

Chapter 4

Issues

Introduction

4.1 The Committee received eight submissions, most of which focussed on the exemption provision on Direct Offshore Foreign Insurers (DOFIs). Before reviewing the debates on that issue, there will be a short overview of the submissions which focussed on other aspects of the Bill and on the complementary Corporations (National Guarantee Fund Levies) Amendment Bill 2007.

Corporations (National Guarantee Fund Levies) Amendment Bill 2007

4.2 The Committee received two submissions on the Corporations (National Guarantee Fund Levies) Amendment Bill 2007. Both the Australian Financial Markets Association (AFMA) (submission 4) and the Australian Securities Exchange (submission 8) supported the Bill's introduction.

4.3 The AFMA commented that the amendments:

...would leave the regulatory protection afforded to securities investors materially unaffected but it would increase the potential for competition and efficiency, improved delivery of services and enhanced financial stability.¹

4.4 The Australian Securities Exchange strongly supported the Bill.

ASX believes that the imposition of a cap on the levies payable by exchanges and their participants in any one year offers the potential to allow the National Guarantee Fund (NGF) to attract a wider range of, well-capitalised, institutions to consider direct participation in ASX markets and associated clearing facilities.²

Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007

4.5 The remaining six submissions essentially focussed on the legislation pertaining to Direct Offshore Foreign Insurers (DOFIs) and its exemption provisions.

4.6 While most of the six submissions provided in principle support for the Bill,³ the Law Council of Australia, and the Association of Consulting Engineers Australia (ACEA) were more judicious. ACEA expressed concern about the impact of the Bill

1 Australian Financial Markets Association (AFMA), *Submission 4*, p. 1.

2 Australian Securities Exchange, *Submission 8*, p. 1.

3 Underwriting Agencies Council (UAC), *Submission 1*, p. 3; and Insurance Council of Australia (ICA), *Submission 2*, p. 1.

on the consulting engineering industry's ability to obtain adequate levels of professional indemnity insurance.⁴

4.7 The Law Council expressed their 'considerable concern' over the regulation of both Discretionary Mutual Funds (DMFs) and DOFIs.⁵ Although DMFs were included in the Law Council's concerns, their correspondence essentially focussed on the same concerns as the remaining submissions; the access of Australian companies to DOFIs and the lack of information regarding the exemption provisions provided in the Bill.

Concerns over the DOFI provisions

4.8 The concern expressed by all six submissions is essentially that should DOFIs effectively be precluded from the Australian market through stringent provisions and limited exemptions, then Australian companies will lose access to essential insurance products which can only be supplied at a competitive price by DOFIs due to their much larger economies of scale, and spread of risk that such international insurers can access.

4.9 ACEA commented:

...that the proposal in the DOFI Bill will be detrimental for consumers because decreased competition from DOFIs coupled with the requirement to buy locally means that insurers are less likely to provide cover at commercially competitive rates or to insure an adequate range of risks, because they have a captive market. Even if local insurers do attempt to manage larger and more complex risks, previously insured overseas, they will look to spread that risk by increasing the cost of premiums.⁶

4.10 The National Insurance Brokers Association (NIBA) gives in principle support to the Bill, agreeing that stronger regulation of insurers is needed.⁷ However, they share the same concerns as ACEA:

Access to global markets is important for Australian larger businesses. They provide these businesses with consistency of cover particularly for more complex risks and in a hard market cycle are often the only markets offering meaningful cover.

The proposed approach in the Bill is unlikely to result in many... global market participants seeking local authorisation. Such global players are simply not interested in placing risks in particular country silos or adding another layer of compliance costs and red tape to their businesses.⁸

4 Association of Consulting Engineers Australia (ACEA), *Submission 5*, p. 3.

5 Law Council of Australia, *Submission 7*, p. 2

6 ACEA, *Submission 5*, p. 3.

7 National Insurance Brokers Association (NIBA), *Submission 6*, p. 3.

8 NIBA, *Submission 6*, p. 4.

4.11 The Law Council of Australia supports these arguments, and also argues that the DOFIs are more resilient in the face of global financial upheavals due to their larger size compared with Australian insurers.⁹

4.12 The Bill provides for DOFI exemptions – such as Lloyd's of London – but does not clarify under what criteria these exemptions are given, and it is a clarification of these criteria that a number of submissions seek.¹⁰

4.13 A number of submissions also noted the Bill's deviation from the recommendations of the 'Potts Review'¹¹ and suggested that the recommendations made by the Review should be adopted within the Bill, rather than the current proposed provisions.¹²

Treasury response

4.14 Treasury officials provided evidence at the Melbourne hearing on 27 July 2007 via teleconference. The officials advised the Committee that Treasury had consulted widely with stakeholders, including those organisations which had lodged submissions to the inquiry.

4.15 Treasury is planning the release of a discussion paper on the planned exemptions in August 2007 for further comment and input by stakeholders, with the intention of publishing an exposure draft setting out the insurance regulations for the exemptions in late 2007, or early 2008 for finalisation in early 2008. Treasury advised the Committee that it is aiming to achieve a balance through a set of exemptions that are practical, flexible in terms of the insurance market cycle, minimise cost to government of administration, as well as minimise costs to customers while still maintaining prudential standards.¹³

4.16 Officials said that Treasury aims to create arrangements so that Australian companies can still access suitable insurance cover from DOFIs should Australian insurers be unable to deliver the required cover at competitive rates. Their aim is to structure exemptions so as not to discourage large and reputable DOFIs from entering the Australian market, while at the same time not discouraging Australian insurers from producing domestic insurance products that can compete with those of the DOFIs.¹⁴

9 Law Council of Australia, *Submission 7*, p. 5.

10 UAC, *Submission 1*, p. 3; ICA, *Submission 2*, pp 1-2.; NIBA, *Submission 6*, p. 3.

11 On 12 September 2003, the Government commissioned the *Review of Discretionary Mutual Funds and Direct Offshore Foreign Insurers* known as the 'Potts Review'.
<http://www.treasurer.gov.au/pcd/content/pressreleases/2007/042.asp> accessed 16 July 2007.

12 NIBA, *Submission 6*, p. 6; ACEA, *Submission 5*, p. 9.

13 Treasury, *Proof Committee Hansard*, 27 July 2007, p. 53.

14 Treasury, *Proof Committee Hansard*, 27 July 2007, pp 53-54.

Committee conclusions

4.17 The Committee, having heard the concerns expressed in the submissions, is satisfied that the consultative mechanism to be implemented by Treasury with regard to DOFI exemptions will produce a set of regulatory provisions that will satisfy the requirements of Australian businesses for access to suitable insurance products, while still maintaining the required prudential standards for the insurance industry. The Committee supports the closure of regulatory gaps identified by the HIH Royal Commission, and the International Monetary Fund. The Committee does not share the fears expressed by some witnesses as to possible significant negative market effects from changes to regulation. Nonetheless, Treasury and APRA should actively monitor market effects to be certain of this.

Recommendation 1

4.18 The committee recommends that the bill be passed.

A handwritten signature in blue ink, consisting of a large, sweeping initial 'M' followed by a series of connected, fluid strokes that end in a small dot.

**Senator the Hon. Michael Ronaldson
Chair**