# Professional indemnity insurance. Market challenges for financial advice licensees.

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# Introduction

One of the flow-on impacts of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (RC) is the implications on the availability, costs and conditions of Professional Indemnity Insurance (PII) for Australian Financial Services License (AFSL) holders.

As PII is a legal obligation, tougher underwriting, reduced capacity, fewer competitors and higher premiums can leave ASFL holders in very difficult circumstances.

Aon, a leading advisor in relation to professional indemnity insurance, and Iress, whose Xplan advice software is used by thousands of financial advisers, have many shared clients and have come together to share their insights on this critical industry-wide issue.

# Contributors

Aon is a leading global professional services firm providing a broad range of risk, insurance, retirement and health solutions. Aon has approximately 50,000 employees in 120 countries.

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Iress is a technology company providing software to the financial services industry. More than 9,000 businesses and 500,000 people globally using Iress software to help them perform better and deliver more.

Stuart Frith, who joined Iress from ASIC, heads up Iress' data intelligence business and is responsible for Iress' data analytics software, Lumen, used by financial advice licensees to identify and manage potential risk and turn data into valuable business intelligence.

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# How has the financial services Royal Commission impacted the PII market?

The RC has had an industry-wide impact. Our discussions with underwriters have revealed that there have been a significant number of notifications made to the insurance market post-RC which has raised underwriters' concerns.

The PII market for financial planners and advice licensees was fairly narrow in any case and since the RC, we have found that this has retracted considerably. Some insurers are choosing not to consider providing capacity for these risks, with only a handful of Australian insurers willing to consider Primary capacity for financial planners and advice licensees. More recently, the London market has become reticent to consider Primary participation given the regulatory landscape in Australia changes so quickly, such that they do not feel sufficiently informed about the nature of this landscape.

We have also seen upward pressure on premium and deductibles, particularly for licensees with larger numbers of Authorised Representatives (AR) and geographical spread. This heightens underwriters' concerns in relation to the licensee's ability for adequate monitoring and oversight. This same upward pressure exists for licensees with claims/loss histories or where their oversight, controls, governance and audit procedures are determined not to be up to scratch.

# How have insurers and underwriters responded to this?

The RC has meant heightened scrutiny by Regulators and the insurance market has been mirroring this scrutiny somewhat by conducting their own deep dive into corporate governance and culture with underwriters requesting more extensive information to assess the risk.

In particular, the nature of the Authorised Representative (AR) model has historically presented insurers with challenges relating to oversight, compliance and control and the auditing of their ARs. We understand that the market has been faced with some significant claims activity in this space and insurers are drilling down more and more into these control and compliance issues, by way of additional underwriting questions and requests for information, when reviewing the risk.

In general, insurers are much more selective in how they deploy their capacity. This is even more apparent with the advent of COVID-19.

# Impacts of the financial services Royal Commission and draft legislative changes for advice licensees

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## We have seen a number of clients, who were served a notice to produce documents or appeared in front of the RC, face specific exclusions being applied to their PI policy at renewal.

Underwriters will no doubt be watching with interest in relation to resultant exposures arising from accountabilities under the draft legislation.

> "The six month delay will afford licensees more time to be ready to comply with the new legislation."

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## The outcomes from the RC, stronger oversight of existing laws by ASIC and Treasury's draft legislative changes, have created—and will continue to create—significant challenges for licensees and advisers.

Treasury has announced a six month delay in the implementation of the FSRC legislative changes to allow advisers to focus their efforts on supporting customers and staff through the COVID-19 crisis. The proposed new legislation will require licensees to have even more granular oversight of advisers and advice generated to ensure compliance with the more complex consent and breach reporting obligations.

The six month delay will afford licensees more time to be ready to comply with the new legislation, however licensees have already been focused on re-engineering their advice processes and compliance framework to ensure they have appropriate controls in place to meet their legal obligations.

Our clients are at various stages of working with their adviser networks to make better use of advice software such as Xplan, to capture data through the advice process. Clients are also actively working to make better use of advice automation tools in Xplan - not only does this facilitate more efficient advice generation but it also provides a data audit trail that supports compliance. Capturing and recording key data from every piece of advice generated and service delivered, not only gives the visibility needed to identify and mitigate risks (that may result in financial loss and business risk), but it also means licensees can quickly respond to ASIC requests for data.

However, while capturing data is part of the solution, being well placed to analyse and take action at speed will be essential given the significant proposed penalties for failing to report breaches.

Many of our licensee clients are already using our data analytics software Lumen, which is integrated with Xplan. This means they can identify risk hotspots and potential rogue advisers, while also providing visibility to address data quality inconsistencies and support monitoring of all adviser behaviour, advice given and advice processes.

While this ability to monitor and identify risks has been important to optimise PI insurance, under the FSRC draft legislative changes, it becomes even more critical to have preventative analytics, such as Lumen offers, to detect potential breaches early enough to mitigate and so minimise the financial and reputational impacts of breach reporting.

# What are the key elements licensees need to have in place to satisfy insurers and optimise PII terms and costs?

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In general, insurers need to see that fundamental elements such as governance controls, oversight and audit procedures are in place. By these we mean:

- **Governance** - the establishment and existence of clear policies and continuous monitoring of their implementation.
- **Controls** - processes for consistently meeting organisational goals of accurate reporting, and compliance with laws, regulations and the governance policies.
- **Oversight** - the mechanisms in place to make sure that the controls are working efficiently and correctly.
- **Audit procedures** - the processes, technique, and methods to obtain evidence to make a conclusion.

Evidence of these has always been important to insurers when reviewing risks, however we are seeing heightened scrutiny in a market that is more challenged than in previous years, with reduced capacity and underwriting appetite.

One specific concern, based on our discussions with some insurers, is the impact of the 'rogue' planner–insurers are keen to ascertain how licensees are attempting to minimise the impact of potential 'rogue' elements in their businesses.

Further to this, the quality and integrity of data is key, and underwriters will want to know how the quality and security of the data is preserved and reviewed/checked.

# What role does technology play in satisfying the requirements of PI insurers?

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For a licensee, it's about the proper use of advice software and leveraging this software as much as possible. When used correctly, the right software provides a defined advice process and an end-to-end automated business solution.

This reduces the potential of adviser error and also facilitates data capture and digitised record keeping–providing the data foundation for efficient oversight and controls.
Secondly, data analytics software including RegTech, such as Iress' Lumen, can leverage this data to reduce licensee risk by providing immediate visibility into all adviser's behaviour, the advice given and the advice processes followed. This is augmented by automated alerting so compliance teams are able to focus on the most important risks.

A licensee could have 50 advisers, with each adviser having 100 clients, and each client having over 200 pieces of data (such as fees, products, personal information, services provided). This equates to 1,000,000 pieces of data or a spreadsheet 50 columns wide by 20,000 rows deep.

With this amount of data–and without data analytics software–it's next to impossible to monitor every adviser, each piece of advice given and the advice process.

**What's the impact?**
Without this visibility, licensees are unable to demonstrate complete oversight of all advice provided under the license and hence it's likely the cost of the PII will increase. It is also likely that licensees will not meet ASIC expectations, including those for the proposed FSRC legislative changes, and would be unable to respond to the increasing number of ASIC notices in a timely manner. These sorts of failures have ramifications for company directors and on the licensees' reputation.

# What are some specific functionalities/capabilities that directly support the key elements of governance, controls, oversight and audit procedures?

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**Governance**

Those in governance roles—including an a business's directors—are increasingly seeking visibility based on objective measures, of how management is effectively managing risks, including their technology and insurance arrangements. This includes risks created by regulatory or statutory obligations, as well as ethics and community standards.

Failures by boards are increasingly leading to media and shareholder scrutiny, heightening the financial and reputation risks of errors. Advice and data analytics software provides the visibility and controls over the advice process, the advisers and the advice given—which is necessary input to an appropriate governance process.

**Controls**

RegTech can run many risk algorithms across data for each adviser, including their client book and client profiles, advice given, products and strategies recommended, revenue earnt, services delivered, adherence to licensee standards and any complaints or audit findings. Findings are summarised visually on dashboards, providing licensees with an at-a-glance, multi-dimensional view of an adviser's behaviour—and any changes in their behaviour over time—identifying risk.

Automated alerting, triage workflow and reporting provides licensees with Key Risk Indicators (ASIC KRIs), a compliance process, and data to investigate and mitigate the risks.

### Oversight

Lumen also records and reports on this to confirm if a licensee has appropriate risk controls and governance in place.

### Audit procedures

The use of alerts based on hard data to inform review or audit file selection is both efficient and risk reducing–it focuses human expertise on those advisers and files that pose the most risk to the licensee.

Data intelligence provides licensees insights beyond what is possible from manual file reviews, allowing adviser data to be cut across multiple dimensions exposing risks at different levels.

For an even greater vantage point, licensees have the ability to see specific risks across the entire adviser population to identify anomalies and expose potential risks including rogue advisers that may not have been visible through reviewing a random sample of files.

> “Failures by boards are increasingly leading to media and shareholder scrutiny.”

# Ultimately, can RegTech help licensees alleviate insurers' risk concerns?

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## RegTech is a fairly new phenomenon and it will be interesting to note its impact on claims activity/loss history and in turn, whether it can shift the dial in a significant way.

RegTech, could assist to alleviate concerns in underwriting risks if the tech can clearly demonstrate enhanced procedures in relation to governance, controls, oversight and audit procedures.

If the particular RegTech can red-flag rogue advisers and alleviate the impact, it could address a significant concern for underwriters.

Use of RegTech to identify compliance issues which are subsequently addressed by the licensee and advisers, can provide evidence of a control environment and the importance of this to the business. Use of RegTech can also provide evidence that a clear reporting mechanism is in place—highlighting issues to management, the Board and ultimately the regulators.

# Conclusion

## The industry-wide impact of the RC has been felt both locally and internationally. It has seen some insurers even choosing not to consider providing capacity for these risks. This, along with increased oversight of existing laws by ASIC and Treasury's proposed FSRC legislative changes, has landed us in a space whereby licensee and adviser challenges are on the increase, and tolerance for non-compliance is on the decrease.

RegTech can help minimise the risk to licensees, advisers and insurers. Albeit in its infancy, RegTech can go some way to alleviate concerns when underwriting risk. With the ability to run a number of risk algorithms, RegTech provides licensees with a comprehensive view of their advisers' behaviours, the advice process and the advice given; capabilities far greater than what can be achieved under the traditional manual audit model—allowing for potential risks to be caught (and dealt with) earlier than later.

From where we are sitting, there is an opportunity for RegTech to have a positive impact on PII in this post-RC world—we are only seeing just the tip of the iceberg.

"RegTech such as Lumen can help minimise the risk to licensees, advisers and insurers, and goes some way to alleviate concerns when underwriting risk.