

# Insurance Brokers

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## Introduction

# Billy Bennett

Insurance brokers play a vital role for both the policyholder and the insurer in the purchase of insurance and risk products. In Australia, insurance brokers are responsible for placing around half of the total insurance business every year. However, in recent years, due to various technological and competitive pressures, the offerings of the broker have expanded into various other services such as risk management, claims management, loss control, and due diligence audits. Arguably to maintain their competitive edge, the role of the broker has moved from a mere proponent of insurance to that of a value-added business partner for insurers and the insured.

The insurance broking industry has continued its trend of consolidation, this being an inherent part of the competitive environment in the broking industry due to demanding and often costly market conditions. This has made it difficult for the smaller broking firms to maintain infrastructure such as technology, systems and talented human resources that are essential to maintain competitive advantage and meet regulatory and operational commitments.

In the wake of the global financial crisis, albeit less severe in Australia than the rest of the world, insurance brokers are dealing with pressure on fees and commissions due to cost pressure of the clients they serve.

Further, the industry is also challenged with socio-economic factors – the shift in consumer behaviour being a key dynamic. The trend towards consumers increasingly using the internet for research and the purchase of insurance; and the impact of telemarketing and contact centres set up directly by insurers have taken its toll on the insurance broker. The brokers who recognise the opportunities to leverage from changing customer needs will be the winners as we head into the second decade of the 21st century.

## 4.1

# Key developments

## Market trends

The weak economic environment has led to some hardening of general insurance prices for personal lines. Increasing claims costs are eroding insurer's reserves and have resulted in increased prices to maintain capital positions. However, commercial lines have not seen the same level of increase in rates and as a result insurance brokers have not seen any significant change in revenues.

Business volumes remain depressed as the contraction in business activity reduced demand for commercial insurance lines and weak consumer confidence has led to slightly reduced demand for personal insurance lines.

## APRA data collection requirements

On 14 December 2009, Corporations Amendment Regulations 2009 (No. 11) was passed requiring intermediaries who are AFS licensees and who deal with an APRA licensed general insurer, Lloyd's underwriter, or an unauthorised foreign insurer, to submit certain data to APRA. The data is in a prescribed form, Form 701, and is to be submitted in respect of premiums invoiced for from 1 May 2010.

## 4.2

# Regulation and supervision

## Australian Securities and Investment Commission

ASIC is the single Commonwealth regulator responsible for market integrity and consumer protection functions across the financial system. Its responsibilities include:

- Enforcement and effective administration of the Corporations Act;
- Ensuring market integrity and consumer protection in connection with life and general insurance and superannuation products, including the licensing of financial service providers; and
- Protection of retail investors and consumers in the financial services sector.

The Corporations Act requires brokers to either hold an Australian Financial Services Licence (AFSL) or become an authorised representative of a separate licensee. Except under limited circumstances, no person or company may carry on an insurance broking business or act as an agent of a foreign insurer unless they hold an AFSL under the Corporations Act or become a representative of a separate licensee.

## Australian Financial Services Licence

The Corporations Act requires all sellers of insurance products to retail clients, including registered insurers and brokers, to obtain an AFSL.

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;
- Compliance with conditions on the licence and with financial services laws;
- Adequate resources (financial, technological and human) to provide services covered by the licence. These requirements do not apply to APRA-regulated entities (such as registered insurers), but do apply to any non-APRA-regulated subsidiaries;

- Adequate risk management systems. These requirements do not apply to APRA-regulated entities, but do apply to any non-APRA-regulated subsidiaries;
- Adequate compliance framework (AS3806, the Australian Standard on Compliance Programs, acts as a guide to minimum requirements);
- Internal and external dispute resolution procedures (where dealing with retail clients); and
- 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.

Once ASIC has granted an AFSL pursuant to Section 913B of the Corporations Act, any variations to authorisations and conditions of the licence can be made electronically via the ASIC website. Financial and reporting obligations under the AFSL may vary depending on the licensee's circumstances and whether additional requirements are imposed by ASIC.

## Renewal of registration

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** – All AFSL holders must be solvent at all times and have a continuous obligation to monitor their solvency.
- **Rolling three-month cash projections** – There are a number of methods available for performing the projections, the most common are:
  - **Option 1** – Reasonable estimate projection plus cash contingency requires licensees to have access to cash to meet any shortfalls in the projected period; or
  - **Option 2** – Contingency-based projection requires licensees to demonstrate that sufficient cash is available to meet commercial contingencies that could impact cash flow.

ASIC has provided additional options for subsidiary entities in consolidated groups to meet their cash needs projections by using the cash flows of their parent entity. This alternative can only be adopted where the subsidiary is able to demonstrate that it has an enforceable commitment from its parent entity to meet its liabilities or reasonably expects that it can draw upon the cash resources of other members of the consolidated group to meet its obligations. Licensees should refer to ASIC Information Release IR 03-44 for further information on this option.

All AFSL holders must have systems to manage risk which includes risk to financial resources. The risk management framework required will depend on the nature, scale and complexity of the business.

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. A licensee is required to prepare and lodge an audited profit and loss statement and a balance sheet within four months of the end of its financial year for non-disclosing entities and within three months of the end of its financial year for disclosing entities.

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.

## Other regulations and related matters

Since 2008, under the Corporations Act, 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 applied. This is applicable for all insurance brokers holding an AFSL – requirements for which are monitored by ASIC. Under the new regulation, 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. For insurance brokers the Act does not consider the advising and placement of general and life insurance as a designated service. Brokers that provide premium funding services and brokers that hold an AFSL and are involved in a client receiving a 'designated service' may be affected.

The Life Insurance Code of Practice governs relationships between life insurance companies, intermediaries and consumers. The Code sets minimum standards for sales practices and the employment of life insurance intermediaries, oversight by life insurance companies and life brokers of the conduct of their staff and agents, and dispute resolution arrangements.

The General Insurance Brokers' Code of Practice which is part of a national self-regulatory scheme, and sets out the responsibilities of participating insurance brokers also requires brokers to establish an internal process for resolving disputes with the insured. Any breach of the Code may give rise to binding orders or sanctions being imposed on the insurance broker. The Insurance Brokers' Compliance Council monitors the Code.

The Insurance Brokers Dispute Facility 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. The Insurance Brokers Compliance Council oversees the facility and consists of government, broking and consumer bodies.

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.

## 4.3

# 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 (such as government bonds), but the rules relating to this are complex and should be considered in detail. Typically, any investment requires a written agreement as to the arrangements, which will address issues such as how investment earnings and losses are shared.

## Lodgement requirements

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). Refer to the section below on key dates for timing of lodgement. Note that it is possible to apply to ASIC under Section 989 D (3) for an extension of time for lodging the forms.

For AFSL holders that are not regulated by APRA, the Auditor's are required to review measures for ensuring compliance with all of the financial requirements set out in the licence conditions, including:

- Ability to pay all debts as and when they become due and payable;
- Total assets exceed total liabilities, or adjusted assets exceed adjusted liabilities; at all times
- Sufficient cash resources are available to meet three months' expenses plus adequate cover for contingencies, based on rolling three-month cash flow projections that meet ASIC's requirements;
- Requirement to hold \$50,000 of surplus liquid funds for licensees that hold more than \$100,000 of client funds; and
- 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.

Furthermore, the management of all licensees will have to demonstrate to the auditor their procedures for ensuring compliance with Part 7.8 of the Corporations Act. This includes requirements in relation to financial records and financial statements, as well as procedures relating to:

- Preventing unconscionable conduct;
- Complying with "anti-hawking" or cold-calling restrictions in relation to financial products; and
- Adequate staff training and identification of breaches.

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.

## 4.4

# Financial reporting

## Annual accounts

Under section 292 of the Corporations Act, public companies, disclosing entities, large proprietary companies and certain small proprietary companies (if required by ASIC) are required to lodge annual accounts.

## Other returns

Bodies other than ASIC and APRA 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 for Fire Service Levy (FSL)
- Workers Compensation
- Stamp Duty
- Tax returns such as FBT return, Business Activity Statements (BAS) etc.
- Insurance Protection Tax – NSW government tax to assist builders warranty and compulsory third party policyholders affected by the collapse of HIH.

## Key dates

The following are the lodgement requirements for AFS licensees:

- For an AFS licensee that is not a body corporate: within 2 months after the end of its financial year.
- For an AFS licensee that is a body corporate and that is a disclosing entity: within 3 months after the end of its financial year.
- For an AFS licensee that is a body corporate that is not a disclosing entity: within 4 months after the end of its financial year

Lodgement requirements for the other returns vary for periods in review and depending on state of operation. For fire brigade returns, the date of lodgement varies depending upon the state and class of business in which the premiums are earned.

Unaudited stamp duty returns are required to be submitted to the relevant state government on a monthly basis. An annual return is also prepared. Again, the lodgement date differs from state to state. This is the same for Workers' compensation.

Registered insurers must lodge an Insurance Protection Tax return by 15 August each year, which includes details of total premiums received from general insurance for the previous year. A policyholder who takes out insurance with a non-registered insurer must lodge a return within 21 days of the end of the month in which the premium was paid. A payment of tax equal to 1 per cent of the premium must accompany the return. An agent or broker may pay this on behalf of the policyholder.

## 4.5 Taxation

### General developments

The Government has continued with ambitious plans for significant tax reform. The comprehensive review of Australia's tax system, otherwise known as the Henry Review has been completed and the final report released to the public on 2 May 2010 together with the Government's response. Despite the 138 recommendations in the Henry Report, the Government has only made a handful of announcements, although there may be further announcements in the May budget.

The Government proposes to reduce the company income tax rate from 30 per cent to 29 per cent for the 2013-2014 income year and to 28 per cent from the 2014-2015 income year and introduce certain changes to the superannuation system including a staged increase in the Superannuation Guarantee payment from 9 per cent to 12 per cent. These initiatives are to a large extent funded by the Resource Super Profits Tax of 40 per cent.

One of the insurance specific recommendations in the Henry Report is the abolition of specific taxes on insurance products, including stamp duties and fire service levies, which is consistent with the recommendations in the "Australia as a Financial Centre: Building on our Strengths" report released by the Australian Financial Centre Forum. The Government has not ruled out this recommendation although any changes will need agreement from the State Governments.

Some other key tax developments during the year are listed below.

- The new Taxation of Financial Arrangements (TOFA) measures which provide a comprehensive regime for the tax treatment of gains and losses arising from financial arrangements have been legislated. The TOFA measures will apply to eligible taxpayers for the income year beginning on or after 1 July 2010 unless the taxpayer chooses to have the rules apply for income years beginning on or after 1 July 2009 (i.e. the "early adopt" election). Taxpayers have a choice as to how TOFA will apply to their financial arrangements.
- New tax consolidation measures were introduced into Parliament on 10 February 2010. One of the significant changes proposed is clarification of the income tax treatment of rights to future income.

## Taxation of insurance brokers

Tax legislation does not contain specific provisions relating to the taxation of authorised representatives and insurance brokers. One of the important tax issues confronting authorised representatives and insurance brokers 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.

- The Federal Government has proposed a reform of Australia's foreign source income anti-tax deferral (attribution) rules. The proposal includes a rewrite of the Controlled Foreign Companies (CFC) rules and the repeal of the Foreign Investment Fund (FIF) rules. The FIF rules will be replaced with a specific, narrowly defined anti-avoidance rule that applies to offshore accumulation or roll-up funds.
- The new International Dealings Schedule - Financial Services 2010 (the IDS-FS 2010) was released by the ATO. The IDS-FS 2010 is the ATO's newly proposed tax return schedule for large (> \$250m turnover) financial services taxpayers to replace the Schedule 25A and Thin Capitalisation Schedule and provide additional information in relation to financial arrangements. For the 2010 Income year the IDS-FS is optional. However, the IDS-FS will be mandatory for affected taxpayers for the 2011 year. For early balancing 31 December substituted accounting period taxpayers, this means that information will be required to be collected and reported in the IDS-FS from 1 January 2010.
- During 2009 (subsequent to the release of last year's "Insurance Facts and Figures Publication"), the Australian Government announced its support for 41 of 46 recommendations that were made by the Board of Taxation in relation to its review of the Administration of the GST System. Generally these changes are aimed at reducing the administrative burden of complying with the GST legislation and represent the most significant package of GST reform in 10 years.

While many supported recommendations were identified as applying from 1 July 2010, the legislative process has only started for some of the recommendations with either Exposure Drafts or Bills being introduced and debated in Parliament during 2010. We expect some but not all of the current proposed changes to be passed by parliament prior to 1 July 2010 with the effective date of the changes ranging from 1 July 2000 to 1 July 2010 (that is, some changes are likely to apply retrospectively). Many of the changes have general application to business taxpayers and it is important for each organisation to consider the impact of each of the proposed or finalised changes.





This publication is designed to provide an overview of the accounting, tax and regulatory environment relating to insurance in Australia. Information contained in this booklet is based on the law and Government announcements as at 16 April 2010.

The information presented in this publication should be used as a guide only and does not represent advice. Before acting on any information provided in this publication, readers should consider their own circumstances and their need for advice on the subject. PricewaterhouseCoopers insurance experts will be pleased to assist – please contact your usual PwC contact or one of the experts listed at the end of this publication.

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