

ON THE PLATFORM

Insurance gaps a risk for industry

*David Huggins*

One of the first things people who make a claim against their financial adviser learn is the big difference between the myth and the reality of how the legal system works.

A good example of this is professional indemnity insurance. Under the law, every person who provides financial advice must hold adequate insurance. Clients of advisers have very extensive rights to make claims if they receive poor financial advice. This insurance obligation was put in place to ensure that when a client made a successful claim they would receive compensation.

One way claims can be made is by way of the Financial Ombudsman Service. When the FOS decides a case, it issues a determination.

Since January 1, 2010, the FOS has issued 126 determinations that have a value of \$21.3 million where the claimant has not been paid. These unpaid determinations amount to one in four of all of the determinations issued by the FOS in the segment of its operations that includes the financial planning industry.

There are four reasons why there is no insurance available to cover these determinations.

The first is deductibles. An insurance policy will have a deductible, which means that before the insurer has to pay anything the adviser has to pay a set amount. Some advisers select a very high deductible to reduce the cost of their insurance. The problem with this is that when a claim is made, they do not have the money to pay the deductible and the insurer does not have to pay anything.

The second is that some advisers do not get any insurance. This is an example where compliance with an important obligation is not being properly regulated by the Australian Securities and Investments Commission.

The third is that the insurance that is purchased is subject to broad-ranging exclusions so that the insurer can decline to pay a claim.

The final reason is that the adviser has not bought enough insurance. Bad advisers invariably have multiple claims made against them and in some cases there will not be enough cover to meet all of these claims.

The problem is actually much worse than the FOS' statistics indicate because many claims that could have been made will not be made because it is apparent that there is no insurance available.

The long-running concern about standards in the financial planning industry has resulted in a multiplicity of new laws and compliance-related obligations.

Clients do not need more laws and regulation, what they need is for the Australian Securities and Investments Commission to be given enough resources to enforce the laws currently in place. If the Federal Government is not willing to do this, it at least needs to focus on insurance arrangements.

There needs to be fundamental reform in this area so that when a client sees a financial planner they know that if they receive poor financial advice any claim that they make will actually be covered by insurance arrangements.

This would be a proactive regulatory system where advisers would have to demonstrate that insurance arrangements are in place before advice could be provided. Such reform would protect clients and serve to improve public confidence in the financial planning industry.

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