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# *Insurance Intermediaries*

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# Introduction

## Billy Bennett

*Insurance intermediaries are an important part of the insurance value chain and continue to play a vital role in the purchase of insurance and risk products for both the policyholder and the insurer. Intermediaries comprise brokers, managing agents and a variety of other forms of agencies. The nature of intermediaries ranges from being fully independent to being a subsidiary of an insurer.*

*The life insurance intermediary industry is subject to significant changes including the upcoming FOFA (Future of Financial Advice) reforms, the objective of which is to address conflicts of interest that have undermined the financial advice provided to investors. These reforms are changing the way financial planners view their income streams resulting in:*

- *Potential changes to their financial planner's business models;*
- *Significant modifications to remuneration structures;*
- *Increased compliance and administration costs*

*These reforms are likely to impact the selling and distribution of life insurance products.*

*Meanwhile, in the non-life insurance intermediary industry, there continues to be significant competition among intermediaries in an environment where rates are soft but may harden as a result of*

*the string of catastrophe events in the region in 2010 and 2011. This has resulted in a number of key trends including:*

- *A war for talent: Wages are a major expense for intermediaries given the service based nature of the industry. Intermediaries employ a highly qualified and experienced workforce and pay them above average wages to ensure high levels of staff retention;*
- *A reduction in broking margins: To maintain profitability when faced with reduced margins and increased competitor activity, intermediaries will need to deliver on cost containment;*
- *A need for technological advancement to compete with direct distribution by insured;*
- *A focus on the provision of consulting type services: In recent years, the offerings of the intermediary have expanded into various other services such as consulting, risk management, claims management, due diligence audits and advisory services. As competition erodes profitability there will be an increased focus on providing such high margin services.*

*To maintain their competitive edge, the role of the intermediary has moved from a mere proponent of insurance to that of a value-added business partner for insurers. Intermediaries cannot afford to sit still – they must ensure they deliver their core services while increasing the value they add to their customers, with a real focus on strategic differentiation.*



## 5.1

# Key developments in 2010/11

### Recent / Upcoming key development

New ASIC & APRA  
Data Collection and  
Reporting Obligations  
from 1 May 2010

### Summary of issue

On 16 December 2009, Corporations Amendment Regulations 2009 (No.11) was passed requiring intermediaries who are AFS licencees an APRA licenced general insurer, Lloyd's underwriter, or an unauthorised foreign insurer (UFI) to submit certain data to APRA on a bi-annual basis. The data is in a prescribed form, Form 701, and is to be submitted in respect of premiums invoiced from 1 May 2010. The objective is to assist APRA to better understand the role of UFIs and Lloyd's in the Australian market and to assess the extent of reliance on the exemptions to the prohibition on placement of insurance with direct offshore foreign insurers (DOFI exemptions) by Australian insurance brokers. APRA will collect this data on behalf of ASIC.

## 5.2

# Regulation and Supervision

## *Australian Securities and Investment Commission*

In Australia, all brokers are required to be licensed by Australian Securities and Investment Commission (ASIC). ASIC administers a number of laws relevant to brokers including the Corporations Act 2001; the Insurance (Agents and Brokers) Act; the Insurance Contracts Act 1984 and the Superannuation (Resolution of Complaints) Act 1993. The Brokers and Agents Administration System (BAS) and Life Unclaimed Monies System are also administered by ASIC.

## *Australian Financial Services Licence*

The Corporations Act 2001 requires brokers to either hold an Australian Financial Services Licence (AFSL) or become an authorised representative of a separate licensee. To obtain a licence, the applicant must meet the obligations under Section 912A and demonstrate that they will provide financial services efficiently, honestly and fairly. The general obligations relate to the insurance brokers' responsibilities in the areas of compliance, internal systems, people and resources.

Specific provisions under the Corporations Act require that financial services licensees have in place the following:

- arrangements for managing conflicts of interest
- a framework to ensure compliance with conditions on the licence and with financial services laws
- adequate resources (financial, technological and human) to provide services covered by the licence
- adequate risk management systems
- existence of internal and external dispute resolution procedures (where dealing with retail clients);
- arrangements to ensure that the competencies of representatives to provide the financial services (as specified on the licence) are maintained and that the representatives are adequately trained to provide those financial services.

Holders of an AFSL are subject to ongoing financial requirements which are described in ASIC RG 166. These requirements include:

- Positive net assets and solvency
- Sufficient cash resources to cover next three months' expenses with adequate cover for contingencies

Licence holders are required to meet ongoing notification obligations, which include requirements to notify ASIC about:

- Breaches and events;
- Changes in particulars (form F205 for change of name of corporate entities, form FS20 for all others);
- Authorised representatives (forms FS30, FS31, FS32);
- Financial statements and audit (forms FS70 and FS71); and
- Appointment/removal of auditor (forms FS06, FS07, FS08 and FS09).

Section 989B of the Corporations Act also outlines ongoing financial reporting and audit obligations. ASIC has released Class Order 06/68 which grants relief to local branches of foreign licensees from preparing and lodging accounts in accordance with Section 989B of the Corporations Act. This relief is only available where the foreign licensee lodges accounts, prepared and audited in accordance with the requirements of its local financial reporting jurisdiction with ASIC once every calendar year.

In addition to annual financial reporting requirements, under Section 912E of the Corporations Act, ASIC can undertake surveillance checks of AFS licence holders. ASIC has the power to vary licence conditions, as well as issue banning orders that prohibit a person from providing financial services.

## *Other regulations and related matters affecting Insurance Brokers*

Under the Corporations Act 2001, insurance brokers and authorised representatives are prohibited from dealing in general insurance products unless they are from an authorised insurer, a Lloyd's underwriter or if an exemption is applied. Under these regulations, insurance brokers are required to maintain records of business placed with direct offshore foreign insurers (DOFIs) and report their dealings on a regular basis to ASIC.

Insurance brokers are subject to the Anti-Money Laundering and Counter-Terrorism Financing Act (AML/CTF Act). Under the AML/CTF Act, the impact on insurance brokers (if providing a 'designated service'), is meeting their statutory obligations in relation to customer verification, customer due diligence and compliance reporting requirements. Insurance brokers are also subject to codes of practice including the Life Insurance Code of Practice and the General Insurance Code of Practice which set standards and responsibilities. The Insurance Brokers Dispute Facility, overseen by the Insurance Brokers Compliance Council, is a national scheme designed to quickly resolve disputes between insurance brokers and their clients. The facility handles general insurance matters up to \$10,000 and life insurance matters up to \$50,000.

### **5.3**

## *Solvency and capital adequacy*

The minimum solvency requirements under the AFSL regime are:

- Positive net assets;
- Sufficient cash resources to cover the next three months' expenses with adequate cover for contingencies; and
- Surplus liquid funds of greater than \$50,000 where the licensee holds client assets of more than \$100,000.

Further conditions may be set out under the AFSL itself. Compliance with these requirements is tested through audits undertaken by the licensee's auditor both annually and at the request of ASIC.

### *Investment Policy*

Authorised representatives and insurance brokers are required to hold monies in a trust account with an ADI, cash management trust or an ASIC-approved foreign deposit-taking institution. The authorised representative or insurance broker is required to disclose to the insured that they intend to keep any interest earned and must deposit the monies into such an account on the day it is received or on the next business day. Funds held in a trust account can be invested in a broad range of investments, but this in practice is rare and the rules relating to this are complex.

## *Financial reporting*

### *Annual accounts*

As AFSL holders, authorised representatives and insurance brokers are required to lodge forms FS 70 (profit and loss statement and balance sheet) and FS 71 (audit report).

Note that it is possible to apply to ASIC under Section 989D (3) for an extension of time for lodging the forms.

For AFSL holders that are not regulated by APRA, and there are audit requirements in respect of compliance with the licence conditions, including:

- Ability to pay all debts as and when they become due and payable;
- The minimum solvency requirements as described above
- Tiered requirement to hold \$50,000 to \$10 million of adjusted surplus liquid funds for licensees that have more than \$100,000 of liabilities from transacting with clients as a principal
- Compliance frameworks and systems of control

In addition, Section 990(K) contains “whistle-blowing” provisions that obligate auditors to report to ASIC within seven days if they become aware of a situation that may adversely affect the ability of the licensee to meet its obligations and that may result in a breach of either:

- the conditions of the licence; or
- the requirements pertaining to trust accounts, financial records or financial statements.

### *Other returns*

Bodies other than ASIC may also require some form of reporting from Brokers (similar to General Insurers). Brokers may be required to submit the following returns if applicable:

- Fire Brigade Returns;
- Workers Compensation;
- Tax returns such as Fringe Benefits Tax (FBT), Stamp Duty, Business Activity Statements (BAS) etc.; and
- Insurance Protection Tax.

# Taxation

## Taxation of insurance intermediaries

Tax legislation does not contain specific provisions relating to the taxation of authorised representatives and insurance intermediaries. One of the important tax issues confronting authorised representatives and insurance intermediaries is the timing of recognition of commission and brokerage income, as this income is often taxed at a later point in time than it is recognised for accounting purposes. The ATO has issued Taxation Ruling IT2626 to provide guidance on this issue. The terms of the contract or arrangement between the insurer and the authorised representative or insurance broker will be of major importance in determining when commission and brokerage income is derived.

An authorised representative or insurance broker is able to recognise an amount of commission or brokerage as income for tax purposes at different points of time.

Examples include:

- When that amount has become a recoverable debt and the authorised representative or insurance broker is not obliged to take any further steps before becoming entitled to payment.
- When the insurance broker can first withdraw that amount from an insurance broking account.
- When that amount has actually been received from the insurer in those situations where the gross premium has been forwarded by the insured directly to the insurer, provided that the receipt by the authorised representative or insurance broker of that amount had not been deferred unreasonably.
- When that amount has been withheld by the authorised representative or insurance broker from the net premiums passed onto the insurer.

Which of these different scenarios is most relevant in any particular situation will be influenced by the terms of the contract between the authorised representative or insurance broker and the relevant insurer.

The authorised representative or insurance broker will be allowed a deduction in the year in which brokerage and commission is refunded where that amount had previously been included in the assessable income of the authorised representative or insurance broker.

## Goods and services tax

Under the Australian GST legislation, some classes of insurance are treated differently, leading to different implications for insurers and insured parties.

Brokerage and fee income earned by insurance intermediaries will generally be subject to GST, regardless of the type of insurance policy involved, however, some exceptions apply such as brokerage in relation to the arranging of international transport.

We note that changes are currently being proposed to the GST legislation that applies to cross-border transport supplies. In the event these changes are passed by parliament, it is likely that they will apply from 1 July 2012. Based on current drafting, the proposed changes are likely to alter the extent to which international transport activities are GST-free or subject to GST and in turn, this will alter the GST treatment of insurance broker services connected to these international transport activities.

For GST purposes, intermediaries are treated as agents of the insurer in relation to issuing tax invoices even though they act on behalf of the prospective policyholder. As a result, the general GST rules regarding agents have application and should be considered.

It is common place for intermediaries and insurers to use Recipient Created Tax Invoices (RCTIs) in the process of documenting brokerage due for insurance sales. Particular GST rules exist in relation to RCTIs and in 2009 a new Determination (RCTI 2009/1) was released allowing RCTI agreements to be embedded in RCTIs. This development was aimed at reducing the administration required to comply with the legislative requirements regarding RCTIs.

## Stamp duty

Insurance intermediaries (i.e. brokers) are not liable to pay stamp duty on insurance policies, as the liability to pay duty falls on the registered insurer.

Where the insurance is provided by an unregistered insurer (e.g. overseas insurer), the insured is the person who is liable to remit any duty payable in the relevant jurisdictions. However, if the broker has remitted the duty on behalf of the insured, the insured will generally be deemed to have complied with the relevant stamp duty requirements.