

**FROM:** Senior Manager, Worldwide Markets (Compliance)  
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**SUBJECT:** AUSTRALIA: FINANCIAL SERVICES REFORM  
ACT 2001  
**ATTACHMENTS:** Appendix 1: Definition of General Insurance  
Appendix 2: Day 1 obligations  
Appendix 3: Definition of a retail client  
**ACTION POINTS:** **Immediate Action**  
**DEADLINE:** **11 March 2002**

With effect from 11 March 2002 the new Financial Services Reform Act 2001 (FSRA) will become effective. The FSRA is the most important legislative development for the general Australian insurance industry since the Insurance Contracts Act and Insurance (Agents & Brokers) Act (IABA) were introduced in Australia in the 1980's.

The new legislation is designed to consolidate the regulation of financial services providers by introducing:

- a single licensing regime under the Corporations Law requiring those that provide financial services to either obtain a licence or avoid this by falling under one of the exemptions that apply; and
- new conduct and disclosure requirements, in particular in relation to retail clients (see Appendix 3 for a definition of a retail client).

The FSRA will apply to all types of general insurance policies provided by Lloyd's in Australia (i.e. those insurance policies 'caught' by the IABA). Reinsurance is not caught by the new legislation and there are exemptions for certain State, Territory and Commonwealth insurance and health insurance which are essentially the same as under the IABA. (See Appendix 1 for further information on exemptions and definition of general insurance.)

## Day 1 Obligations

Although the existing regime (i.e. the IABA) will continue to apply during a transition period, certain new obligations will apply from 11 March 2002, formally known as the “Day 1 obligations”. These focus on specific insurer requirements and Lloyd’s underwriters and their Australian distributors therefore need to determine immediately what changes may be required to existing practices and documentation to ensure these new Day 1 obligations are met. Appendix 2 summarises the requirements relevant to general insurance. In brief, the Day 1 obligations relate to requirements and standards for:

- receipt of monies from the insured
- prohibitions on solicitation
- consumer information requirements
- “cooling-off periods”
- new products

(The retail client requirements regarding the provision of a Financial Services Guide or Statement of Advice, or the new accounting requirements will not apply until the transition period ends.)

Whilst the Day 1 obligations are virtually complete (with only minor changes expected), a number of regulations which affect their operation are yet to be finalised. The regulations are expected to be completed by late February 2002, and will be addressed as necessary in a subsequent bulletin.

If you wish to seek further legal advice on compliance with the Day 1 obligations, Keith Stern can refer you to a Sydney based lawyer who has been advising Lloyd’s if you do not have your own legal advisor.

### **Licensing Impact: Transition Period**

The IABA, which covers the obligations of insurance intermediaries, and in particular the registration of insurance brokers, will be repealed and replaced by the FSRA. However, Lloyd’s underwriters and their Australian distributors (i.e. coverholders, other agents and insurance brokers) can take advantage of a transition period of up to 2 years, during which time the provisions of the IABA will continue to apply.

The new regime, which is to be regulated by the Australian Securities and Investment Commission (ASIC), does not remove obligations under:

- The Insurance Act 1973 (Cth). Lloyd’s underwriters will remain authorised and regulated by APRA under this legislation.
- The Insurance Contracts Act 1984 (Cth) and Marine Insurance Act (1909) (Cth), although some minor amendments have been made.

This means that insurers and insureds will be subject to the obligations imposed by the above legislation in addition to the FSRA requirements.

The transition period runs for 2 years from 11 March 2002. This gives the Lloyd's market and its Australian distributors (i.e. coverholders, other agents and insurance brokers) up to 2 years in which to determine the most appropriate licensing structure to operate under in the new regime.

Over the past few months Lloyd's Australia Ltd has continued to negotiate with the Australian Treasury with a view to obtaining a satisfactory licensing structure applicable to the Lloyd's market. We anticipate that a further update to the market will be released once the draft regulations have been finalised by the Australian Federal Government (currently expected late February 2002). At that point we will be able to outline the proposed licensing structures and how Lloyd's will operate with its Australian distributors under the new regime.

## **General**

Further information on the FSRA can be obtained by viewing the Australian Treasury and ASIC websites [www.treasury.gov.au](http://www.treasury.gov.au) and [www.asic.gov.au](http://www.asic.gov.au). However, if you have any queries with regard to this bulletin, or if you require more detailed information regarding the Day 1 obligations, please contact any of the following:

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This bulletin has been sent to underwriters, Lloyd's brokers and managing agents.

Andrew Smith  
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## APPENDIX 1

### Definition of ‘General Insurance’

Below are outlined the relevant clauses of the Insurance (Agents & Brokers) Act 1984 and the Insurance Act 1973 to assist with the determination of a ‘general insurance’ policy.

#### **Insurance (Agents & Brokers) Act 1984**

##### **Part I**

##### **Clause 6      Application of the Act**

- (1) Subject to sections 7 and 8, the application of this Act extends to contracts of insurance and proposed contracts of insurance, and to conduct in connection with such contracts and proposed contracts, being contracts or proposed contracts the proper law of which is or would be the law of a State or of a Territory in which this Act applies or to which this Act extends.
- (2) For the purposes of subsection (1), where the law of a contract or proposed contract would, but for an express provision to the contrary included or to be included in the contract or in some other contract, be the law of a State or of a Territory in which this Act applies or to which this Act extends, then, notwithstanding that provision, the proper law of the contract is the law of that State or Territory.

##### **Clause 7      Exemptions to application of Act**

This Act does not apply to or in relation to contracts and proposed contracts:

- (a) of reinsurance; or
- (b) of insurance entered into, or proposed to be entered into, by a registered health benefits organization, as an insurer, in the course of its business as a registered organization within the meaning of Part VI of the National Health Act 1953; or
- (c) of insurance entered into, or proposed to be entered into, by the Export Finance and Insurance Corporation under the Export Finance and Insurance Corporation Act 1991, other than short-term insurance contracts within the meaning of that Act; or
- (d) for interests in approved benefit funds (within the meaning of the Life Insurance Act 1995) of friendly societies (within the meaning of that Act).

**Clause 8 State and Northern Territory Insurance**

This Act does not apply to or in relation to:

- (a) State insurance or Northern Territory insurance; or
- (b) A contract of insurance or proposed contract of insurance entered into or proposed to be entered into by:
  - (i) a State or the Northern Territory; and
  - (ii) some other insurer; as joint insurers.

**Clause 9 Definitions**

In this Act, unless the contrary intention appears:

*general insurance business* has the same meaning as *insurance business* has in the Insurance Act 1973.

**Insurance Act 1973**

**Part I**

**Clause 3 Interpretation**

(1) In this Act, unless the contrary intention appears:

*insurance business* means the business of undertaking liability, by way of insurance (including reinsurance), in respect of any loss or damage, including liability to pay damages or compensation, contingent upon the happening of a specified event, and includes any business incidental to insurance business as defined, but does not include:

- (a) life insurance business;
- (b) accident insurance business undertaken solely in connection with life insurance business;
- (c) pecuniary loss insurance business carried on solely in the course of carrying on banking business and for the purposes of that business by an ADI;
- (d) business in relation to the benefits provided by a friendly society or trade union for its members or their dependants;
- (e) business in relation to the benefits provided for its members or their dependants by an association of employees or of employees and other persons that is an organisation within the meaning of the *Workplace Relations Act 1996*;

- (f) business in relation to a scheme or arrangement under which superannuation benefits, pensions or payments to employees or their dependants (and not to any other persons) on retirement, disability or death are provided by an employer or an employer's employees or by both, wholly through an organization established solely for that purpose by the employer or the employer's employee or by both;
- (g) business in relation to a scheme or arrangement for the provision of benefits consisting of:
  - (i) the supply of funeral, burial or cremation services, with or without the supply of goods connected with any such service; or
  - (ii) the payment of money, upon the death of a person, for the purpose of meeting the whole or a part of the expenses of and incidental to the funeral, burial or cremation of that person;

and not other benefits, except benefits incidental to the scheme or arrangement;
- (h) business undertaken by a person, being a carrier, carrier's agent, forwarding agent, wharfinger, warehouseman or shipping agent, relating only to the person's liability in respect of goods belonging to another person and in the possession, or under the control, of the first-mentioned person for the purpose of the carriage, storage or sale of those goods;
- (i) business undertaken by a person, being an innkeeper or lodging-house keeper, relating only to the person's liability in respect of goods belonging to another person and in the possession or under the control of a guest at the inn or lodging-house of which the first-mentioned person is the innkeeper or lodging-house keeper or deposited with the innkeeper or lodging-house keeper for safe custody;
- (j) the business of insuring the property of a religious organization where the person carrying on the business does not carry on any other insurance business; or
- (k) business as a registered health benefits organization, a registered medical benefits organization or a registered hospital benefits organization carried on by an organization that is registered organization within the meaning of Part VI of the *National Health Act 1953*.

## APPENDIX 2

### DAY 1 OBLIGATIONS – TO BE MET BY 11 MARCH 2002

Some of the Day 1 obligations, detailed below, only apply to retail clients (see Appendix 3 for a definition of a retail client).

- **Trust account requirement for money received before product issued s1017E (*applies to all business*)**

This requires that any money received by an insurer or its agent from the insured, *where a contract is not entered into before, at the same time or immediately after the money is received*, must be placed in a prescribed account and held on trust for the insurer. A contract is entered into when agreement is reached. This may occur before policy documents are issued or before the insurer actually goes on risk.

In all other cases the existing money handling requirements under the IABA (i.e. section 37/37A for non-broker agents and section 27 for broker agents) will apply until the transition period ends.

***Lloyd's underwriters need to*** - determine if their agents in Australia receive money from the insured where no policy has been entered into. Where this occurs, procedures should be changed to ensure the agent deposits the money into the relevant prescribed account within the required time period.

[Please note this section may be subject to amendment regarding the activities of insurance broker agents. An update will be provided if further changes occur].

- **Anti hawking prohibition s 992A (*applies to all business*)**

This section deals with two separate concepts:-

- a) unsolicited meetings (i.e. face to face) – the provisions are only intended to apply to face-to-face meetings and not telephone calls or contact via correspondence or the Internet. They essentially impose a direct prohibition on a person offering to issue or sell a product as a result of an unsolicited meeting; and
- b) other unsolicited personal contact (i.e. telephone calls or contact via correspondence or the Internet). There is no direct prohibition but new requirements are introduced which must be met before the offer to issue or sell a product is made due to an unsolicited personal contact (e.g. the client must be given the opportunity to opt out and can only be contacted within certain hours).

[Please note that there are a number of interpretations and practical problems with this section, which remain unresolved. Regulations have not yet been finalised and it is possible that the Government may seek to amend this section.]

*Lloyd's underwriters and their Australian distributors need to* - determine if they sell products in unsolicited meetings or by way of other unsolicited contact and adjust their practices to avoid breaching the new provision.

▪ **Confirmation of transactions s 1017F (*applies to retail clients only – see Appendix 3 for definition*)**

This requires formal confirmation of insurance transactions (i.e. cover notes, new business, renewals, variations and cancellations) to be provided in accordance with “prescribed content requirements” as soon as reasonably practicable after the transaction occurs.

The confirmation must provide information that the product issuer reasonably believes the insured needs (having regard to the information the insured has received before the transaction) to understand the nature of the transaction, including but not limited to:

- a) the identity of the issuer and insured; and
- b) if required to be given by a person other than the issuer – the identity of that person; and
- c) (i) details of the transaction; and
  - (ii) a description of the transaction; and
  - (iii) any amount paid or payable by the holder in relation to the transaction unless this amount was not known at the time of confirmation; and
  - (iv) any taxes and stamp duties payable in relation to the transaction unless this amount was not known at the time of confirmation.
- d) if it is an acquisition or disposal, identify the financial product and the number and amount of financial products that are the subject of the transaction; and
- e) if the transaction involves more than one financial product (i.e. separate contracts only), the price per unit of the products.

The above obligation applies to insurers, however, an insurer can use their representatives to meet the requirement on their behalf.

The insurer or their agent can meet this requirement in two ways (or a combination of the two):

- Option 1 – by giving the customer or their representative (e.g. broker) *access to* a confirmation facility where the client or their insurance broker can ask for the relevant confirmation if necessary (this will usually be a call centre or electronic facility); or
- Option 2 – by *giving actual* confirmation electronically or in writing to the client or its agent (e.g. an insurance broker) e.g. in the schedule or renewal or cancellation notice etc.



*Lloyd's underwriters and their Australian distributors need to* - determine which method suits their business arrangements and implement the appropriate changes where required.

- **Cooling off periods 1019A and B** (*applies to retail clients only – see Appendix 3 for definition*)

A 14-day statutory cooling off period is brought in for new business and renewals subject to certain restrictions as to when an insured can exercise the right e.g. where a claim has been made or the period of cover has ended.

It does not apply to: -

- Renewals of policies that are of less than 12 months in duration (it does apply to the first issue of cover); or
- Interim contracts. These are contracts of insurance that are intended by the insurer a) to provide temporary insurance cover; and/or b) to be replaced or superseded by another contract of insurance. Cover notes or similar documents confirming cover pending the issue of full documentation do not trigger the start of the cooling off period.
- ***For travel insurance and other similar policies covering short-term events, the cooling off period ends at the earlier of the start of the relevant event (e.g. the journey) or the end of the 14-day period.***

Insurers have certain rights to deduct amounts for time on risk, unrecoverable taxes and reasonable administration fees etc. The regulations have specified that the amount that will be repaid to the retail client may be varied so that:

- a) if a tax or duty of any kind has been paid, or is payable by the product issuer because of the issue of the financial product and either:
  - (i) if the tax or duty has been paid, the issuer is unable to obtain a refund or the tax or duty; or
  - (ii) if the tax or duty has not been paid, the tax or duty does not cease to be payable as a result of the exercise of the right to return the financial product, the amount that would otherwise be repaid is reduced by the amount of the tax or duty.
- b) the amount that would otherwise be repaid may be reduced to account for reasonable administrative and transaction costs (other than the payment of commissions or similar benefits) incurred by the issuer of the financial product that:
  - (i) are reasonably related to the acquisition of the financial product and the subsequent termination of the contract or legal relationship; and
  - (ii) do not exceed the true cost of an arms length transaction.

- (c) if the financial product is a risk insurance product or that part of a financial product that is a risk insurance product, and
- (i) has been issued for a specific period; and
  - (ii) a proportion of that period has already passed when the right to return the risk insurance product is exercised, the amount that would otherwise be repaid may be reduced by a proportion equal to the proportion of the period that has passed.

*Lloyd's underwriters and their Australian distributors need to* - determine if their policies or practices need to be changed to ensure that insureds at least receive the minimum benefits provided by the section.

- **Part 7.9 New Product Disclosure requirements** e.g., includes the requirement to provide a **Product Disclosure Statement**, i.e., a document that insurers must prepare that contains prescribed information for retail clients as set out in the FSRA. (*Applies to retail clients only – see Appendix 3 for definition*).

These new requirements should not apply until 11 March 2004 unless the underwriter deliberately opts into the new requirements, or after 11 March 2002 offers the product for the first time in Australia. However, if the product issued after 11 March 2002 is a new one which provides the same kind of cover, or cover in relation to the same kind of asset, as a product previously in existence, then the new product will not be caught by this requirement.

*Lloyd's underwriters and their Australian distributors need to* – determine if the new requirements will apply to any new product classes issued by them after 11 March 2002.

## APPENDIX 3

### Definition of a 'Retail Client'

A person will be a "retail client" in relation to general insurance if the financial product is, or a financial service provided to the person relates to, a general insurance product, and:

- either the person is an *individual* or the insurance product is or would be for use in connection with a *small business* – (i.e. manufacturing business 100 employees or less, other business – 20 employees or less); *and*
- the general insurance product is one of the following types as defined in the regulations - motor vehicle, home buildings, home contents, sickness and accident, consumer credit, travel insurance, or personal and domestic property insurance product.

The definition of the first 6 product types above are similar to the definitions of the prescribed contracts in the regulations to the Insurance Contracts Act 1984. However, the definitions are not limited to insurance where the insured or one of the insureds is a natural person as is the case with the Insurance Contract Act prescribed contracts. This is to take account of the fact that the definition of retail client for general insurance can include insurance provided to an individual or a *small business*.

The definition of a personal and domestic property insurance product only applies to a contract that provides insurance cover in respect of loss or damage to the property that is *wholly or predominantly* used for personal, domestic, or household purposes by the insured, or a relative of the insured, or any person with whom the insured resides and ordinarily used for that purpose.

"Property" is defined to include (n.b. it is not an exhaustive list) any of the following – moveables, valuables, a caravan or mobile home, an on-site mobile home, a trailer, a marine pleasure craft, a horse, a domestic pet and a mobile phone.

Where there is a single contract containing a number of wholesale and retail covers (e.g. motor and sickness and accident (retail types), and general liability and machinery breakdown (wholesale types), the whole product is treated as retail. However, if the packaged product is made up as separate contracts but marketed together, then only the retail contracts are caught by the retail client requirements.