

□ INSURANCE

New Code of Practice launched

The new General Insurance Code of Practice developed by the Insurance Council of Australia (ICA) was launched on 18 July. The Code sets minimum service standards for all types of general insurance products for individuals and businesses but does not cover workers' compensation, compulsory third party (CTP), medical indemnity and marine insurance.

For the first time the Code applies to insured businesses as well as individuals. General insurers who adopt the Code will be required to meet measurable performance standards in their dealings with customers, including settling claims within specific time periods and providing clear information about policy coverage.

Insurers will continue to be monitored under the existing Code during a 12 month transitional period up to July 2006 to allow for alignment of procedures to the new standards. After an insurer adopts the new Code all policies issued and claims notified will be subject to the requirements of the new Code – claims already notified to the insurer remain subject to the existing Code. The Insurance Ombudsman Service (IOS) is preparing a document for release to the insurance industry that will clarify obligations during the transition period.

The ICA has announced that its members, who represent 90% of the general insurance market, will adopt the new voluntary Code. Other parts of the general insurance industry, including overseas insurers, will not need to adopt the Code although they are encouraged to do so. Insurers selling products through Australian financial services licensees may be asked to address non compliance with the Code and report any concerns to IOS.

Insurers adopting the Code will need to review their insurance sales processes and claims handling processes, including considering the following:

Initial inquiry, buying, renewal

- Forms and call centre scripts need to be reviewed to ensure that only relevant information is asked for and taken into account. The underwriting guidelines need to support this process. Training may need to be updated so that guidelines are clearly understood and consistently applied by staff.
- Declinature scripts and associated referral procedures to assist the declined customer will need to be developed.
- Authorised representative agreements will need to be reviewed to ensure they incorporate reporting obligations with respect to alleged breaches of the Code and other obligations consistent with the Code.

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introduction



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In this issue of our *Financial Services Law Bulletin* we discuss the new General Insurance Code of Practice. The Insurance Council of Australia has organised a series of seminars in each state and territory to raise awareness of the new Code and its role in protecting consumers. Each signatory will implement the standards in a way that is appropriate for their business ensuring that Code standards are met or exceeded. Several insurers have already indicated their support for the new Code and confirmed their intention to commence planning for the adoption of the code during the transition period.

The Code can be downloaded at:
http://www.codeofpractice.com.au/Portals/5/ICA_CodeOfPractice.pdf

□ REINSURANCE

APRA won't count reinsurance without the paperwork

Documentation of reinsurance arrangements is sometimes a haphazard process, or worse, not really done at all. APRA has decided that such practices are no longer acceptable for Australian general insurers, and will be adjusting the capital adequacy calculations of those insurers whose non-facultative reinsurance arrangements are not documented in accordance with the requirements of new draft Prudential Standard 230: *Reinsurance Management*.

The new Standard proposes a two-stage process by which APRA will verify reinsurance arrangements. In essence, the verification process requires insurers to sign declarations two and then six months after the reinsurance arrangements take effect, detailing the degree of documentation in place at that stage. The stage one declaration does not have to be submitted to APRA, but must be signed by the CEO and Chief Reinsurance Officer. The stage two declaration must again be signed by the CEO and Chief Reinsurance Officer, and lodged with APRA within 10 business days of the conclusion of the six months following inception of the reinsurance.

By the six month stage, insurers are expected to hold final contracts relating to their reinsurance arrangements and for the reinsurance to be fully placed (or if not, to provide details of any gaps). The declaration must also, amongst other things, detail whether the insurer has the relevant placing slips in its possession and whether it has a signed and stamped full treaty wording, including any appending schedules.

These declarations will be considered by APRA when calculating an insurer's capital requirements. Any reinsurance arrangements that don't comply with the documentation requirements will not be taken into account for calculations of capital adequacy. APRA intends for the requirements to be phased in over a three year period, such that one year after the Standard takes effect, 60% of reinsurance recoveries by value must comply, 80% must comply after two years and there must be 100% compliance with the Standard after three years. APRA proposes that this Standard be finalised and issued by January 2006.

Local insurers will need to ensure their reinsurance is placed with cooperative reinsurers that appreciate the effect non-compliance will have on the bottom line of Australian insurers.

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Claims

- Employee training programs must deliver measurable claims handling expertise. The training will need to include principles of general insurance and any relevant consumer protection law. The programs must include ongoing monitoring and remedial training to detect and address any deficiencies.
- Compliance systems must be established and maintained to ensure deadlines are met and any breaches detected and reported to IOS. The system should including a process for agreeing to alternative time frames when the prescribed

time frames are not practical.

- Contingency plans must be established and maintained for catastrophe response to ensure compliance with Code time frames (which may involve a process for agreeing to alternative time frames).
- Financial hardship obligations must be understood by staff. Training should be provided to ensure responsive and sensitive handling.

Complaints handling

- Information in existing standard documentation and brochures must be reviewed to ensure consistency with requirements of the Code.

- New brochures explaining obligations arising under the new Code may need to be prepared.

The Code does not create any legal rights or cause of action between the insurer and policyholder however it does provide for the imposition of sanctions following investigation of the Code Compliance Committee. The insurer may be required to undertake corrective action, submit to compliance audits, publish corrective advertising and/or publish the non-compliance.

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□ BROKER REMUNERATION

Broker investigations and financial services reforms

ASIC's report* on insurance broker remuneration arrangements concluded that Australia's brokers were not engaging in bid-rigging. Despite this finding, tighter control procedures and greater disclosure arrangements are expected in light of continued scrutiny by ASIC into the areas of conflicts of interest and disclosure of remuneration. Conflict avoidance mechanisms, suggested in the report, are likely to impose practical difficulties on inherent broker activities.

* A copy of the report is available from the ASIC website at www.asic.gov.au or by contacting the ASIC Infoline on 1300 300 630.

Background

In 2004, the New York State Attorney General investigated allegations of "steering" and "bid-rigging" by brokers in the United States. "Steering" is a practice which involves brokers encouraging staff to transact with favoured insurers, which in turn pay higher commissions. More seriously, "bid-rigging" involves procuring non-arm's length quotes from insurers in order to make a favoured insurer's bid appear more competitive.

In response to the allegations in the United States, numerous international regulators analysed the remuneration practices of general insurance brokers. ASIC's investigations were based on documentation provided by 15 brokers of varying sizes and nine insurers, relating to the period 1 July 2003 to 9 December 2004.

In summary

ASIC's report noted that Australian brokers have not been engaging the type of systemic misconduct identified in the United States. Nevertheless, broker management of conflicts of interest and disclosure of remuneration are areas which will continue to be scrutinised by ASIC. Although no enforcement action is planned, ASIC anticipates the need to change certain broker procedures and compliance arrangements in order to better deal with conflicts. The precise impact that these changes will have on brokers' dealings with general insurers is unclear at present, however, the continued scrutiny is likely to attack inherent conflicts in remuneration arrangements between brokers and insurers.

Relevant industry bodies, such as APRA, are expected to play a part in ensuring that a consistent approach is taken in conflict management in the

future. The Commonwealth Government Refinements Proposals Paper seeks to wind back many of the more onerous disclosure and licensing requirements within the financial services regulation framework. However, conflict avoidance management in the more general sense is not outlined in the paper.

ASIC's report does not remedy the lack of certainty in ascertaining whether a relationship or practice will in fact lead to a conflict and hence a breach by brokers of their legal requirements. The influence of various interests on brokers, in the context of complex relationships between brokers, insurers and clients, does not inherently lend itself to clear conduct guidelines in brokering practice. Instead, subtle circumstantial distinctions appear to govern whether a breach has occurred or not.

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A more indepth discussion of the report is available at www.ebsworth.com.au

□ NEWS IN BRIEF

General insurance

- ASIC has released a consultation paper proposing relief to allow distributors to provide certain dealing services in relation to general insurance products without the need to be licensed or appointed as an authorised representative of an AFS licensee. Proposed relief would apply where, among other things, the distributor arranges for the issue of certain general insurance products of an Australian general insurer, and that insurer accepts responsibility for the conduct of the distributor. ASIC intends to issue its final policy by October. Comments on the proposals are required by 2 September.
- The ICA launched its general insurance code of practice in early August. Contact any member of our financial services team listed below for further up-to-date details.
- APRA's proposal to exempt captive insurers from prudential regulation has been put on hold after more than 20 submissions were received in response to its discussion paper. Another discussion paper is to be drafted down the track.

FSR

- ASIC has published guidance material to help financial product advisers comply with the financial services advice provisions of the *Corporations Act 2001*. QFS 157 addresses: "Do I need to follow the exact wording in the Corporations Act when I give a general advice warning?" and QFS 158 deals with "Can I give a client general advice about a financial product if I have information about their personal circumstances?"
- ASIC recently released the findings of a review of advice given in late 2004 and early 2005 by financial advisers to more than 260 people thinking of switching super funds. The findings identified some instances of misconduct, and ASIC has indicated that super switching advice will continue to be closely monitored by ASIC, and action taken where clients are impacted by licensees and advisers failing to comply with their obligations. In response, the Financial Planning Association has expressed concerns about the methodology used and the way data was presented in ASIC's report.

Superannuation

- Legislation to abolish the superannuation surcharge finally passed the Senate in early August.
- The following revised and additional FAQs were released last month by APRA to assist trustees applying for an RSE licence: FAQs 1.1 and 9.1 have been updated, and new FAQs 1.6, 2.5, 2.8, 4.3 and 10.1 have been released.

Other news

At the roundtable meeting recently held by Senator Chris Ellison to discuss proposals for anti-money laundering legislation reform, there was general consensus on the notion that the new system should allow a risk-based approach, allowing the flexible application of obligations. Among other things, Senator Ellison agreed that customers already identified under the *Financial Transaction Reports Act 1988* need not be re-identified.

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