



AFA Submission to Treasury in relation to professional indemnity insurance for financial planners and dealers in securities.

Prepared by the Association of Financial Advisers Ltd.

November 30 ,2006.

#### Introduction

The recent Department of the Treasury paper, in regard to the implementation of mandatory professional indemnity insurance in November 2006, has highlighted a range of issues that impact on the role of Financial Advisers. The proposed changes are driven by the need to protect consumers given the failure of Westpoint and the AFA supports and applauds Treasury's desire to ensure consumers are protected.

We are however aware of the need to ensure that the robust market for advice remains in place and is not impacted unfairly by these proposed changes.

What has become clear is that the failure of WestPoint has focussed the whole government and the industry on 3 key issues:

1. How to ensure that consumers are protected.
2. How companies bring products to market & how they are researched,
3. How advisers provide advice & recommendations to their clients.

The AFA's analysis of the Key Issues.

a. Product failure.

What Westpoint has highlighted is the need for products offered to consumers to be

robust, fair and delivers to its mandate. We have seen that the primary driver of consumer complaints in the past five years has been the failure by product manufacturers of financial services product.

Fundamentally this product failure is partially attributable to the current regulations and also to the regulator, who did not detect the decline of the fortunes of the Westpoint, until it had reached a point of dysfunction. Therefore the reporting process and regulatory process failed.

There needs to be a process whereby the regulator can supervise the entry of product onto the financial services market otherwise these failures in product may continue and manifest themselves as consumer anger against all parts of the Industry.

*Recommendation:*

The AFA recommends that ASIC have requirement & jurisdiction to ensure new products not only meet legal hurdles but comply with sound business and robust principles.

b. Legislative drafting conflict issue: Liability of licensees for representatives.

The exposure draft sent to us relates to paragraph 912B of the Corporations Act, and in effect is the replacement for the time expiry of the former 912 B(2), which was the sunset clause in the act that ceased the regulation on the 30th of June 2006.

However, the Treasury drafting although adequate for a replacement, ignores entirely part 7-6, division 6, section 917F, the Effect of Division 6. Especially it totally ignores section 917F(6), which deals with limitation, and is where large scale licensees have drawn their legal right to exclude liability from their licences, and transfer this liability to the advisers, by way of commercial contracts transferred authorised by paragraph (a)

The Treasury proposal for consideration addresses only liability insurance for licensees. By the use of this paragraph 917F(6)(a), the licensees can effectively with the support of the Corporations Act move this liability to advisers and indeed already have. The regulator ASIC has many examples of these authorised representative contracts which include a full indemnity of the licensee by the adviser. Consequently the Treasury amendment and proposed regulation replacing 912B is definitely not in the interest of consumers, and will reduce the legal liability of dealers in securities accordingly.

The AFA takes the view that a concurrent repeal of sections 917F(6) and 917F(7) is fundamental to making the Treasury regulation workable. To do otherwise would mean the regulation once law, could be subverted by contract changes across the whole financial services industry by even small dealers in securities, and thus obviate any liability that they may have even under this proposed regulation.

We applaud the Treasury action to fix this anomaly in relation to 912B, but suggest that further advice be sought in respect of the deleterious effect of 917F(1) of the objects and aims as laid out in a commentary on the draft regulations.

## Final Comments.

The failure of Westpoint has focussed the whole industry on 3 key issues:

4. How to protect consumers and ensure they are protected.
5. How companies bring products to market & how they are researched,
6. How advisers provide advice & recommendations to their clients.

Mandating higher levels of PI Cover will have the following unintended consequences for the market place.

1. Smaller licensees will not be able to afford the PI cover required.
2. Large institutions will push liability down to advisers and have no liability themselves.
3. A free market with choice for advisers & consumers will be under serious threat because of this high cost of PI cover.
4. The cost to entrepreneurial small business owners will be substantial as they assess their choices & options.

The options as we have outlined above are:

1. Ensure the regulator has a mandate to assess products & companies in a thorough manner.
2. This will ensure that product failure issues are minimised.
3. Continue on with Consumer education as this is the best long term option, consumers making informed choices.
4. Continue to ensure a free & open market for Advice by not penalising the smaller independent operators. To this end we recommend the repeal for setting aside by regulation of 917F(6) and (7). This will then achieve what the Treasury and the ASIC require, and make the aims and objectives of the government.

Please find attached to our submission a number of letters from AFA members and other interested parties. The AFA supports and endorses these letters which demonstrate the impact that these draft regulations will have on many Advisers and licencees.