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Appendix 2: Definition of a Retail Client
ACTION POINTS: **Immediate Action**
DEADLINE: **Immediate**

Market Bulletin Y2736 dated 22nd February 2002 advised that with effect from 11 March 2002 the Financial Services Reform Act 2001 (FSRA) was to become effective in Australia.

Although the pre-existing regime continues to apply during a transition period, certain new obligations were introduced from 11 March 2002 (formally known as the “Day 1 obligations”), as outlined in the previous Market Bulletin. In brief, the Day 1 obligations related to requirements and standards for:

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

The bulletin explained that the Day 1 obligations were subject to possible change, because legislation affecting their operation had not yet been finalised. The relevant regulations have now been finalised and Appendix 1 provides an updated version of the requirements applicable to general insurance, such that the previous version of this Appendix can be discarded. The Day 1 obligations relating to the receipt of monies from the insured and the prohibition on solicitation should be read in their entirety as a number of changes have been made since the last bulletin. However, only minor changes have been made to the other Day 1 obligations and these changes have been underlined for ease of reference.

Lloyd's Australia continues to negotiate with the Australian Treasury with a view to obtaining a satisfactory licensing structure to apply to the Lloyd's market (with effect from the expiry of the transition period, 11 March 2004). It currently appears that the Treasury has so many issues to consider in relation to the FSRA that a final decision will not be given before the end of July. A further bulletin will be issued once this decision has been received.

Further information on the FSRA can be obtained by viewing the Australian Treasury and ASIC websites www.treasury.gov.au and 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:

Lloyd's General Representative in Australia

Keith Stern Tel: 00 61 2 9223 1433
 Fax: 00 61 2 9223 1466
 Email: keith_stern@bigpond.com

Lloyd's Worldwide Markets

Market Services Desk: Tel: 020 7327 6677
 Email: market.services@lloyds.com

Maxine Hooper Tel: 020 7327 6291
 Email: maxine.j.hooper@lloyds.com

Andrew Smith Tel: 020 7327 5349
 Email: andrew.d.smith@lloyds.com

Fax: 020 7327 5255

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

Rosemary Beaver
Head of Compliance
Worldwide Markets

APPENDIX 1

DAY 1 OBLIGATIONS

Some of the Day 1 obligations, detailed below, only apply to retail clients (see Appendix 2 for a definition of a retail client).

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

Please read the whole of this section's update as a number of changes have been made to it since the last update.

This section provides that:

- where a product issuer (ie the insurer) is paid money by a client (whether retail or wholesale) to acquire an insurance policy (money paid to a representative of an insurer would be seen as being received by the insurer); and
- the policy is not *entered into* before, at the time, or immediately after they receive the money (remember an insurer may have entered into a contract even though they are not on risk until a later time),

the insurer must ensure that the money is paid on the day that it is received or the next business day, into an account (or accounts) that meet(s) a number of particular requirements [see sub section 1017E(2), (2A), (5) and Regulation 7.9.08 – 7.9.08B for details of all of these requirements such as the designation requirement and dealing with interest, which can be accessed at www.treasury.gov.au.]

If a payment is made by cheque, the payment will only be seen as made or received when the cheque is honoured. [See regulation 7.9.61C.]

The above is not intended to apply to insurance brokers (even when acting as agent of an insurer). Insurance brokers need only to continue complying with the requirements regarding their Insurance Broking Accounts and insurance monies under the IABA during the transition period.

In addition, the above, will not apply to the handling of monies put into an account by any insurance broker and agent that have obtained a licence.

Section 1017E requires the product provider to return the money or issue the policy within a month after the day on which the money was received, or if this is not reasonably practicable, by the end of such longer period as is reasonable in the circumstances [see sub section 1017E(4)]. If this cannot be done, the money must be transferred to the Australian Securities & Investment Commission (ASIC) in accordance with Regulation 7.9.61A.

Where the money has been paid to acquire an insurance product and the product provider issues another product which is the same as the new product, except for the date on which it ceases to have effect (i.e. cover note) and the product provider has not issued the new product, then this money may be taken out of the account provided after doing so the product provider:

- issues the new product before the date on which the other cover ceases to have effect; or
- returns the money to the person by whom it was paid before the date on which the other product ceases to have effect.

[See Regulation 7.9.61B]

You should refer to the section and relevant regulations for full technical details of the requirements.

Lloyd's underwriters need to - determine if their agents that are not insurance brokers 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.

- **Anti hawking Prohibition s 992A (NOW ONLY applies to retail clients – see Appendix 2 for definition)**

Please read the whole of this section's update as a number of changes have been made to it since the last update.

Section 992A has been amended to only apply to retail clients. Previously it applied to retail and wholesale clients. It prohibits a person from:

- (a) offering financial products for issue or sale in the course of, or because of, an unsolicited meeting with another person – the provisions are only intended to apply to face-to-face meetings and not telephone calls or contact via correspondence or the Internet; and
- (b) making an offer to issue or sell a financial product in the course of, or because of, unsolicited personal contact (this has recently been limited to telephone calls and no longer relates to contact via correspondence or the Internet) with another person unless the person has been:
 - (i) contacted during the prescribed hours (8.00am to 9.00pm on a day in the State or Territory in which the person to whom the offer is made is located, excluding Christmas day, Good Friday and Easter Sunday);
 - (ii) they are given an opportunity to register on a no contact/no call register at no cost to them and select the time and frequency of any future contacts. PDS requirements apply after the transition period ends.

In situations where the hawking provision is breached, sub section 992A(4) provides the affected person with a right of return and refund in respect of the relevant product exercisable within 1 month after the expiry date of the cooling off period for the financial product, or one month and fourteen days in the event that no cooling off period applies to the financial product.

Regulation 7.8.22 provides that this right of return does not apply to:

- An interim contract of insurance within the meaning of subsection 11(2) of the Insurance Contracts Act 1984 (Cth); or
- A risk insurance product that is of less than 12 months duration and the renewal of an existing product on the terms and conditions to which the product is currently subject (i.e. the renewal of monthly insurance).

[Please note that this section is still ambiguous and open to interpretation in a number of respects. It is anticipated that ASIC may issue a release on how it will regulate this section of the Act.]

Until any further changes are made, Lloyd's underwriters and their Australian distributors should:

- avoid offering or selling a product in an unsolicited meeting to a retail client. If an unsolicited meeting occurs, avoid offering or selling the product in that meeting. They should be able to discuss it generally but should arrange a second meeting or telephone call where they arrange and sell the product. In this way they should avoid being seen as making a pressure sale as it gives the customer the opportunity to say no to further contact, etc. Alternatively, contact insureds other than by way of a meeting (e.g. unsolicited telephone call per the requirements below) and arrange for a solicited meeting with their consent. The aim should be to avoid any pressure sales occurring in the course of an unsolicited meeting; and
 - for unsolicited telephone contact which is not prohibited, they should make sure the telephone sales procedures meet the requirements of the section and if not determine what needs to be done.
- **Confirmation of Transactions s 1017F** (applies to retail clients only - see Appendix 2 for definition)

Changes made to this requirement since the last release are underlined. In addition, set out below are further details on the requirement for those interested.

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

It is relevantly not required for:

- a variation of the terms of all financial products in the class to which the financial product belongs;
- the debiting for fees or charges in respect of the financial product or other transactions involving the product;
- a transaction required or authorised by a law of the Commonwealth or of a State or Territory.
- a transaction consisting solely of an additional contribution towards the product;
- the acceptance or settlement of a claim.

The confirmation must:

- provide the 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) give details of the transaction including:
 - (i) the date 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 the 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
 - provide the amount the insured is required to pay or that is payable to acquire or dispose of the product.
 - (e) if the transaction involves more than one financial product (i.e. separate contracts only), the price per unit of their products.

[See the section and Regulation 7.6.63B, E, F and G for full details.]

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

The insurer can use their agent to meet the requirement on their behalf 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.

A broker, unless acting as agent of the insurer, cannot provide the confirmation or facility. A Lloyd's coverholder is deemed to be an agent of the insurer and therefore can provide the confirmation or facility.

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 period s 1019A and B** (applies to retail clients only – see Appendix 2 for definition)

Only minor changes have been made to this requirement since the last release. Set out below is further detail on the requirement for those interested and the relevant changes have been underlined.

A 14-day statutory cooling off period has been brought in for new business and renewals subject to certain restrictions as to when an insured can exercise the right.

In summary, insurers must give an insured a right to return an insurance product at least in accordance with the requirements of the FSRA.

The FSRA provides that the relevant client is not able to exercise the cooling off right if:

- they have exercised a power or right under the policy (e.g. made a claim) or the policy has ended; or
- the policy covers an event that will start and end within the cooling off period (e.g. a trip overseas, a race or a delivery voyage etc) and the event has started.

The cooling off period starts at the earlier of:

- the time when the confirmation requirement was complied with by the product issuer; or
- the end of the fifth day after the day on which the product was issued (i.e. contract entered into).

The cooling off period does not apply to:

- 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.
- any general insurance product that is:
 - of less than 12 months duration; and
 - a renewal of an existing product on the terms and conditions to which the product is currently subject.
- **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.**

Other than the above it will apply to new business and renewals. When the right is exercised, the product issuer is obliged to refund the relevant money paid to acquire the product to the client in accordance with its directions. A right of cancellation may be exercised in relation to a risk insurance product by notifying the responsible person in a way permitted by the responsible person [See regulation 7.9.64A]

Insurers have certain rights to deduct amounts for time on risk, unrecoverable taxes and reasonable administration fees, etc. The Regulations have specified 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 2 for definition)

The only relevant change made to this requirement since the last update is underlined below.

These new requirements will not apply until 11 March 2004 unless the Lloyd's underwriter deliberately opts into the new requirements, or after 11 March 2002 offers the product for the first time in Australia. Please note that the trigger for this requirement is an offer of business/product for sale, not the actual binding of a risk – see Regulation 10.2.77). 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 – consider whether the new requirement applies when they are issuing a new product after 11 March 2002 which does not provide the same kind of cover, or cover in relation to the same kind of asset, as cover that they have previously issued.

APPENDIX 2

Definition of a 'Retail Client'

[No changes have been made to the definition since the last release but further information is included aimed to assist consideration of this concept for those interested.]

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 if two tests are met:

- The individual or small business test; and
- The product type test.

To qualify as a retail client both the person and the product must pass their respective tests. A client who does not qualify as a retail client will be a wholesale client. It is possible that some people will be retail clients for some products (e.g. they meet the individual test and product test), but a wholesale client for other products (e.g. they meet the individual test but not the product type test).

The two test are as follows:

- **Test 1** – 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*

AND

- **Test 2** – 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;
 - 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*.

Personal and Domestic Property

This covers a contract that provides insurance cover (whether or not the cover is limited or restricted in any way) in respect of loss or damage to 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.

The regulations provide that property is taken to be a wholly or predominately used for personal, domestic or household purposes if the insured gives a written statement to the insurer prior to issue that the property is intended to be used wholly or predominately for one or more of those purposes.

Even if the insured signs such a statement, however, the property must still be able to objectively be regarded as being ordinarily used for the purposes for which the insured uses the property before the relevant policy will be regarded as retail.

What happens with mixed retail and wholesale product types in a single contract?

The position appears to be as follows:

- if 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; and
- 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.