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Financial Advisers left out in the cold

What is the point of an insurance policy that doesn't provide the cover that the client needs and expects at time of claim? None whatsoever, according to the Institute of Financial Advisers.

Professional financial advisers who have spent thousands of dollars over the years on Professional Indemnity (PI) insurance are facing abandonment by their Professional Indemnity reinsurers, potentially costing financial advisers and their clients millions of dollars in rejected claims.

Nearly every professional financial adviser has Professional Indemnity (PI) insurance cover. It is designed to cover many of the costs of them inadvertently getting things wrong and to cover the legal costs of defence in the event of an allegation of negligence.

It appears approximately 75-80% of the local PI market is held by one insurer, Lumley. Most of the adviser group schemes are underwritten by them with many individual advisers holding cover directly with them. Scheme members of the Institute of Financial Advisers (IFA) PI are also exposed to Lumley's.

Many PI claims stories have recently come to the attention of the Institute of Financial Advisers (IFA) where a distressing pattern of behaviour has been shown by Lumley's who have consistently rejected claims from financial advisers.

The IFA, through its professional adviser, sought clarification with Lumley over their policy wording, but to date have not received any reasonable explanation of why the claims have all been rejected.

Tony Vidler, a Director of the Institute of Financial Advisers (IFA) says, "Incredibly, Lumley has decided to apply some twisted logic in reading its own policy wording to suit its claims management objectives."

Vidler says PI insurance has never been designed or intended to provide a guarantee to any client's investment performance. "However, it is to be expected that if an adviser is proven to have been negligent, then the client could probably reasonably expect to be able to point to the actual loss suffered as a method of establishing damages if they were seeking compensation."

Vidler says the PI policy is primarily there to cover the legal costs of defence in the event of an allegation of negligence. "We all understand that it isn't there to make good an investor's capital loss. The keywords are 'defence' against 'allegations'. So the claimants are not seeking compensation for money lost."

The financial catastrophe bringing this issue to light is of course the massive and traumatic collapse of entire sections of the NZ investment market and the ensuing impact on financial advisers' clients.

Vidler says that some clients want to hold their financial advisers responsible for their loss. "Sometimes a client's claim regarding financial adviser negligence has merit and sometimes it doesn't. However, regardless of the merit of the client's case, the adviser must respond to that complaint, generally at a very significant financial cost and with very significant stress and anxiety impact too. Advisers console themselves that at least the actual legal costs of defence are covered by the PI cover, so some of the business impact is mitigated meaning that a negligence claim without merit won't put them out of business."

Now we have a situation where many advisers carrying Professional Indemnity insurance cover are suddenly finding that it is essentially useless to them.

"Most insurers, on most lines of business, work very hard to pay valid claims and meet their client's expectations," says Vidler. "In New Zealand most clients, most times, get the result they expect when the insured disaster strikes. But PI cover seems to be the exception with some insurers simply declining claims presented to them by their investment adviser clients."

"The adviser, having paid premiums and faithfully maintained the cover, faces the immediate problem of having to meet the defence costs directly, as their first obligation is to deal with the customer's issue and then to survive commercially," says Vidler. "It is usually unwise to go

litigating against a corporate giant who could keep you tangled up in legal shenanigans for years. This is good financial outcome for the insurer, but a disaster for the financial adviser. This provides yet another reason for consumers to distrust the financial services industry where the finger can be pointed more easily at the advisers, not the insurer.”

“Imagine if a medical insurer, with three quarters of the coverage for New Zealanders, suddenly declined nearly every medical claim that came their way, even though those claims were absolutely in accordance with their own policy wordings and coverage? There would be an uproar, and probably immediate government intervention, and rightly so.”

Professional Indemnity cover is supposed to provide a further level of integrity to the advisory market. However, when the PI insurer simply declines to act in accordance with its own contractual obligations, the adviser is left to attempt to manage the client allegation by themselves. “In many cases the adviser will have insufficient resources to do justice to the matter and is unlikely to have the resources to legally pursue the defaulting insurer at the same time,” says Vidler, “As a result, the client will probably not get an opportunity to settle the matter equitably, even in cases where it has merit.”

Vidler says there is no doubt that many financial advisers and their clients are being left out in the cold by some insurance companies on professional indemnity negligence claims. “It is an appalling situation that does nothing to give confidence to New Zealand consumers in the value of insurance. The advisers themselves increasingly distrust some of these companies now.”

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