

SETTING UP A SYNDICATE SERVICE COMPANY IN AUSTRALIA

31 MARCH 2009

DISCLAIMER

This is for reference only and is not considered to be legal advice. Whilst all care has been taken to ensure the accuracy of the information Lloyd's does not accept any responsibility for any errors or omissions. Lloyd's is not responsible or liable for any alleged damage arising from reliance upon the information provided.

BACKGROUND TO LLOYD'S OPERATION IN AUSTRALIA

The Lloyd's authorisation in Australia allows business to be written either by coverholders (including syndicate service companies) based in Australia (or elsewhere), or syndicates directly in London (or located at certain other Lloyd's Trading Centres around the world such as Lloyd's Asia).

Coverholders based in Australia are subject to the regulations regarding insurance intermediaries in Australia. A syndicate service company would operate as an underwriting agent in Australia and for the purposes of approval at Lloyd's, it would be subject to the same accreditation programme that applies to prospective coverholders.

Key considerations for becoming a service company in Australia

- Intermediary regulation and licence requirements
- Lloyd's trust fund arrangements
- Tax implications (including the issue of permanent establishment)
- Regulatory reporting
- Commercial implications

Intermediary regulation and licence requirements

- Intermediaries in Australia must be set up as either an underwriting agent, or insurance broker.
- Such intermediaries must establish an Australian registered company in accordance with the Corporations Act. It is recommended that applicants should seek local legal and tax advice on the local requirements.
- Insurance intermediaries in Australia must obtain the appropriate Australian Financial Services Licence (AFSL) and they have to apply to the Australian Securities & Investments Commission (ASIC) which is the body that issues AFSL's. This process can be lengthy (typically at least 3 months) and the timeframe should be factored into the expected commencement date of the business. More information can be located on ASIC's website, www.asic.gov.au. It is quite usual for AFSL applicants to obtain third party assistance from specialist firms who can assist them with their applications. Lloyd's Australia can provide details of such firms on request.
- Importantly there is scope for an exemption from having to have an AFSL in accordance with the provisions of Section 911A(2)(g) of the Corporations Act. Under this exemption if the agent acts for an insurance carrier that is regulated by APRA and the service they provide is only to wholesale (commercial) clients, then they may be exempted from the AFSL requirement. It is recommended that the intermediary/service company obtains an independent legal opinion to support the application of this exemption if it is to be relied upon. Lloyd's Australia can provide details of local lawyers who are experienced in the workings of this legislation.
- Underwriting agents may become members of the Underwriting Agencies Council, details can be found on the UAC website www.uac.org.au and brokers may become members of the National Insurance Brokers Association, www.niba.com.au or other cluster groups such as the Steadfast Group www.steadfast.com.au. However, it is not mandatory for the intermediary to become a member of any of these organisations, for either local regulatory or Lloyd's purposes.

Lloyd's trust fund arrangements

- Under the terms of Lloyd's authorisation, the regulations relating to the relevant provisions of the Insurance Act 1973 require, Lloyd's Underwriters to maintain trust funds in Australia. The assets in the trust funds are managed by National Australia Trustees Ltd (a subsidiary of National Australia Bank) on behalf of Lloyd's and the funds are adjusted quarterly and annually.
- The values in the trust funds are based on each syndicate's Australian liabilities and the value of written premiums. Whilst the service companies are not required to maintain assets in the trust funds themselves, it is important to note that any business written by the service companies will be aggregated at syndicate level and will impact on the overall funding requirements for each syndicate.

Tax implications (including the issue of Permanent Establishment)

- There is no premium tax in Australia, but all policies issued by coverholders and service companies in Australia are subject to GST (10%). Other policyholder taxes and charges including stamp duties, fire service levies, insurance protection tax (NSW only) will also apply. More information relating to these taxes and charges can be found on Crystal on www.lloyds.com.
- Lloyd's underwriters are subject to income tax at prevailing rates (currently 3%) , this is derived from Division 15 of the Income Tax Assessment Act 1936. Underwriters are effectively taxed by the Australian Tax Office (ATO) at the point of sale i.e. a notional profit margin of 10% is assumed by the ATO and the income tax rate (currently 30%) is applied to it. This tax is withheld by the service company from the underwriters' remittances and paid over to the ATO.
- When establishing an Australian service company, the managing agent, of the syndicate will need to consider whether a permanent establishment has been created by the actions of the service company. The issue of whether a permanent establishment of the underwriting members has been created can only be addressed on a case by case basis, but it will turn on the question of whether the service company is dependent or independent of the members of the syndicate. However, even if a permanent establishment is established it is held that Division 15 will apply to policies of insurance issued by the service company, if it can be established that the establishment of the Australian service company did not constitute a principal office or branch of the underwriting members of the syndicate. This is a complicated area of tax law and it is suggested that specific advice/clearance on this point is obtained. On request, Lloyd's Australia can provide details of tax professionals who have considered this issue previously.
- Intermediaries as Australian companies will have to pay their own local taxes such as income tax (on profits), GST and payroll taxes, for which local taxation advice should be sought.

Regulatory reporting

- Lloyd's regulatory reporting is compiled by Lloyd's centrally, using Xchanging data.
- On a quarterly and annual basis, Lloyd's must submit regulatory statistics to the Australian Prudential Regulation Authority (APRA).
- On a quarterly and annual basis, Lloyd's submits 'terrorism' data to the Australian Reinsurance Pool Corporation (ARPC) in respect of business written by those syndicates who have chosen to reinsure with the Pool
- Coverholders (including service companies) are not required to report data directly to APRA or ARPC.
- Whilst Lloyd's regulatory and terrorism reporting requirements have been centralised, from time to time underwriters and service companies will be required to provide additional information about their Australian business.

Commercial implications

- There are clearly advantages and disadvantages to establishing a service company.
- Advantages
 - f* There are no additional trust fund or capital and solvency implications, other than those required by the Corporations Act.
 - f* It is a fairly simple model and doesn't require APRA approval.
 - f* If the service company is only writing wholesale or commercial classes of business and only offering Lloyd's security, then it may qualify for an exemption from having to obtain an AFSL.
 - f* Establishing a service company doesn't necessarily create a permanent establishment of the underwriting members of the syndicate and in which case there is no need to lodge underwriter tax returns in Australia.
 - f* No requirement for the service company to co-locate with others under one roof.
 - f* All regulatory and terrorism reporting is conducted centrally by Lloyd's.

- Disadvantages
 - f* If the service company doesn't qualify for an exemption from the AFSL requirements, then the licence application process can be time-consuming and costly.
 - f* The service company will need to handle the local taxes and charges.
 - f* There may be some damage or fall-out with existing relationships, brokers and coverholders alike.
 - f* There will be initial capital/start-up costs.
 - f* Staffing issues – hiring local competent staff can take time and bringing staff across from the UK will have visa/immigration implications.

Application for a Service Company

The service company applicant should use the same form for coverholder applicants. The form can be located on www.loyds.com and is <http://loyds.com/the-market/i-am-a/delegated-authority/applications-and-processes>

The application form should be lodged with Delegated Authorities at Lloyd's via Atlas.

Code of Practice for Coverholders, Underwriting Agents and Service Companies

Lloyd's has agreed to be bound by the Insurance Code of Practice (CoP) issued by the Insurance Council of Australia. The CoP can be located on the Insurance Council's website, www.insurancecouncil.com.au

Underwriters and their coverholders (including service companies) are jointly responsible for ensuring that they comply with the Code of Practice.

Prior to writing any business for a Lloyd's syndicate there must be a written binder agreement in place between the service company and the syndicate. The binder used is usually LMA3019 and this must also include the addition of LSW649(c) which sets out the duties and obligations of the coverholder/service company. LSW649(c) includes a requirement to adhere to the CoP.

Service companies should note that the Code of Practice includes ongoing requirements and after approval, Lloyd's Australia will continue to provide assistance to the service company to ensure that those requirements are met.