

□ DUTY TO INSUREDS

Conflicts in brokers' duties

In our August *Financial Services Law Bulletin*¹ we reported on ASIC's investigation into various breaches of duty by brokers to their insureds. In the wake of these investigations, brokers are required to implement conflict avoidance mechanisms. To be able to implement these, brokers must know exactly who their insured is and what duties they owe to both insureds and third parties.

The question "who is your insured?" is deceptively simple. Brokers are urged to give some more thought to the issue, especially where different insureds have conflicting interests. This can arise with directors' and officers' (D&O) insurance policies where a company takes out the insurance policy, but the policy is also taken out on behalf of the company's directors and officers. In those circumstances, the broker's duty to act in the interests of its insured may cause a conflict and result in a breach.

Who is your insured?

D&O policies are common. Usually, a company will pay the D&O insurance premiums on behalf of their directors, secretaries and other officers. The contract will therefore be between the broker and the company. Any directors, even if they are listed as "insureds" under the policy, are not necessarily parties to the insurance contract. Where directors are listed as "insureds", they can be listed individually or as a generic group. Sometimes directors are involved in carrying out the insurance arrangements and sometimes they merely know that insurance has been taken out for their benefit. These factors can make it difficult to assess whether the broker's client is just the company or also includes individual directors.

Duties owed to insureds

When placing insurance for a client and when a claim is made by a client insured, a broker has the duty to:

- act honestly;
- act carefully; and
- avoid or disclose conflicts of interest.

These general duties prevent a broker from preferring the interests of one client above another in relation to the making of the claim.

Third parties

Third parties are not parties to the contract between the broker and the insured. Therefore a broker will not owe any contractual duty to a third party who may benefit under the contract. However, there is a trend in the development of the duty of care and fiduciary duty to extend brokers' duties to people who know of, rely on and are vulnerable to, their conduct. Two recent cases provide examples of exceptions to this

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introduction



Brian Thomas
Partner

The anti-money laundering regime is getting closer (see article on page 2). Draft legislation will be available in November and the regime will impact on the relationship between organisations (including lawyers and accountants) and their clients.

Clients should know the type of conduct that will trigger reporting obligations and, whilst complying with their obligations, avoid drawing unnecessary attention to themselves.

We will provide guidance when the proposed legislation is released.

□ ANTI-MONEY LAUNDERING REFORMS

Anti-money laundering update

The most recent Financial Action Taskforce (FATF) Plenary meeting was held in Paris on 12–14 October. On the agenda was a review of Australia's anti-money laundering and counter terrorist financing systems.

Australia was criticised for complying with only 12 of the 40 anti-money laundering recommendations and none of the nine special counter terrorist financing recommendations. This criticism comes as no surprise. Draft legislation, incorporating these recommendations, has not yet been released.

Senator Ellison has now announced that a draft bill for public consultation will be available in November. The proposed timeline will give lawyers and accountants only 4 months to respond to the proposed reforms, before they are introduced into Parliament in early 2006.

The proposed reforms will apply impose high level obligations on lawyers and accountants to assess the source and

destination of funds as well as the key figures involved.

As reported in our September *Financial Services Law Bulletin*, the new regime will emphasise customer due diligence standards and the reporting of suspicious transactions. From your perspective, this means additional checks under the new legislation will be required for their dealings with professional advisers.

You should be aware of these requirements so that the necessary information is readily available and innocent transactions do not draw unnecessary attention to their business.

Marina Ripoche Graduate Lawyer
e: mripoche@ebsworth.com.au

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general trend, yet in doing so they do not present a clear guide as to the circumstances in which a duty would not be owed.

In *MacMillan v KBS*² a person, whose loss arising from a broker's negligence was reasonably foreseeable, sued the broker despite not being a party to the policy. The broker was held not to owe the relevant duties to that person on the basis that the person was not a party to the contract with the broker and the principle that a contractual duty of care is owed only to contracting parties unless justice or commercial convenience requires otherwise.

In the *BNZ* case³, a bank whose interest was noted on the policy as mortgagee claimed that it was owed a duty of care and should have been informed that the insurance had not been renewed by the insured mortgagor. In that case, it was held that the broker did not owe relevant duties to the bank because nothing in the correspondence between the broker and the bank gave rise to a foreseeable reliance by the bank on the broker.

Recently, in the *Arimco Mining* case⁴ the Supreme Court inferred that directors are intended to be parties to contracts of D&O insurance. This was so even though the directors were not strictly parties to the contract of insurance nor defined as "insureds" under the policy. The case does not specifically look at brokers' duties and therefore is not conclusive on the issue.

Conflicts

ASIC's report focused on conflicts between an insured and insurer. This sort of conflict can occur where the broker's client is the insured, but the broker is being remunerated by commission from the insurer. ASIC recommended disclosure and conflict avoidance mechanisms should be implemented to deal with these conflicts. However, it noted that some conflicts of interest cannot be cured by disclosure and must be avoided altogether.

Conflict can also occur between the duties owed by a broker to different insureds or even third parties. An

obvious example in relation to a D&O policy is where the company and its directors disagree about whether to pursue a claim under the insurance policy. For example, a director may want to pursue a claim for which he or she is insured to defend his or her reputation but the company may not because it would disproportionately increase their premium. In this case, it may not be sufficient for the broker to disclose the conflict. Brokers are therefore encouraged to assess potential conflicts and establish avoidance mechanisms when they place insurance for multiple insureds and for the benefit of third parties.

Marina Ripoche Graduate Lawyer
e: mripoche@ebsworth.com.au

¹ Available online at: www.ebsworth.com.au

² (1990) 1 Lloyds Rep 98

³ *Bank of New Zealand v Sedgwick James Limited* (1995) 8 ANZ Ins Case 61-280.

⁴ *Martin John Green in his Capacity as Liquidator of Arimco Mining Pty Limited (in Liquidation) v CGU Insurance Limited & Ors* [2005] NSW SC 254

□ CASE UPDATE

TPD claim unable to be granted

The recent decision of Lindgren J of the Federal Court of Australia in *Cullinane v Mercer Benefit Nominees Limited* dismissed the applicant's claim that the respondent trustee's decision to deny her claim for a disablement benefit was not fair and reasonable in the circumstances.

■ *Cullinane v Mercer Benefit Nominees Limited* [2005] FCA 1470

Importantly, the case provides support for, among other things, the following:

- The "unable" test for total and permanent disablement (TPD) claim is more stringent than the "unlikely" or "unable and unlikely" test.
- The Superannuation Complaints Tribunal (SCT) is not required to review the trustee's decision making process, but only its outcome; that is, whether the decision, in its practical operation in the circumstances relating to the applicant, was fair and reasonable (even if, in the process, the wrong definition was applied).
- Medical opinion that the applicant can make a graduated return to work, even where the applicant is not currently fit for full-time employment, supports rejection of a TPD claim.
- The weight to be given to evidence is for the SCT, not the court.
- The trustee/SCT is not required to find a particular occupation in which the applicant would find work before rejecting the claim.
- The SCT is not specifically required to address full-time/part-time work issues unless raised on the evidence or in submissions.

Emily Nighjoy-Wong Lawyer
e: enighjoywong@ebsworth.com.au

□ NEWS IN BRIEF

Superannuation

- FAQ 4.3 regarding police checks has been updated by APRA in order to clarify APRA's requirements for foreign police checks. For further details, visit the APRA website at: www.apra.gov.au/Superannuation/FAQ.cfm
- Draft regulations have been released giving effect to the government's superannuation contributions splitting policy, which will allow contributions to be "split" or shared with a spouse, on or after 1 January 2006 on a voluntary basis.

Insurance

- APRA released a discussion paper and draft prudential standards on 27 October 2005 outlining a proposed strengthening of the prudential supervision of general insurance in the areas of capital adequacy, assets in Australia and custodian requirements. When finalised the standards will apply to General Insurance from 1 October 2006. Comments are invited by 28 November 2005.
- APRA has released a discussion paper and draft prudential standard on the implementation of the Basel II advanced measurement approaches to operational risk. For further details, see www.apra.gov.au/media-releases/05_49.cfm
- APRA has released for comment a proposal for a new bi-annual statistical publication, the *Half Yearly General Insurance Bulletin*, which will include detailed information at both an individual insurer and aggregate industry level,

including: aggregated industry tables, key entity specific information, public insurer data and Lloyd's Australia data. The Bulletin is to replace the previously published *Selected Statistics on the General Insurance Industry*.

- APRA released its Annual Report on 28 October 2005. Electronic copies of this publication are available on APRA's website at: <http://www.apra.gov.au/AboutAPRA/Annual-Report-2005.cfm>

FSR

- Draft legislation in relation to the FSR Refinements have been released for comment. Proposed changes include:
 - licensees who give personal advice on general insurance products (i.e. insurance brokers) will not be required to give a statement of advice;
 - licensees who provide general advice only (i.e. underwriting agencies) can remove information about the range of commissions/remuneration they earn from their FSG,
 as well as various changes to the FSG, SOA and PDS disclosure regime.
- ASIC has released a new version of the FS 53 PDS in-use notice form for product disclosure statements. The new in-use notice includes a second part that deals with superannuation fee data collection for the purpose of uploading superannuation fee data onto ASIC's FIDO website. For further information, see ASIC information release IR 05-56.

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□ NEWS IN BRIEF

General

- ASIC has issued guidelines regarding the requirement in section 205G of the *Corporations Act 2001* that directors of public companies must notify the ASX about holdings and changes to relevant interests in securities of the company or a related body corporate. Generally, a director has a “relevant interest” in a security if the director is the holder of the security or if the director has the power to control the voting or the disposal of the security. A director must notify the ASX within 14 days of the change; a breach of section 205G is an offence that carries a penalty of up to \$1,000 or imprisonment for 3 months or both.
- The ACCC has issued a draft determination giving preliminary authorisation to the Australian Direct Marketing Association’s 2005 Direct Marketing Code of Practice. Submissions from interested parties are sought before the ACCC makes a final determination authorising the Code.
- The Commonwealth Government announced in early October the creation of a new Taskforce to investigate methods of reducing the corporate compliance burden in Australia. The Taskforce will report by 31 January 2006.
- ASIC announced relief on 27 October 2005, for licensees from the authorisation requirements for distributors of general insurance products. The relief is provided under ASIC Class Order [10 05/1070]. General insurance distributors allows Australian financial services licensees the option to appoint people to deal in general insurance products on their behalf, without having to appoint them as authorised representatives.

Emily Nighjoy-Wong Lawyer
e: enighjoywong@ebsworth.com.au

For more information, please contact us:

Peter Daley Partner	e: pdaley@ebsworth.com.au	t: 61 7 3303 8812
Ian Enright Partner	e: ienright@ebsworth.com.au	t: 61 2 9234 2302
John Goulios Partner	e: jgoulios@ebsworth.com.au	t: 61 3 8624 2006
Peter MacKenzie Partner	e: pmackenzie@ebsworth.com.au	t: 61 2 9234 2591
Ann Newbrun Partner	e: anewbrun@ebsworth.com.au	t: 61 2 9234 2533
Michael Neylan Partner	e: mneylan@ebsworth.com.au	t: 61 2 9234 2312
Brian Thomas Partner	e: bthomas@ebsworth.com.au	t: 61 2 9234 2592

sydney melbourne brisbane

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