THE FUTURE OF FINANCIAL ADVICE – WILL REFORMS HAVE ANY IMPACT ON CLAIMS?

3 APRIL 2013 | PROFESSIONAL INDEMNITY & FINANCIAL LINES

In the wake of the global financial crisis, and following several well publicised financial advice disasters, the Future of Financial Advice (FOFA) reforms emerged. As 1 July 2013, or 'F-Day' fast approaches we reflect upon what we know so far, and what FOFA is likely to really mean for the insurers and brokers of financial service providers.

After a year of optional compliance, the FOFA legislative reforms will become compulsory on 1 July 2013. These reforms are designed to improve consumer trust and confidence in the financial advice industry. They purport to do so by dealing more effectively with conflicts of interests, improving competency, quality and affordability of advice and encouraging greater ethics, standards and professionalism.

The reforms are targeted at several areas in which financial planners and advisers have received bad press. In particular the FOFA reforms include:

(a) A statutory obligation for the advisor to act in the best interests of the client when providing advice (the best interests duty);
(b) A "safe harbour" which is a list of steps that, if taken, mean that an adviser will be considered to have satisfied the best interests duty;
(c) A ban on conflicted remuneration, being a benefit, monetary or otherwise, that could reasonably be expected to influence the choice of financial product recommended or advice given;
(d) More stringent requirements around the charging of ongoing fees;
(e) The promotion of scaled advice, meaning advice limited to a particular aspect of a client's financial circumstances rather than a full financial plan;
(f) Enhanced licensing and enforcement powers for ASIC;
(g) Civil penalties for breaches of various provisions.

All sounds very positive, commonsense even. But will the reforms have any repercussions for the insurers who cover financial advisers and the brokers who place those advisers' risks? Are the reforms likely to increase or decrease an adviser's exposure to claims by clients and others who have sought their advice? Or is it all just a lot of FOFA about nothing?

On an optimistic assessment, the reforms may lead to better practices, resulting in fewer and less significant claims. The promotion of scaled advice may help reduce the number of claims where a client requests specific advice but then later alleges a failure to advise upon other unrelated aspects of their personal circumstances. And ASIC's enhanced powers should theoretically weed out the bad apples, reducing the number of rogue advisers in the industry. All of this should be good for insurers.

But on the flip side, if financial advisers continue with old practices and fail to comply with the FOFA reforms, claims are likely to be easier to make and harder to defend in circumstances where advisers will now be in breach of express legislative requirements. Any poor practices also seem more likely to be exposed where clients are savvier and ASIC takes a more aggressive role. In addition, ASIC's increased involvement may impact upon insurers who offer inquiry costs cover, and the courts' new powers to order compensation may affect those insurers offering statutory liability cover.

However, at this stage, it is really too early to tell what effects the reforms will have. As with any reforms, the true effects will take some time to crystallise. ASIC's registration data indicates that the take up rate of optional compliance has been a grand total of 5 licensees nationwide. Today's FOFA retained clients are unlikely to suffer any loss, let alone bring a claim, for at least a year and probably several. However, underwriters, claims managers, brokers and insureds alike will need to keep a close watch on developments over the coming months and years. In the meantime, brokers may benefit from taking a proactive role early, liaising with insureds about the strategies they are putting in place to ensure FOFA compliance. Underwriters might also take the opportunity to review policy wordings to ensure that the scope of cover is clear.

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