Response to ASIC Consultation Paper 87

Compensation and insurance arrangements for AFS licensees

Dated: 24 September 2007

INTRODUCTION

We believe Professional Indemnity Insurance (PI) arrangements are an important element in the continued operation of the financial services industry and that regulation should operate in a manner that recognises the financial capacity of industry participants and the safety of customers.

A number of themes recurred in the comments of IFSA Members on the matters raised by ASIC Consultation Paper 87 on Compensation and insurance arrangements for AFS licensees (CP 87). They are:

- Problems with the professional indemnity (PI) insurance market, including availability of appropriate insurance cover.
- Difficulties with the scope of PI insurance - cover does not extend to breaches of the Corporations Act, dishonesty and fraud.
- Members do not agree with the guidance put forward by ASIC regarding disclosure of their PI insurance cover in a financial services guide (FSG).
- Members do not agree with ASIC's proposal on "run-off" cover.
- Members do not agree with ASIC's proposal on obtaining PI insurance cover, or self insuring, for financial products not on the licensees approved product list.

Additionally, Members questioned the timing of CP 87 given the current review by the Financial Industry Complaints Service of monetary thresholds and the announced merger of FICS, the Banking and Financial Services Ombudsman and the Insurance Ombudsman Service.

If, following consultation, a Regulatory Guide is issued and new requirements are effectively imposed on licensees then appropriate transitional arrangements will be needed as many AFSL holders will have already re-negotiated their PI insurance arrangements and the next policy renewal will fall after the end of the transition period of 1 July 2008.

References to paragraphs in this submission are references to numbered paragraphs in ASIC Consultation Paper 87: Compensation and insurance arrangements for AFS licensees.

A. GENERAL COMMENTS

A.1 Professional Indemnity Insurance Market

The statement is made at paragraph 16 that:

> ASIC "expect that the insurance industry will respond to the opportunity created by mandatory PI insurance cover to develop new products that will help PI insurance fulfill the purpose of the compensation arrangements".

If history is any guide following the introduction of similar requirements for the insurance broking industry in 1984 there is no guarantee that underwriters will, or are able to, be flexible in amending PI policies to meet any ASIC required conditions.

While now, in a soft (cheap) insurance market underwriters may potentially be flexible, this flexibility would most likely evaporate when the market turns and becomes hard (expensive). We question what would happen when underwriters place restrictions on the PI insurance that may breach the ASIC requirements. In other words, that the insurance reflecting the requirements outlined in CP 87 is not made available on commercial terms.

We note at paragraph 57, that ASIC acknowledges in the ASIC commissioned report *Compensation Arrangements for Financial Services Licensees – Research into Professional Indemnity Insurance Market* (December 2006) that existing limitations and issues render many of the recommendations in CP 87 unrealistic. It needs to be acknowledged that while PI insurance provides a valuable service in providing a level of indirect protection for many customers, it is a commercial activity provided by companies with a primary responsibility to their shareholders and is not a public service. PI is taken by a licensee as protection against loss to the licensee arising from a claim against the licensee by a customer (see response to Question B4Q1).

We note that there is currently limited underwriter capacity in the market and ASIC have excluded Discretionary Mutual Funds (**DMF**). Additionally, amendments to the Insurance Act have been recently made requiring Direct Offshore Foreign Insurers (**DOFIs**) to be authorised by the Australian Prudential Regulation Authority and comply with Australia's risk focussed prudential framework (see Minister for Revenue and Assistant Treasurer Press Release No.117, 20 September 2007). Rather than facilitate greater capacity being created the legislation may operate as a disincentive to some current DOFIs operating in the Australian market to the point that it will not be attractive for them to remain.

The use of excesses and deductibles is also important and will become only more so should the market become harder. It is a common and legitimate feature of such insurances and indeed may be required due to lack of capacity or, as part of the means by which underwriters encourage an alignment of interests between insured and insurer. Excesses and deductibles should not be seen or considered as against the basic policy that the primary way to comply will be to have adequate PI insurance, and that excesses and deductibles (including significant excesses and deductibles for larger institutions) do not require that the insurance is not "adequate".

We anticipate that most conglomerates, especially those with related APRA regulated bodies which includes many IFSA Members, will self insure with higher excess limits so there is likely to be a reduction of capital in the PI

insurance market. This will lead to a re-pricing of risk covering the smaller and arguably higher risk compulsory PI insurance market. This, in turn, will probably result in further restrictive terms and prohibitive premiums for smaller licensees as underwriters consider factors such as the quality of management systems, what is on the approved product list and the insured's claims record.

A.2 Approved Product List (**APL**)

At paragraphs 65-67 of CP 87 it is stated that if a PI policy does not provide cover for advice provided by a licensee's representative about financial products not on the APL of the licensee, and such cover is not reasonably commercially available, then the licensee should set aside sufficient financial resources to cover this risk.

Most PI insurance policies rely on 'approved product lists'. It appears that ASIC is seeking to compel licensees to either get cover for 'non approved products' or put aside capital to cover the risk. This is not, in our view, within the scope of ASIC's regulatory authority. Such a requirement would need to be expressly included in the Act.

B. RESPONSE TO SPECIFIC QUESTIONS

Question B3Q1: Do you agree with our proposals on what is an adequate amount of cover per claim? Please give reasons.

IFSA does not agree with ASIC's proposals on what is an adequate amount of cover per claim.

A general "per claim" limit linked to an EDR limit is unworkable. This is because claims may be able to be aggregated for the purposes of application of a single policy deductible (excess) and consequently a higher per claim limit than an EDR is required. It would not be possible to meet a 1 January 2008 or 1 July 2008 compliance date if ASIC was to pursue this change.

In addition, we note that PI policies are currently written on a "claims made" basis not "claims incurred", therefore compliance with the approach suggested by ASIC is not possible.

Neither regulation 7.6.02AAA(1) of the Corporations Regulations (the Regulations) nor the accompanying Explanatory Statement indicate any role for ASIC in setting minimum amounts of PI insurance. Rather the legislative requirements leave it to licensees to make "a reasonable and realistic assessment of liability that a licensee might be subject to as a result of membership of one or more external dispute resolution schemes" and "the extent to which potential claims outside of the external dispute resolution framework need to be considered". ASIC's role in setting adequacy levels is restricted to sub-regulation 7.6.02AAA(2).

We agree that licensees must have the financial capacity to meet any excess or deductible. We note that the maximum deductible of 5% of annual revenue (as proposed for small licensees) could be high, given the Melzan report which indicated that the typical excess is 1% and that the top end is no more than 2.5% of annual revenue for advisers with a good claims record.

We note that a poor claims record quickly translates into a much higher excess (typically $50,000 to $200,000) for smaller licensees and further consideration needs to be given to ensuring that this group have a practical means of meeting their obligations. Our recommendation, therefore, is that greater flexibility needs to apply, so that individual licensees can determine their potential exposure to claims and put in place suitable arrangements, which are appropriate given the size, nature and complexity of their business.

Question B3Q2: Do you agree with our proposals on what is an adequate aggregate amount of cover for insurance brokers? Please give reasons.

We understand that the following comments also represent the views of other industry participants on this matter.

ASIC appears to accept that the previous arrangements under the *Insurance (Agents and Brokers) Act 1984* (**IABA**) were appropriate and were seen to be effective over twenty years of experience. IFSA is uncertain as to why the same rationale is not applied to other licensees, many of whom are Life Insurance Brokers who deal in life insurance and superannuation and, therefore, are subject to higher EDR limits and to the IABA PI insurance requirements. A number of these Life Insurance Brokers are related to IFSA Members.

Although it is proposed that the maximum level of cover for brokers would remain the same as it is at present, there are a number of common issues for brokers of PI insurance and also for other licensees under ASIC's proposals. These issues include the following significant matters which impact on the availability of 'appropriate' cover:

1. Cover:

   To include:

   (a) All breaches and obligations of the licensee and their representatives under Div 7 of the Corporations Act.

   (b) Fraud and dishonesty

   (c) Awards made by EDRs including the IBDL & FICS.

2. Excess:

   Excesses could be a problem for licensees, particularly the larger ones with bigger excesses.

   Small excesses (well below the $100 000 IBD limit) allowed where the business can confidently sustain as an uninsured loss. Larger excess may need the approval of ASIC and possibly the introduction of some form of industry support fund.

3. Run Off Cover:

   Policy to include run-off cover for the "longest period reasonably available".

4. Exclusions: Extremely limited.

5. Security: Generally APRA regulated body.

The issues involved are complex but they could have significant implications for brokers and other licensees, particularly larger brokers and licensees and for industry PI insurance schemes such as the National Insurance Brokers Association (**NIBA**) scheme.

Question B3Q3: Do you agree with our proposals on what is an adequate aggregate amount of cover for other licensees? Please give reasons.

At paragraph 9 of CP 87, EDR schemes are recognised as the main venue for compensation claims and, that a licensee's PI insurance cover must be adequate having regard to its EDR scheme membership.

ASIC has sought to specify a minimum 'aggregate' cover based on a formula for which no rationale is provided other than its "research suggests that most licensees will need a minimum cover of $2 million in aggregate" and that "this is likely to be adequate for smaller licensees, but might not be for larger licensees ". The calculation of an adequate aggregate amount is arbitrary. It is suggested that revenue is arbitrary and not an appropriate basis on which to make such a calculation

Additional drivers that we believe are taken into account in determining adequacy include:

1. Review former and current statements of claim(s) to ensure that they are below current limit;
2. Review current business activities, authorised representatives, salaried financial advisers and licences held;
3. Review the number of clients, where they are derived and the FUM/revenue attributable to them;
4. Brokers assurance that PI policy cover, extensions and exclusions are standard;
5. The performance of extensive benchmarking against other companies who are in the same industry, have similar market capitalisation and also have a limit greater than a specified minimum;
6. Keeping abreast of any publicly noted rectification costs incurred by competitors.

More flexibility is required in the approach to determining what are "adequate arrangements". It is appropriate for licensees to have flexibility to adopt alternative approaches in meeting the compensation requirements. As stated in response to Question B3Q1, we consider that adequate arrangements will vary between licensees.

ASIC should take account of the likelihood that the licensee and related licensees would fail to meet claims that may realistically arise or be unable to access capital to

cover liabilities as they are due. The risk profile/exposure of the licensee should take account of the nature and size of the licensee and related licensees.

Question B3Q4: Should we continue to distinguish between insurance brokers and other types of licenses? Please give reasons.

ASIC consider that because "Insurance brokers have been subject to PI insurance requirements under the former Insurance (Agents and Brokers) Act 1984 for many years, and" they "understand that the regime was reasonably effective" then they "propose to continue to treat the amount of cover specified under that repealed Act as adequate for licensees in the business of insurance broking" (which would include IFSA Members with life insurance brokers). This leaves the position of life brokers who are also financial planning licensees unclear – are they to be subject to the old IABA requirements of which they have had to comply with or the higher levels applying to other AFSL holders.

Consistent with the objective of the Financial Services Reform Act 2004 to create a "level playing field", we believe there should be one set of uniform requirements applying to all AFS licensees. There is no basis on which any distinction should be made between the situation of insurance brokers and that of other financial planning licensees.

Question B4Q1: Do you agree with our proposal on what is an adequate scope of cover? Please give reasons.

We note the ASIC statement at paragraph 31 that "section 912B requires that insurance must cover loss or damage suffered by retail clients …….". The assertion misstates section 912B which provides that "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 representatives". The law does not remove moral hazard but merely seeks to reduce it.

IFSA does not agree with the scope of the cover as proposed by ASIC. PI insurance policies will not usually cover fraud and dishonesty by principals and, therefore, would not comply with the approach suggested by ASIC. Additionally, PI insurance policies are written on a "claims made" not a "claims incurred" basis. In an ongoing policy renewal, run-off (claims made in a current period relating to negligent acts committed in a prior period) is accomplished by renewal of the policy. This is usually maintained for a period of 6 years after contract completion. However, if a licensee ceases to operate, the insurer would not automatically provide run-off cover but the option of providing it would be at the discretion of the insurer. Therefore, there would be no cover, or limited cover, available to licensees in this situation (see response to Question E1Q1).

We agree with the view that PI insurance is not going to cover everything going wrong, nor do we believe that it should, as covering all risks may create moral hazard not only for the insured but also for consumers who may as a result be less careful in choosing a financial adviser. The indemnity scheme suggested by ASIC would

introduce moral hazard and its cost would likely be largely borne by large licensees. We are, therefore, opposed to it.

It should be noted that industry PI insurance scheme underwriters are generally becoming more restrictive in the cover they make available. Coverage of fraud, dishonesty and breaches of the Corporations Act are usually not available on most policies available in the market.

Question C1Q1: Do you agree with our proposal on partially adequate cover? Please give reasons.

Partially adequate arrangements are suitable especially for individual licensees who are subsidiaries of a larger conglomerate group. In this situation, there is likely to be a high deductible and substantial level of cover. The licensee then effectively self-insures for any amount below the deductible and assuming the net assets are adequate to cover this amount, the arrangement should be seen by ASIC as acceptable.

Question C1Q2: Are there any other practical problems with our proposal that licensees manage this issue of partially adequate cover by setting aside sufficient own financial resources?

Yes, the definition of “setting aside” adequate resources is unclear. The test is adequacy of net assets compared with exposure. Is ASIC assuming that provisions should be made in the entity’s accounts?

In relation to the process proposed by ASIC where the cover is not fully adequate, we note that the total exposure to potential claims would be hard to estimate, especially where the licensee is relatively new and does not, therefore, have a history of claims made in the past as a guide to making the estimate.

If "approved" policy wordings are provided by underwriters then Section C - PI insurance that is not fully adequate becomes irrelevant. However, we question step 3 of the 4 step process that you "Ensure" cash flows will be sufficient to cover claims not covered by the policy. Cash flows may be impacted by a range of external factors not within the control of the licensee. If there is an adequacy problem in a PI policy a Licensee is unlikely to be able to guarantee that their future cash flow would be adequate.

It is our view that licensee’s should have the ability to meet the requirements in a manner that is flexible and reflects the risk profile of their business. Some licensees may elect to use cash flow projections, whilst others may rely on net asset calculations to demonstrate that capital is available to meet liabilities as required. We recommend that the requirements should be flexible and outcomes based, and believe the current approach is too prescriptive.

Question C1Q3: Is the cash flow method suggested here sufficient to deal with the issue of partial adequacy? What role do you think overdrafts and other forms of financial support may play here? Please give details.

The cash flow method suggested is, in our view, impractical and is inconsistent with the existing requirements for RSE licensees. PI insurance would not normally be in place to cover losses that can be forecasted in a simplistic way. The policy covers civil liability claims which cannot be estimated under a cash flow model. Further, RSE licensees, which are subject to the new proposals, do not currently have to prepare cash flow projections as they are regulated by APRA and APRA determines the financial requirements that apply.

It would be an anomalous result to suggest RSE licensees now comply with these proposals in addition to their existing obligations. ASIC should consult further with APRA on issues that relate to prudentially regulated institutions.

Overdrafts are not a useful way to self insure as it would be difficult to estimate an overdraft limit.

Question D1Q1: Do you agree with our approach to assessing alternative arrangements? Please give reasons.

The approach is reasonable and takes into account the capacity of larger institutions to absorb unexpected losses compared with smaller institutions.

Question D1Q2: Should applications for approval of alternative arrangements have to be accompanied by external expert reports (e.g an assessment by an actuary or auditor)?

No, there should not be additional requirements. Licensees are already subject to annual compliance and financial audits.

Question D3Q1: Do you agree with our choice of examples? Please give details of any other example you believe is appropriate.

Self Insurance approach

Self insurance is a common approach by many IFSA Members as well as other large conglomerates. However, the nature of the self insurance arrangements is generally not as described. By way of example: a highly capitalised entity will generally arrange insurance either through a traditional underwriter or by using a ‘captive’ and the nature of the ‘self insurance’ is by way of the level of excess applicable to the PI insurance arrangement. The level of excess represents that portion of the potential risk that is ‘self insured’. We are aware that some larger conglomerates might hold very large insurance policies but with excess limits up to $1M. These conglomerates also cover their subsidiaries under these ‘self insurance’ arrangements.

A number of IFSA Members who have ‘insurance brokers’ as members of their group have had to maintain PI insurance as required by the IABA (Example A). These members have, however, limited these policies to the minimum required by the Act. In reality the group then ‘self insures’ the balance between the upper limit of the minimum cover required by the Act and the balance of the excess applying to the

group insurance arrangements. Given the absence of a statutory requirement, we believe all would opt for the ‘self insurance’ model described above.

The feedback IFSA has received from Members is that they are more likely to adopt this approach where there is an ‘exempt licensee’ within the group rather than provide guarantees to their related licensees in view of the APRA requirements to provide capital reserves to cover such guarantees. On this basis, IFSA believes that rather than a “small number of very highly capitalised providers” opting for self insurance the majority would opt for the Example A type of arrangement referred to above. We, therefore, suggests that this model also be included as an example.

“Member compensation fund”

IFSA acknowledges that there already exist several ‘association’ style PI insurance schemes (e.g. National Insurance Brokers Assoc and some boutique financial planning groups) as well as a form of compensation fund for the stock broking industry.

Given the scale and nature of the IFSA Membership, we do not believe that a compensation fund type of arrangement is suitable for our members. We would also be concerned if such a scheme were to be approved for other associations that also involved IFSA Members. Membership of such a scheme would, we believe, ultimately result in highly capitalised and stable licensees subsidising the failure of smaller members of the fund.

Question E1Q1: If you do not agree with requiring run-off cover, what do you suggest as an alternative to ensure cover is available for losses that are only identified some time after the original incident (eg the poor advice)?

The insurance market does not currently provide automatic run-off cover and the industry remains concerned about the ability to source run-off cover in response to these proposals. Historically, PI insurance has operated on a “claims made” basis and it is unlikely and unreasonable to expect the industry to move to a claims incurred basis. Generally ‘run off’ would not be an issue for IFSA conglomerate members who are likely to self insure.

It should be noted that the Insurance Agents and Brokers Act 1984 specified that regulations would prescribe a 'run-off' period. The PI Insurance underwriters would not make a market that would cater for compulsory run-off cover and consequently Government never specified a 'run-off' period. That situation has not changed and hence the ASIC statement that "Licensees should obtain run-off cover for as long a period as is commercially available" is made in a commercial vacuum.

There is no evidence in the regulation or the Explanatory Statement to support the ASIC statement that "Run-off cover is a factor that ASIC is required to consider in assessing alternative arrangements under s912B(3)(b), so the legislature clearly regards run-off cover as important".

We regard that any alternate arrangements would be at the discretion of the PI underwriters.

Question F1Q1: Should anyone other than an APRA-regulated insurer be able to provide PI Insurance cover for the purposes of the compensation requirements? Please give reasons.

PI insurance may be partially sourced from rated direct offshore foreign insurers. Consideration should be given to approving insurers rated A or better (by recognised credit rating agencies such as S&P, Fitch). This provides consistency with Basel regulatory capital insurance mitigation prerequisites.

We note the proposed Direct Offshore Foreign Insurers (DOFI) review by APRA may have a bearing on this and in our view is likely to precipitate a reduction in the market, rather than lead to an increase in the number of participants. We also note the release by the Treasury of a Discussion Paper on Exemptions for Direct Offshore Foreign Insurers following the enactment of the Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007.

Although Mutual Discretionary Funds (**MDFs**) are not 'contracts of insurance' as defined in the Corporations Act, providing they are operated in the Australian jurisdiction, ASIC should consider allowing them to be considered for the purposes of 'alternative arrangements'. We also note that there is no mention of 'Captives' in the Consultation Paper and would hope that they can also be considered for the purposes of adequate compensation arrangements.

Question F1Q2: Are these questions helpful for licensees to consider in assessing what is adequate cover? Are there any other processes or procedures that you follow when obtaining and maintaining PI insurance that ASIC should discuss in its policy?

These questions are helpful for licensees to consider in assessing what is adequate cover,- see answer to B3Q3.

The initial assessment process outlined in CP 87 does not recognise that not all licensees will have a claims history.

Question F1Q3: Is the guidance in this Section likely to directly result in any increase in your compliance costs? Please give details, including figures and reasons.

To comply with proposed requirements for each affected entity within the group would be costly and uneconomical. Additionally, as the cover specified by ASIC in CP 87 is not currently available in the market, we are unable to determine or estimate the cost. Given the scarcity of this type of policy, and the time and resources taken to complete the renewal process under existing arrangements, which in many cases extends beyond the time allowed for consultation on these proposals, it is unreasonable to expect industry to provide accurate expected compliance costs.

Given the increased complexity of the proposed measures, the time, resources and costs which accompany a licensee's standard insurance renewal process would likely increase if the proposals set out in CP 87 were to proceed without amendment.

Question F2Q1: Do you agree with our guidance on disclosure in FSGs?

IFSA does not agree with the proposed ASIC guidance on disclosure in FSGs. The proposal goes well beyond the requirements of regulations 7.7.03A and 7.7.06B. We also note that while the initial draft Regulations contained more detailed requirements relating to the content of FSGs, that content was removed demonstrating clearly the policy intent relating to disclosure.

It should be clear that PI insurance is a legal liability policy intended to cover the insured, not provide a mechanism for compensation to third parties. The suggested disclosures do not provide any additional consumer protection and are unlikely to be understood by the general consumer, and hence their inclusion is not supported. A brief statement of the existence of PI insurance should suffice.

We also note that:

- The proposal is silent on the disclosure requirements for licensees who are exempt from the requirement to hold PI cover. This has the potential to confuse clients who may assume that if the statement does not appear in the FSG for an exempt licensee, that the licensee does not have adequate compensation arrangements.
- The value of the disclosures provided in CP 87 is questionable. The proposed disclosure standards create more confusion for the client and may have a negative effect on the client's perception of the regime.
- It is not clear that all of the additional information that is proposed in Proposal F2 to be included in the FSG is useful for clients at the FSG stage where they are simply deciding whether to obtain financial services from the licensee.
- The disclosure guidelines do not, in our view, provide clear concise and effective disclosure to clients. We submit that a simple statement that:

  > "The licensee has in place compensation or insurance arrangements that comply with its legal requirements"

  is sufficient disclosure in an FSG, notwithstanding that additional disclosure on compensation arrangements can be made at the request of the client.

Question F3Q1: Do you agree with our proposals regarding maintaining our existing PI insurance requirements or should those regimes be replaced with the new PI insurance requirements?

There should only be one set of requirements for PI insurance, which are sufficiently flexible to apply to all licensees taking into account the size, complexity and requirements of their business. It would not be efficient to maintain two regimes.

Question F3Q2: Should ASIC treat compliance with any existing PI insurance regimes administered by other regulators as adequate for the purposes of the Corporations Act? Please give reasons.

Yes.

Question F4Q1: Do you agree with our proposals regarding new licensees (i.e. new licenses from 1 January 2008)?

For reasons outlined previously, including the uncertainty of ASIC policy requirements and the present unavailability of the type of cover proposed by ASIC we do not believe that 1 January 2008 is a reasonable commencement date (see further comments at Part D(c)).

Question G1Q1: Do you agree with our proposal on approved guarantees? Please give reasons.

A large financial institution has the financial resources and cover to satisfy investor compensation liability. Provision of a guarantee is unnecessary, has capital implications and adds to compliance costs. Extension of the exemption provisions to a conglomerate is recommended. It should also be noted that APRA Standard APS 222 *Associations with Relate Entities* prohibits guarantees that are unlimited either on an individual entity or aggregate level.[1]

APRA has indicated, however, that guarantees that are limited in time and amount would satisfy the requirements of APS 222. It is, however, unclear whether each subsidiary licensee of an APRA regulated entity would require a separate guarantee in its favour or, that one guarantee in favour of all subsidiary licensees would suffice. It is also unclear what the capital implications therein might be. It is our view that if a guarantee were provided, it would be adequate for the purposes of compliance with the PI requirements.

Notwithstanding the above, we believe that the provision of a guarantee from an APRA regulated entity to its subsidiary licensees is unlikely to be used because of the capital implications. Therefore, we recommend that ASIC consider more flexible options for complying with adequacy requirements. For example, an alternate mechanism to a guarantee which provides evidence of financial support but does not impact capital, such as an inter-group arrangement.

Question G1Q2: We understand that APRA may treat such guarantees as a form of capital support. Taking this into consideration, to what extent do you think this exemption is likely to be used?

If a guarantee or additional insurances are required this will increase the cost for the licence holders and increase compliance costs. A guarantee is unlikely to be used if

[1] http://www.apra.gov.au/policy/final_adi_standards/revised/APS222(July%202003).pdf

there are significant capital implications. An alternate mechanism to a guarantee is required which does not impact capital but provides evidence of support if required.

C. MISCELLANEOUS COMMENTS

As a general comment, we believe that the proposed measures are impractical, inefficient, uneconomical and irrelevant to, in particular, large conglomerate groups and financial services providers, who are also prudentially regulated. In our opinion, the proposals overlap with APRA's prudential jurisdiction and it should be left to APRA to determine an appropriate level of risk capital having regard to the particular risk profile of an institution.

In addition, the market for professional indemnity insurance would be required to undergo significant change if it were to be able to supply the cover suggested by ASIC. This is acknowledged in CP 87.

ASIC seems to be suggesting that the financial services industry initiate a reform of the PI market because ASIC believes that current PI insurance arrangements are inadequate. This is an unreasonable proposition and ASIC should reconsider its position on the basis of the submissions it receives for this proposal. Indeed, the recent Parliamentary Joint Committee on Corporations and Financial Services report on "Statutory Oversight of the Australian Securities and Investments Commission" states that "the Committee remains to be convinced that insurers will offer PI insurance to all existing financial planning firms". Although the report specifically refers to financial planning firms, it can be taken as a proxy for all affected licensees.

In addition to these general comments, the consultation paper raises a number of specific issues which we have addressed in this paper including, among other things, (a) the scope of the proposed PI arrangements, (b) claim limits and changes in claim basis, (c) meaning of "adequate" PI insurance (d) availability of cover and (e) commencement date of proposals.

D. COMMENTS ON EFFECT OF PROPOSALS ON COSTS & COMPETITION

(a) What are the likely compliance costs?

Direct costs include cost of purchasing additional insurance cover or the cost of a guarantee. In addition, additional disclosures in the PDS and FSG will result in additional printing costs on an ongoing basis (as the disclosures will need to be maintained over time).

(b) What will be the likely effect on competition?

IFSA recognises the benefits stricter compensation arrangements will bring including increased consumer protection. While a number of IFSA Members have large advisory networks through which their financial products are made available to consumers,we are concerned that some of the smaller or boutique financial service providers may not be able to access what might be classed as 'adequate PI insurance' and thus be forced to exit the market. By way of example, many consumers prefer to

access our members' financial products via what might be described as the 'independent market'. The proposed requirements may effectively result in smaller providers exiting the market, lead to greater convergence and reduced competition. This will limit the advice options for consumers as smaller boutique financial service providers may disappear.

Additionally, IFSA believes the proposals impact unfairly on licensees with substantial revenues or net assets, and on licensees who are part of a conglomerate group but who do not have the benefit of an exemption.

The anticipated adverse effect on competition would be contrary to ASIC's statutory objective to "maintain, facilitate and improve the performance of the financial system and the entities within that system in the interest of commercial certainty, reducing business costs, and the efficiency and development of the economy".[2]

(c) What may be other impacts, costs and benefits?

Compliance by 1 July 2008 is unlikely and is not a realistic timeframe. Factoring in ASIC's timetable for consultation, the proposed release of ASIC's final policy in November 2007, the suggested compliance date does not allow sufficient time to enable licensees to determine with any certainty what the requirements will be and, certain types of cover specified in the consultation paper may still not be available in the market on commercial terms.

IFSA submits that the requirements, for new and existing licensees, should commence from 1 January 2009 with a transition period of twelve months from that date to take account of the variances in licensee's "treaty years". This would also allow time for the PI market to consider and potentially develop cover that would meet ASIC requirements.

[2] Australian Securities and Investments Act 2001 Section 1, subsection 2(a)