

INSURANCE COMPLIANCE SPECIALIST

REGULATORY COMPLIANCE - RISK - GOVERNANCE

APRA authorisations & ASIC licenses
practical impacts for general
insurance

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Paul's Golden Rules

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Paul's Golden Rules for Authorisations & Licences

- Golden Rule 1 – Only APRA authorised insurers can 'carry on insurance business' in Australia
- Golden Rule 2 – UFI's and DMF's are not APRA authorised insurers but Lloyd's underwriters are
- Golden Rule 3 – If you issue or distribute general insurance products you must have an AFS Licence or be an Authorised Representative of a Licensee or rely upon a Section (2) exemption
- Golden Rule 4 – Treat Authorised Representatives as external employees
- Golden Rule 5 – One AFS Licensee cannot appoint another Licensee as its representative unless Golden Rule 6 applies
- Golden Rule 6 – An underwriting agency or insurance broker can only act for an APRA authorised insurer under a binder agreement, however they are the agent of the insurer not the insured
- Golden Rule 7 – The same Golden Rules apply to claims as apply to distribution



Firstly, it's important to understand the nature of Insurance

- Insurance is a risk transfer, loss-spreading arrangement. Generally speaking, it involves an insured transferring to an insurer the burden of a certain type of financial loss the insured might suffer if an event specified in the arrangement:
 - fortuitously occurs during the period of the arrangement ('occurrence' insurance); or
 - is the subject of a claim first made against the insured, or of circumstances first notified to the insurer, during the period of the arrangement ('claims made' liability insurance)
- The period of the arrangement (insurance period) is a fundamental aspect of an insurance arrangement
- An insurer takes on that financial burden by promising it will make good such loss by paying money or a corresponding benefit (money's worth) to the insured as required by the arrangement: *Prudential Insurance Co v Inland Revenue Commissioners*

Pynt, G. *Australian Insurance Law: A First Reference* (2018) 4th Ed LexisNexis Butterworths (p 4)



APRA authorisation

Golden Rule 1 – Only APRA authorised insurers can ‘carry on insurance business’ in Australia

- Insurance business is defined in section 3 of the *Insurance Act 1973 (Act)* and 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 so defined (the Act goes on to exclude life, health, marine and other insurance. The Act applies to general insurance only)
- Only Australian general insurers, foreign general insurers & Lloyd’s underwriters may be authorised by APRA under s12 of the Act
- The authorisation of Lloyd’s Underwriters is covered under section 93 of the Act

Section 9 Insurance Act 1973

- A person commits an offence if:
 - the person carries on insurance business in Australia; and
 - the person is not a body corporate or a Lloyd’s underwriter; and
 - there is no determination in force under subsection 7(1) that this subsection does not apply to the person (the effect of which is to allow the person to carry on insurance business without being authorised under the Act to do so)



Status of Unauthorised Foreign Insurers

- Certain contracts of Insurance may be placed with Unauthorised Foreign Insurers (UFI) however UFI's are not authorised by APRA and are unable to carry on insurance business
- The *Insurance Regulations* 2002 defines a UFI (section 4) and Part 2 of the Regulations sets out insurance contracts that are not insurance business

- Section 4A – This Part (Part 2) applies to a contract of insurance for which the insurer is, or is proposed to be, an unauthorised foreign insurer & Sections 4B,C & D sets out insurance contracts that are not insurance business.
 - Section 4B – Insurance contracts for high valued insureds, who are defined as:
 - Operating revenue for a financial year of at least \$200m;
 - Value of gross assets for a financial year of at least \$200m; or
 - Number of employees for a financial year at least 500
 - Section 4C – Insurance contracts for atypical risks e.g. hazardous properties, war, terrorism, medical research, space, aircraft, vessels other than pleasure craft and equine.
 - Section 4D - Insurance contracts for other risks that cannot reasonably be placed in Australia.

In deciding whether the risk insured under that contract cannot reasonably be placed with an Australian insurer, the Australian insurance broker must be satisfied, on reasonable grounds, that:

- there is no Australian insurer that will insure against the risk; or
- the terms (including price) on which any Australian insurer will insure against the risk are substantially less favourable to the insured than the terms on which the unauthorised foreign insurer will insure against the risk; or
- insurance with an Australian insurer would be substantially less favourable to the insured than with an unauthorised foreign insurer because of other circumstances.

Fun Fact

UFI's are not regulated by APRA however general insurance intermediaries (Insurance brokers) are required, under Part 7.6B of the *Corporations Regulations* 2001, to provide data to APRA. These Regulations require general insurance intermediaries to provide data about their dealings in general insurance business, particularly their dealings with unauthorised foreign insurers.

The data is defined in Form 701. Reference additional information on the Insurance brokers reporting framework here:

<https://www.apra.gov.au/general-insurance-intermediaries-reporting-framework>



Status of Discretionary Mutual Funds

- A Discretionary Mutual Fund is defined in Section 5 of the *Financial Sector (Collection of Data) Act 2001*
- A discretionary mutual fund is a fund (however constituted) for making payments on the happening of a specified event (where there is uncertainty as to whether, or when, the event will happen), that is a fund:
 - To which 2 or more persons contribute, and:
 - Out of which payments may be made in respect of liabilities, losses, damages or expenses of the contributors; and
 - That is governed by rules under which any such payment for the benefit of a contributor is subject to a discretion of a person or body; or
 - That is declared to be a discretionary mutual fund, or included in a class of funds that are declared to be discretionary mutual funds, by regulations made for the purposes of this paragraph

- Remember that the nature of insurance and the definition of insurance business in section 3 of the *Insurance Act 1973* requires an arrangement or undertaking, that is; a contractual obligation
- Under a discretionary risk product, the protected person has the right to have their claim considered and for a decision to be made about paying the claim (the exercise of discretion).
- Mutuels usually operate under a Board with a constitution and a policy wording that outlines the cover
- Mutual Capital Instruments (MCI) were introduced to the *Corporations Act (2001)* in 2019. They allow an MCI mutual to issue shares to complement their capital base.
- Usually a Mutual will be supported by reinsurance.

Golden Rule 2 – UFI’s and DMF’s are not APRA regulated insurers
but Lloyd’s underwriters are



Who needs an Australian Financial Services Licence?

s911A *Corporations Act* applies

- A person who carries on a financial services business in Australia must hold an Australian financial services (AFS) licence covering the provision of the financial services (section 911A(1) *Corporations Act*). Issuing & distribution of General Insurance products is a financial service.

Unless

- They have been appointed as an Authorised Representative on behalf of the AFS Licensee: or
- Rely upon an exemption in sub-section (2)

Typically insurers who don't have their own AFS Licence will rely upon:

- Subsection (2)(b) where the insurer issues the insurance product(s) and under an arrangement (typically broker agreement) with an AFS Licensee (typically a general insurance broker) the insurance broker distributes the insurance product
- However, don't forget that only APRA regulated insurers and Lloyd's underwriters can issue insurance products (carry on insurance business) so typically only an APRA regulated insurer would rely upon (2)(b) although most have their own AFS Licence.

Golden Rule 3 – If you issue or distribute general insurance products you must have an AFS Licence or be an Authorised Representative of a Licensee or rely upon a Section (2) exemption



Appointment as an Authorised Representative

s916A of the *Corporations Act* applies – Sections (1) and (2)

- A financial services licensee may give a person (the authorised representative) a written notice authorising the person, to provide a specified financial service or financial services on behalf of the licensee
- The financial services specified may be some or all of the financial services covered by the licensee's licence

So what does this mean?

- The Authorised Representative agreement must be in writing and made available to clients when asked. Usually a one page Authority Certificate will be provided covering the insurance products and scope of the authority for this purpose so that the full agreement (containing confidential information) does not have to be provided.
- The Authorised Representatives (AR) authority cannot be greater than the AFS Licensee's authority and licence conditions. You can't give away (authority) what you don't have (under your Licence) however the AR can be limited to only some of the services that the Licensee is licensed to carry out.
- The AFS Licensee's general obligations under section 912A of the Corporations Act include obligations to:
 - Take reasonable steps to ensure representatives comply with the financial services laws (1)(ca); and
 - Ensure that its representatives are adequately trained (1)(f)

Golden Rule 4 – Treat Authorised Representatives as external employees



One AFS Licensee cannot appoint another Licensee as its representative

Ok, this seems a relatively simple one ... (hint, it's not) and is fundamental to understanding whether a financial firm acts for the insured or the insurer

s916D(1) *Corporations Act*

- A financial services licensee cannot be the authorised representative of another financial services licensee
 - Subject to exception 916E, in a practical sense, this means that the AFS Licensee will be acting for the insured and any agreement with the other Licensee will need to make this clear. The agreement would also include effectively who 'owns' the client. Usual agreements include a broker agreement (insurer and insurance broker) and wholesale insurance broker agreement (insurance broker and insurance broker or underwriting agency (for open market placements)).
- Unless exception section 916E applies

Golden Rule 5 – One AFS Licensee cannot appoint another Licensee as its representative unless Golden Rule 6 applies



Underwriting Binders

Enough suspense, here is section 916E *Corporations Act*

- Despite section 916D, a financial services licensee (the authorised licensee) may be the authorised representative of another financial services licensee who is an insurer, if the authorised licensee acts under a binder given by the insurer
- For all purposes connected with contracts that are risk insurance products, or with claims against the insurer, in respect of which the authorised licensee acts under the binder:
 - The authorised licensee is taken to act on behalf of the insurer and not the insured; and
 - If the insured in fact relied in good faith on the conduct of the authorised licensee, the authorised licensee is taken to act on behalf of the insurer regardless of the fact that the authorised licensee did not act within the scope of the binder

See its all making sense now, isn't it?

- If an Underwriting Agency or Insurance Broker has underwriting or claims authority from an insurer & has an AFS Licence, and the insurer has an AFS Licence, then the Underwriting Agency or Broker must be appointed under a written underwriting binder & act for the insurer not the insured
- The insurer must be an APRA authorised insurer (cast your mind back to Golden Rules 1 & 2)
- If a Underwriting Agency is placing open market business (not under a binder) and have an AFS Licence then effectively they are doing so as a wholesale broker. Section 916E exception doesn't apply as it's not binder business but open market business, therefore due to section 916D, the Underwriting Agency under this situation, is acting for the insured not the insurance broker. In this situation the Underwriting Agency would have a Wholesale broking agreement with the insurance broker stating they are not the representative of the broker, are acting for the insured however there would be restrictions on the ownership of the client.

Golden Rule 6 – An underwriting agency or insurance broker can only act for an APRA authorised insurer under a binder agreement, however they are the agent of the insurer not the insured



So what about insurance claims?

I'm glad you asked.

Nothing in the Financial Service Laws changes the Golden Rules for claims. Previously, insurance claims handling and settlement service was excluded as a financial service. With (practical) effect from 31st December 2021 (applications must be lodged with ASIC by 30th June 2021 or else you miss out – this is a strict deadline date) insurance claims handling and settlement service is no longer excluded & therefore is a financial service.

Don't forget the principle underlying Golden Rule 3, you need to be licensed to provide a financial service so...if insurance claims handling and settlement is a financial service then *ipso facto* you need to be Licensed.

Importantly for claims

- The situation with APRA Authorised Insurers is unchanged
- s911A - who must be Licensed includes the new Section 911A(2)(ek)(i) to (vi) *Corporations Act* in respect of providing claims handling and settlement services
- s911A (2) exemptions have been expanded to include Sections 911A(2) (ek), (el), (em) & (en) *Corporations Act*
- s916A appointment as an Authorised Representative is unchanged
- S916D is unchanged, an the s916E exemption for binders remains (claims binder)

Who must be Licensed to provide claims handling and settling services in relation to an insurance product?

- (i) the insurer under the insurance product;
- (ii) an insurance fulfilment provider who has authority from the insurer to reject all or part of a claim under the insurance product
- (iii) an insurance claims manager;
- (iv) an insurance broker (within the meaning of the Insurance Contracts Act 1984) who provides the claims handling and settling service in relation to the insurance product on behalf of the insurer;
- (v) person who has provided, or has entered into an arrangement to provide, financial product advice to a person insured under the insurance product (including a person insured as a third party beneficiary under the contract of insurance that constitutes the insurance product, within the meaning of the Insurance Contracts Act 1984) and who also provides the claims handling and settling service on behalf of the insurer under the insurance product;
- (vi) a claimant intermediary representing a person insured under the product in pursuing a claim under the product

Golden Rule 7 – The same Golden Rules apply to claims as apply to distribution



How to approach Authorisations and Licence issues?

Grab a marker & whiteboard and map it all out

Step 1 – Understand the Business's corporate structure & ownership and the business arrangements for insurance product issuing, distribution and claims

Step 2 - In respect of general insurance products you will always need an APRA authorised insurer or a UFI or DFM but be aware of the restrictions and limitations if a UFI or DMF

Step 3 – In respect of general insurance product distribution you will always need someone who has an AFSL

Step 4 – Understand legal requirements of how the AFSL engages with others & what written agreement follows (broker agreement, authorised representative agreement or binder agreement). This will also determine who they are acting for, insured or insurer.

Step 5 – In respect of claims, understand whether the service that is being provided is a claims handling and settling service (as defined under the *Corporations Act*) and whether the entity providing that service requires a Licence or can be appointed as an Authorised Representative or is subject to an exemption. Ensure the claims agreement reflects the legal obligations.

Step 6 – If in doubt, call Paul Muir 0419 695 173





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Thank you – take care & stay safe 😊

