

□ INSURANCE

Australia underinsured

The ASIC Report "Getting home insurance right – A report into underinsurance" (8 September 2005) was instigated as a result of the Canberra bushfires in January 2003 that destroyed 488 homes and highlighted the fact that Canberra homeowners were underinsured by 40% on average.

Report findings

The investigations showed that underinsurance occurs when the sum insured under a policy does not reflect increased rebuilding costs. For example, the Consumer Price Index (CPI) increased by 17% between March 2000 and March 2005, while building costs increased by 33%.

A comparison was then conducted of Australian and overseas insurance policies. Common overseas policies include Total Replacement Cost policies under which the insurer, rather than the consumer, takes on the burden of accurately estimating rebuilding costs, and Extended Replacement policies that cover consumers against inflation in building costs which often follows mass disasters. More common in Australia are Sum Insured policies, which cap the insurer's liability at a certain amount, and Indemnity policies, which only cover the depreciated value of the building at the time of the loss.

The Report highlights the inaccuracies of certain online insurance calculators and recommends those which use "elemental estimating" as a means of reducing the risk of a homeowner being underinsured. Underinsurance could also be prevented by shopping around for online quotes. Consumers may save between \$100 and \$150 on their premium for the same level of cover. Alternatively, consumers may be able to increase their level of cover by \$100,000 or more without paying a higher premium, depending on the chosen insurer.

Recommendations

ASIC recommends insurers review the tools they provide to assist consumers in estimating accurate rebuilding costs. Insurers should also disclose to consumers whether the sum insured covers only material and labour costs or extends to supplementary costs such as architect's fees.

Another significant recommendation is for the ICA to work with insurers to consider whether Total Replacement Cost and Extended Replacement policies are viable. Where Indemnity policies are still offered, the insurer should draw the consumer's attention to the risk of being underinsured and any limitations in cover for supplementary costs.

In our view, the recommendations could set a benchmark and insurers who do not address ASIC's recommendations risk being exposed to misleading or deceptive conduct

continued on page 2 >

in this issue

EU reinsurance directive signals increasing regulation of reinsurers	2
News in brief	3

introduction



Ian Enright
Partner

In this issue of our *Financial Services Law Bulletin* we discuss the European Parliament's vote to approve the proposed EU directive on reinsurance. It is anticipated that the EU Council will soon accept the European Parliament's resolution and that the proposal will be adopted – read the full article on the following page.

In firm news, our Sydney office made the move in early September into our brand new offices at 126 Phillip Street. The bold, brave fit-out design incorporates elements such as shared offices, communal breakout spaces and the widespread use of glass, delivering on our desire to create a sense of community at work, and promoting interaction and collaboration amongst our team and with our clients. Please drop in and look around our new home when you are next in the neighbourhood.

□ REINSURANCE

EU reinsurance directive signals increasing regulation of reinsurers

On 7 June 2005 the European Parliament voted to approve the proposed EU directive on reinsurance. It is anticipated that the EU Council will soon accept the European Parliament's resolution and that the proposal will be adopted.

The directive establishes a supervisory regime for reinsurance in the Community. In particular, it sets out the principles of single licence and "home" country control for the prudential supervision of reinsurers. The main objectives include:

- establishing a sound and prudent regime in the interests of policy holders;
- entrenching mutual recognition of supervision by Member States; and
- the introduction of a harmonised system for reinsurance supervision leading to the abolition of the pledging of assets to cover outstanding claims and provisions.

As there are currently no harmonised supervision rules in the EU, the proposed directive signifies an important change. The lack of a regulatory framework has resulted in:

- significant differences in the level of supervision of reinsurers;
- uncertainty for direct insurance companies (and their policy holders);
- barriers to trade within the internal market;
- administrative burdens and costs; and
- weakening the EU position in international trade negotiations.

Specifically dealing with the unique nature of the EU, the home Member State's authorities are given exclusive competence in respect of the financial supervision of the reinsurance company, including the activities it carries on either through branches or by way of freedom of services. The fundamental principle of mutual recognition is at the root of the legal framework laid down by this proposal.

Additionally, Member States may not adopt provisions requiring the prior approval or systematic notification of general and special policy conditions, scales of premiums and forms and other printed documents which a reinsurance

undertaking intends to use in its dealings with ceding or retroceding companies.

Of note, the directive reflects certain Australian requirements. In particular article 19 provides that Member States require any person who proposes to hold some ownership in a reinsurer to first inform the authorities of the home Member State, indicating the size of the intended holding. Also, article 24 requires that confidential information be subject to conditions of professional secrecy.

Ann Newbrun Partner
e: anewbrun@ebsworth.com.au
Marina Ripoche Graduate Lawyer
e: mripoche@ebsworth.com.au

Australia underinsured > from page 1

claims, especially in relation to the information they provide at renewal time.

Looking to the future

ASIC will continue to address the issue of underinsurance through joint efforts with the ICA and other parties. In the meantime ASIC has urged homeowners to consider the level of insurance they hold and to take the time to assess their rebuilding costs using various online calculators and to shop around for more cost-effective premiums. Likewise, insurers and brokers should familiarise themselves with the Report's findings and recommendations.

Ann Newbrun Partner
e: anewbrun@ebsworth.com.au
Marina Ripoche Graduate Lawyer
e: mripoche@ebsworth.com.au

□ NEWS IN BRIEF

ASIC

ASIC has updated *PS 146 – Licensing: Training of financial product advisers* in order to set out revised minimum training standards for persons who provide financial product advice to retail clients. ASIC claims it is a response to industry concerns that the superseded training requirements were not flexible enough for persons only giving advice on basic deposit products and related non-cash payments.

Progress report

ASIC has eight stages or projects of the Refinements to Financial Services Regulation allocated to it. In a recently released progress report, ASIC notes that it has completed three of the eight projects, with the remaining five to be completed by November. Those five include:

- a proposal to reduce repetition of the general advice warning;
- proposed relief and guidance for providers of online calculators other than superannuation calculators;
- guidance in respect of giving a general advice warning, and whether general advice can be given where an adviser has information about the client's personal circumstances;
- proposed relief from the authorisation requirements for certain distributors of general insurance products; and
- relief and guidance for providers of superannuation calculators.

Example Statement of Advice

At the end of August, ASIC published an example Statement of Advice (SOA). ASIC considers that the following are important in the preparation of a SOA:

- the length – the example SOA is only 12 pages;
- there are no “weasel words” e.g. no lengthy disclaimers and exclusions;
- it is written in simple, plain English;
- that it contains adequate disclosure of conflicts, fees and commissions; and
- there is a clear explanation of the scope and limitations of the advice.

Extension of relief for unregistered managed investment schemes

ASIC has indefinitely extended relief for unregistered managed investment schemes by extending ASIC Class Order CO 98/55: Investments in Unregistered Schemes. This extension will allow responsible entities of registered managed investment schemes to continue to invest scheme property in asset-backed securities involving unregistered managed investment schemes.

AFSL exemption for general advice in media or poster advertisements

Class Order CO 05/835 was made on 31 August 2005 and exempts issuers of financial products from the requirement to

hold an AFSL where they provide general advice in media or poster advertisements, however the issuer must include in the advertisement a statement to the effect that a person should consider the suitability of the product for their situation.

Fee disclosure requirements

ASIC has released advice regarding the effect of the enhanced fee disclosure requirements of the Corporations Amendment Regulations (No 1) 2006, which apply to PDSs for superannuation products from 1 July 2005 and other financial products, including managed investment schemes, from 1 July 2005. It makes recommendations relating to:

- adequate disclosure of management costs and the relevant indirect cost ratio;
- estimated performance fees;
- information the fees and costs template should contain for multiple investment options;
- what balanced fund information needs to be disclosed where there is more than one balanced investment option; and
- currency of information to be disclosed.

Anti-money laundering

A fourth government and industry round table on anti-money laundering was held in early September, at which the following was agreed:

- customer due diligence standards to be set in legislation;
- framework for reporting suspicious transactions would be developed after further consultation and will be published as subordinate legislation;
- transaction issues will continue to be discussed before implementation; and
- the next stage of the process will be the release of draft legislation, which will form the basis of future discussion.

General insurance

NIBA – Draft Code of Practice

NIBA has released a report on its Code of Practice, and based on the findings of that report, has also released a Draft Code of Practice.

New requirements for LMIs

APRA introduced a revised capital and reporting framework for lenders mortgage insurers (LMIs) on 13 September 2005 which is designed to provide increased protection to policyholders. APRA says the revised prudential standards and new reporting requirements involve a more risk-sensitive regulatory capital model and a significant increase in minimum regulatory capital requirements.

continued on page 4 >

□ NEWS IN BRIEF

Life insurance

Due to the adoption of International Financial Reporting Standards (IFRS) in Australia, APRA intends to implement changes to the regulatory reporting requirements for life insurers, including friendly societies, from 1 January 2006.

Financial markets

A broking firm was recently fined the maximum possible –\$25,000 – for deliberately breaching trading rules after trying to correct a sell order that erroneously valued a parcel of bond futures at zero. Management of the firm were found to have shown disregard for the operating rules as a “result of their direct involvement in the trading actions and decision making”.

Auditors

The Institute of Chartered Accountants in Australia released in September a series of questions and answers relating to auditor independence provisions in CLERP 9. Visit the ICAA website for these questions and answers at:

<http://www.icaa.org.au/news/index.cfm?id=A115935384>

Superannuation

Following the review of the provision of pensions by small superannuation funds, the Commonwealth Government’s response, released by the Office of the Minister for Revenue on 27 September, is supposed to provide greater flexibility to the market linked income stream (MLIS) by extending the term of the pension so payments can continue until the member reaches the age of 100 and by allowing annual MLIS payments to vary between + or – 10%. These changes, and others, will apply to new pensions commencing from 1 January 2006.

Georgina Orr Lawyer
e: gorr@ebsworth.com.au

For more information, please contact us:

Peter Daley Partner	e: pdaley@ebsworth.com.au	t: 61 7 3303 8812
Ian Enright Partner	e: ienright@ebsworth.com.au	t: 61 2 9234 2302
John Goulios Partner	e: jgoulios@ebsworth.com.au	t: 61 3 8624 2006
Peter MacKenzie Partner	e: pmackenzie@ebsworth.com.au	t: 61 2 9234 2591
Ann Newbrun Partner	e: anewbrun@ebsworth.com.au	t: 61 2 9234 2533
Michael Neylan Partner	e: mneylan@ebsworth.com.au	t: 61 2 9234 2312
Brian Thomas Partner	e: bthomas@ebsworth.com.au	t: 61 2 9234 2592

sydney melbourne brisbane

Ebsworth & Ebsworth Lawyers respects your privacy and allows only limited use and disclosure of personal information. A copy of our privacy policy is available on our website. This publication is not legal advice. Professional advice should be sought before applying the information to your particular circumstances. We regularly produce publications to keep our clients up-to-date with important legal developments. If you do not wish to receive this publication in the future or if you would like to receive other publications, please email: publications@ebsworth.com.au © Ebsworth & Ebsworth Lawyers 2005