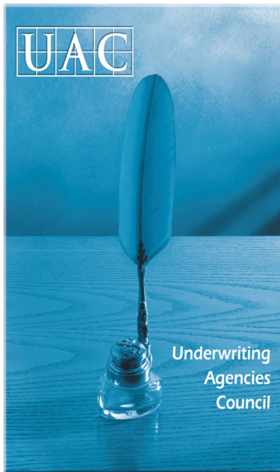

Submission to the Senate Standing Committee on Economics
Inquiry into taxation and financial sector legislation bills

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Background

UAC's purpose is to serve the interests of Australia's underwriting agencies. UAC has more than 65 full members, representing the vast majority of Australian underwriting agencies. Membership is also open to non-voting associates. Underwriting agencies manage insurance transactions on behalf of their principal insurers, which are based in Australia and overseas. Many agencies' security is from Lloyd's of London.

Agencies frequently operate in specialist, niche markets, offering an array of insurance products that may not be available from other sources. The majority of business is transacted via insurance brokers.

Underwriting agencies are responsible for about $1.6 billion of premiums paid by Australian businesses and consumers annually. Underwriting agencies are appointed by insurers to issue policies and pay claims on their behalf.

All UAC members hold appropriate licences issued by the Australian Securities & Investments Commission under the *Financial Services Reform Act*.

UAC is committed to the security and advancement of its members and provides a forum and a voice for underwriting agencies.

Given that the security of some underwriting agencies is provided via direct offshore foreign insurers (DOFIs), the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Bill 2007* is of paramount interest to UAC and it is that Bill to which the comments in this submission are addressed.

UAC already has participated in discussions with Treasury, ASIC and APRA representatives on the Bill.

UAC's understanding is that the Federal Government's intention is to protect individual consumers and small businesses from unwittingly insuring with low-grade insurers that presumably would be in a higher-risk category for financial collapse and claims default. The protection would extend to third-party claimants under liability policies.

The intention is that, unless business is specifically exempt, it must be placed with Australian licensed insurers, which would mean DOFIs currently operating in the Australian market would be required to be licensed. Australian brokers would be prohibited from placing non-exempt business offshore.

<u>UAC's response to the Bill</u>

UAC, like the Federal Government, believes there is a place for DOFIs in the Australian market, and is committed to working with DOFIs that are well capitalised and well managed. Australia should encourage quality, offshore insurers to participate in the Australian market to add competition and diversity.

UAC agrees with the proposition put by Minister for Revenue and Assistant Treasurer Peter Dutton that insurers that pose a lower risk should face a reduced regulatory burden. The way in which exemptions from the standard licensing regime under the *Insurance Act 1973* are determined is the question UAC wishes to see addressed in detail.

UAC shares the government's view that under-capitalised insurers that may be domiciled in jurisdictions that are unregulated or insufficiently regulated are a risk and should not be supported.

Australian insurance buyers need to be able to access offshore markets because the products and services they require are often unavailable in the Australian market, or unavailable at an affordable price.

UAC members, which provide specialist, niche insurance services, are frequently able to provide coverage, via Lloyd's of London or DOFIs, that is unobtainable from domestic underwriters.

While UAC offers in principle support for the Bill, questions that require clarification include:
- Who determines exemptions and on what basis?
- Is the criterion to be availability of a product in Australia or availability at a reasonable price?

Continuity of cover is vital for insureds, particularly for professional risks lines. Availability of cover and capacity changes as the market fluctuates. We must avoid a situation where a line is available from an exempted underwriter one year and not the next because domestic capacity has changed and that underwriter is no longer eligible for an exemption.

Some UAC members place only small portions of premium income with DOFIs and it is unlikely those DOFIs would agree to fund the cost of being regulated in Australia when their premium income derived from domestic business is very low. However, their elimination from the market would limit availability of cover for Australian policyholders.

Despite the fact that these insurers may offer innovative products, underwriting expertise and capacity, if they view the burden of regulation under the *Insurance Act 1973* as too onerous, their skills and abilities will be lost to the Australian market. A consequence is dilution of competition, which is not in insurance buyers' best interests. It may mean unavailability of specific products they require to insure their assets and liabilities, or premium increases and reduced terms & conditions from limited suppliers able to offer those products.

UAC is aware that the National Insurance Brokers' Association (NIBA) has raised the need to distinguish between retail (consumer and SME) insurance buyers and large, sophisticated corporate insureds. It is the corporate insureds that are most likely to require access to offshore insurance markets because of the size and complexity of their risks.

UAC understands NIBA has suggested a threshold of $30,000 in premium (included taxes and charges) be established. Any insurance buyer operating above the threshold would be permitted to access DOFIs.

NIBA has pointed out that an annual premium of $30,000 would purchase around $30 million of insured value for normal commercial property. An exemption based on premium would mean the same arrangements applied to property and liability business. It would fluctuate with hard and soft markets.

A threshold would protect individual consumers and unsophisticated insurance buyers, like many SMEs. Insurance buyers in the $30,000+ annual premium category are most likely to use licensed insurance brokers to access the insurance markets and would work with their brokers to consider the options and security available from a range of insurers, onshore and offshore, that may be best able to meet their specific insurance and risk management requirements.

UAC understands there is some support for NIBA's proposed threshold and views it as a possible option, however, there are difficulties in supporting it outright. The following comments, from UAC board members, illustrate the varied opinions on how exemptions can best be achieved and the difficulties that will be encountered in developing a workable solution. Both directors are senior executives with lengthy insurance industry experience.

One board member's view is that a premium threshold could work, but needs to be better defined. His comments are:

- A product exemption would not work, due largely to the generic nature of product descriptions and designs. A public liability policy is essentially the same or a very similar product for a small, family-owned light manufacturing business or a publicly listed company with diverse manufacturing operations and a large turnover. However, policy limits and premiums would be vastly different. For example, a second-hand, single-engine light aircraft would still require an aviation insurance policy, which is essentially the same or a similar product to the policy required for a top-of-the-range, multi-engine corporate jet. In both cases, the product is basically the same but the premium differential would be significant and could range from $5,000 to $250,000.
- An exemption by client type also has difficulties. In almost all industry segments there are very small and very large clients. To determine a suitable threshold point would be difficult. For example, a one-man crane operator or small business with a couple of cranes compared to a national company with dozens of cranes could have asset values of $100,000 to $100 million. Similarly, a professional engineering practice could range from a two-partner office to a large regional firm, with the obvious difference in fee income as a determinant of establishing the level of professional indemnity risk.
- Given the difficulty of distinguishing the small client from the larger client via insurance product or type of client, the premium differentiator as a proxy benchmark has some attraction.

In contrast, another board member had the following comments on a premium-based threshold:

- While a premium value cut-off would be simple to administer, it may be an over-simplification. Although a $30,000 premium represents property to a value of $3 million, in some fields, it may not represent premium paid by a sophisticated insurance purchaser, for example, in a crane operator's business.
- It would mean that a DOFI could write business in Australia for one client with a $30,000+ premium but not for another with a smaller premium. That, in effect, would exempt a particular policy rather than exempting an insurer and make it difficult for them to operate here. Imagine going to all the effort with a broker to negotiate terms (for a premium over $30,000) and being almost ready to write the business when the client changes their asset schedule or their requirements, which puts the premium below the threshold so you then can't complete the business.
- There would be a substantial number of policies in Australia that would be over $30,000 in a firm market but less than that figure in soft market conditions. We would then have insureds able to place business with an insurer one year but having to shift it the next - not a desirable outcome, particularly in professional risk lines.

- Is a $30,000 threshold for an insured's entire program or per policy? If it is per policy, it may be that an insured can place only part of their business with a DOFI and the rest would have to be placed onshore. In some fields (for example, contractor's plant and associated liabilities) it is not wise to spread various policies across different insurers as it may lead to dual insurance or, worse still, gaps.
- The points above suggest any exemptions should be granted on an insurer-by-insurer basis or product line by product line rather than policy by policy. That would allow APRA to exempt a particular DOFI for either its entire product range or a particular line of business but not other lines it may write.

UAC believes the above points highlight the difficulties in formulating precise details for the regulations to accompany the Bill. The issue will require much industry consultation and communication and UAC, as a peak body whose members will be affected by the Bill, is keen to participate in the ongoing discussions in an attempt to develop a compromise position that all stakeholders in the industry can live with.

Murray Rogash
Chairman
Board of Directors
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July 6, 2007