards some form of common administration.

2.14 The experience of respective parties in making and responding to claims for compensation in terms of time, cost and outcomes, including claims pursued through an internal or external dispute resolution scheme or the courts.

2.15 Circumstances in which retail clients have been unable to recover compensation awarded to them, or have not pursued claims because of the low probability of being able to recover any award in practice.

2.16 Circumstances in which retail clients have found it difficult to pursue a claim for loss or damage against a provider of financial services, including where the provider is no longer carrying on business, has become financially stressed or insolvent.

2.17 Any experience in pursuing compensation from financial services providers who are not in fact licensed as required.

2.18 Any practical difficulties arising from differences between the standards of liability for licensees under Chapter 7 of the Corporations Act, the general law and under EDR schemes, and the ambit of liability covered in professional indemnity insurance policies obtainable by licensees.

2.19 Any issues in practice with compensation claims against licensees by retail clients in regard to the distinction between inappropriate advice or misconduct by a licensee on the one hand and investment losses in the absence of such misconduct on the other.

2.20 Ability of clients to pursue claims through EDR schemes against parties, other than licensees with whom they have dealt, who may bear some responsibility for loss or damage (for example directors or auditors).

2.21 Ability of licensees to seek recourse against other licensees or parties, who may bear some responsibility for the loss or damage suffered by a retail client, in relation to an award of compensation in favour of that client under an EDR scheme.

