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Senator Annette Hurley
Chair
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Senator Hurley

Inquiry into the Financial Sector Legislation Amendment (Enhancing Supervision and Enforcement) Bill 2009

AXA Asia Pacific Holdings Limited (AXA APH) is a public company listed on the Australian Stock Exchange, and is the holding company for the AXA APH group, which provides a range of financial services in 11 different markets: Australia, China, Hong Kong, India, Indonesia, Malaysia, New Zealand, Philippines, Singapore, Taiwan, and Thailand. Some subsidiaries within the AXA APH Group provide life insurance and superannuation in Australia, and are regulated by the Australian Prudential Regulation Authority (APRA). If the Financial Sector Legislation Amendment (Enhancing Supervision and Enforcement) Bill 2009 (the Bill) is enacted, AXA APH will be regulated by APRA, as the Non-Operating Holding Company (NOHC) of The National Mutual Life Association of Australasia Limited, a life insurance company regulated by APRA.

AXA APH welcomes the opportunity to make a submission to the Inquiry. AXA APH recognises the importance of prudential regulation, and seeks to work cooperatively with regulators in all the markets within which it operates. Given the recent failures of financial services companies in other parts of the world, AXA APH recognises the need to critically consider the effectiveness of prudential regulation in Australia. However, AXA APH has significant concerns about the extent and effectiveness of the powers proposed to be granted to APRA by the Bill. Some of the measures are not required to achieve the stated policy objectives, and will create unwarranted and excessive regulatory burdens on NOHCs and their subsidiaries. This additional regulatory burden can be a disincentive to using Australia as a base for regional activities, contrary to the Government's plans to make Australia a regional centre for financial services.

Life Companies are required by the Life Insurance Act 1995 (the Act) to give priority to the interests of current and prospective policyowners over the interests of shareholders. This is a unique provision that does not have an equivalent in the Banking Act 1959 and the Insurance Act 1973. Because of this special requirement there is no need to replicate the powers APRA currently has to regulate the NOHCs of banks and general insurers.

Any powers provided to APRA should be aligned to the purpose of the Life Insurance Act, which is to protect the interests of owners and prospective owners of life insurance policies. This not the case with this Bill as it is currently drafted.

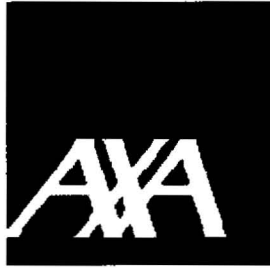
Any powers provided to APRA to direct the NOHCs of life companies must be reviewable decisions. Under the Bill, APRA is able to direct the NOHC to remove directors and senior managers, and to prohibit borrowing or the payment of dividends. Such directions can have significant consequences for a listed company, and yet the NOHC is denied procedural fairness, and is unable to challenge the direction.

If you have any queries in relation to the attached submission or would like to discuss any of the comments raised, please contact me on 03 8688 4890 or 03 8688 2653.

Yours sincerely

A handwritten signature in black ink that reads "Geoff Roberts". The signature is written in a cursive style with a large, stylized 'G' and 'R'.

Geoff Roberts
Group Chief Financial Officer
AXA Asia Pacific Holdings Limited



**Submission to the Senate Standing
Committee on Economics inquiry into the
Financial Sector Legislation Amendment
(Enhancing Supervision and Enforcement)
Bill 2009**

1. Introduction

AXA Asia Pacific Holdings Limited (AXA APH) is a public company listed on the Australian Stock Exchange, and is the holding company for the AXA APH group, which provides a range of financial services in 11 different markets: Australia, China, Hong Kong, India, Indonesia, Malaysia, New Zealand, Philippines, Singapore, Taiwan, and Thailand. Some subsidiaries within the AXA APH Group provide life insurance and superannuation in Australia, and are regulated by the Australian Prudential Regulation Authority (APRA). If the Financial Sector Legislation Amendment (Enhancing Supervision and Enforcement) Bill 2009 (the Bill) is enacted, AXA APH will be regulated by APRA, as the Non-Operating Holding Company (NOHC) of The National Mutual Life Association of Australasia Limited, a life insurance company.

AXA APH welcomes the opportunity to make a submission to the Inquiry. AXA APH recognises the importance of prudential regulation, and seeks to work cooperatively with regulators in all the markets within which it operates. Given the recent failures of financial services companies in other parts of the world, AXA APH recognises the need to critically consider the effectiveness of prudential regulation in Australia.

However, AXA APH has significant concerns about the extent and effectiveness of the powers proposed to be granted to APRA by the Bill. Some of the measures are not required to achieve the stated policy objectives, and will create unwarranted and excessive regulatory burdens on NOHCs and their subsidiaries. This additional regulatory burden can be a disincentive to using Australia as a base for regional activities, contrary to the Government's plans to make Australia a regional centre for financial services.

In addition, all the Australian subsidiaries of AXA APH will also come within APRA's remit for the first time. Not only will this have the potential to create regulatory duplication, it will also create a significant additional regulatory burden on AXA APH and its subsidiaries, many of which are currently regulated under other regimes, including the Corporations Act and the ASX Listing Rules.

The existing regulation of life companies has proved to be effective. Despite the recent global financial crisis, and the resultant collapse of share markets and reduced liquidity, the financial position of Australian life companies has remained sound. Life Companies are required by the Life Insurance Act 1995 (the Act) to give priority to the interests of current and prospective policyowners over the interests of shareholders. This is a unique provision that does not have an equivalent in the Banking Act 1959 and the Insurance Act 1973. Because of this special requirement there is no need to replicate the powers APRA currently has to regulate the NOHCs of banks and general insurers.

Given this, in AXA APH's view the Government has not sufficiently demonstrated the need for regulatory measures such as those outlined in the Bill, particularly as they affect companies that are not life companies. Contrary to the principles outlined by the Rethinking Regulation Report, the case for action for this Bill has not been clearly established; there is no evidence that alternative policy options have been considered, and a rigorous cost-benefit analysis of the outcomes produced by the Bill does not appear to have been undertaken.

Further, as the Bill has the potential to significantly affect its current operations, AXA APH is concerned that the Bill was introduced into Parliament without prior consultation and contrary to Recommendation 7.6 of the "Rethinking Regulation: Report of the Taskforce on Reducing Regulatory Burdens on Business" Report of August 2006 (Rethinking Regulation Report).

2. Summary of the AXA APH submission

The following summarises the AXA APH submission:

- The Life Insurance Act 1995 (the Act) already provides APRA with all the powers it needs to protect the interest of policyholders. The proposed amendments are not necessary.
- Life Companies are required by the Act to give priority to the interests of current and prospective policyowners over the interests of shareholders. This is a unique provision that does not have an equivalent in the Banking Act 1959 and the Insurance Act 1973. Because of this special requirement there is no need to duplicate the powers APRA currently has to regulate the NOHCs of banks and general insurers.
- If the Committee considers it necessary to provide APRA with the ability to directly regulate NOHCs, these regulatory powers should not be extended to subsidiaries of NOHC's. To do so will very significantly extend the regulatory burden imposed by the Bill without any demonstrable additional protection to policyholders. Such unnecessary regulation is contrary to the previous Government's findings in the Rethinking Regulation Report.
- The Bill will provide APRA with powers to act in the public interest. Any powers provided to APRA should be aligned to the purpose of the Act, which is to protect the interests of owners and prospective owners of life insurance policies. If the Committee considers it necessary to provide APRA with the ability to directly regulate NOHCs, the test for the exercise of any of APRA's new powers in relation to NOHCs and their subsidiaries should be that the action is required to protect the interests of policyholders.
- If the Committee considers it necessary to provide APRA with the ability to directly regulate NOHCs, the definition of NOHC is too narrow, which may result in AXA APH being required to divest itself of assets and cease undertaking certain activities because it may be deemed to be *"carrying on a business, other than a business consisting of the ownership or control of other bodies corporate"*. This would be costly to AXA APH and penalise its shareholders.
- If the Committee considers it necessary to provide APRA with the ability to directly regulate NOHCs, the decisions by APRA should be reviewable by a court or administrative tribunal. Many of these powers, for example to prevent borrowing and the payment of dividends are very intrusive and can significantly affect the operations of an entire financial services conglomerate. An efficient and effective mechanism for a NOHC to seek review of a decision by APRA to exercise these and other powers is essential.

3. Purpose of the Bill

The purpose of the Bill has been outlined in two press releases and the Explanatory Memorandum.

In a press release dated 2 June 2008, the Treasurer indicated that the Government's intention was to introduce legislation to regulate NOHCs *'recognising that NOHCs can have a significant impact on the safety of these entities'*. This was the only reference to life companies in a press release that dealt predominantly with new protections for customers of authorised deposit taking institutions and general insurers.

In a joint press release dated 2 March 2009 issued by the Assistant Treasurer and Minister for Competition and the Minister for Superannuation and Corporate Law, reference was made to the Bill providing APRA with the ability to seek 'a consistent and comprehensive range of injunctions from the Federal Court of Australia on prudential matters...'

The Summary of the Regulatory Impact Statement contained in the Explanatory Memorandum provides the following three reasons for the Bill:

- registration of NOHCs will enable APRA to develop capital requirements for groups on a consolidated basis;
- APRA may extend its current standard on governance for life companies to apply to NOHCs of life companies; and
- APRA may extend its current standard on fitness and propriety for life companies to apply to NOHCs of life companies.

While AXA APH understands the potential need to monitor corporate groups more generally, the Bill as currently drafted goes well beyond the purposes outlined above, providing APRA with extensive powers over NOHCs and other non life subsidiaries within a conglomerate. These powers allow significant and unnecessary interference with the operation of the conglomerate without appropriate controls as to how the powers are exercised.

The Act already ensures that the assets of life companies are 'quarantined' from the assets of related companies, and that priority is given to policyholders. The existing provisions provide adequate protection for policyholders, including protection against contagion risks from other parts of the corporate group to which a life company belongs.

In addition, over the last couple of years, AXA APH has voluntarily provided APRA with information about the group's activities within Australia and the Asia Pacific. While understanding APRA's concerns in relation to the concept of 'contagion risk' AXA APH does not share their concern, given the existing regulatory framework that applies to life companies, and which already gives APRA extensive powers to protect policyholders' interests.

AXA APH and its subsidiaries work cooperatively with regulators in all the markets within which it operates and is subject to various regulatory regimes in these markets. Overlaying this local regulation with an additional layer of regulation on the entire group is unnecessary.

AXA APH submits that the proposed amendments are not necessary. The Act already provides APRA with all the powers it needs to protect the interest of policyholders.

4. Impact on NOHCs and their subsidiaries

A. Notification Requirements

Clause 82 of the Bill creates an obligation for a NOHC or a subsidiary of a NOHC to notify APRA of a matter that materially and adversely affects its financial position. While there may be some grounds for such notification from a NOHC, AXA APH submits that there is no justification for imposing such a reporting obligation on the subsidiaries of a NOHC.

If the financial impact on the subsidiary is sufficient to materially adversely affect the NOHC or the life company, then the NOHC or life company will have the obligation to notify APRA. If the financial impact on the subsidiary does not have a material effect on the NOHC or life company, it does not warrant notification.

There are more than 60 Australian subsidiaries within the AXA APH Group, reflecting our long history of growth by acquisition and the diversified nature of our business activities within Australia. (Other financial conglomerates operating life companies in Australia have similar structures). Imposition of these notification requirements on each of these subsidiaries will impose a very significant additional regulatory burden on the AXA APH Group, as each change to the NOHC and every subsidiary will need to be monitored and assessed to determine whether the change is notifiable. This will be one more regulatory impost to be considered by managers and directors of companies.

This will result in APRA being notified of events that are material to the subsidiary but have no material impact on the NOHC, the life company or policyholders.

AXA APH submits that the notification requirement should not extend to subsidiaries of NOHCs.

B. Investigations

Clauses 103 to 108 of the Bill amend section 137 of the Life Insurance Act to give APRA the power to investigate the business of a NOHC if APRA believes it is in the 'public interest' to do so.

APRA already has powers under this section to investigate the 'life business' of a life company (which has a specific meaning under the Act) only in circumstances where APRA believes it is in the best interests of policy owners to do so.

The proposed amendment, by specifying 'public interest' rather than the best interests of policyowners, gives APRA broader powers to investigate any, or all, parts of the business of a NOHC than it currently has to investigate life companies. There is no evidence that APRA requires this broader power, which goes beyond the principal object of the Act, *'to protect the interests of the owners and prospective owners of life insurance policies in a manner that is consistent with the continued development of a viable, competitive and innovative life insurance industry'*. APRA's powers should remain aligned with its expertise and the principal object of the Act.

Section 138 of the Life Insurance Act already gives APRA a broad power to investigate the activities of an 'associated company' of a Life Company where it is investigating the life company.

AXA APH submits that the existing section 138 of the Life Insurance Act already gives APRA powers sufficient for it to investigate the NOHC, and provides the appropriate limits for such an investigation. Therefore, the proposed amendments to section 137 of the Life Insurance Act are not required.

The existing requirement of section 138 of the Life Insurance Act that APRA undertake an investigation of the life company as a prerequisite to investigating the NOHC does not impose an unreasonable restriction on APRA's powers. In practice, it is difficult to imagine how or why any investigation by APRA of a NOHC would not also involve an investigation of the life company.

AXA APH submits that if section 137 is to be amended, the Bill should be redrafted to remove the public interest test and to limit APRA's powers to investigate the business of a NOHC to the extent that APRA is satisfied that such an investigation is required in the best interests of the policy owners of any life company which is a subsidiary of the NOHC.

C. Power to make Standards

Clause 131 of the Bill provides APRA with a broad power to make standards that apply to life companies, NOHCs, and the subsidiaries of NOHCs. The only restriction on APRA's proposed power is that it must be *'in relation to prudential matters...in order to protect the interests of policy owners or prospective policy owners'*. The expression *'prudential matters'* is not defined in the Life Insurance Act. There is no apparent reason why APRA requires such broad powers to make standards that apply to NOHCs and their subsidiaries.

AXA APH submits that APRA's powers to make standards for NOHCs should be limited to standards relating to governance and fitness and propriety, which are the two standards identified in the Explanatory Memorandum.

AXA APH further submits that there is no justification for giving APRA the power to make standards for the subsidiaries of NOHCs. There is no evidence that such a power will protect or enhance the interests of policyowners.

These powers would duplicate similar existing requirements that apply to each of the 22 AXA APH subsidiaries which currently hold Australian Financial Services Licences and are regulated by the Australian Securities and Investments Commission (ASIC) but are not currently also regulated by APRA. (The two superannuation trustee companies and the life company within the AXA APH group are currently regulated by both APRA and ASIC.) This additional regulatory burden would place these subsidiaries at a competitive disadvantage to other companies that aren't associated with a life company.

At a practical level, the imposition of a single APRA standard such as fitness and propriety on all subsidiaries of NOHCs would have a very significant regulatory impact. For example, the Fitness and Propriety standard provides specific assessments that must be undertaken upon appointment of a 'responsible person' to a life company, and ongoing monitoring, reporting and training requirements.

There are more than 60 Australian subsidiaries of AXA APH (and many other subsidiaries in foreign jurisdictions.) Extending the fitness and propriety obligations to the Australian subsidiaries would require significant additional resources and occupy significant amounts of time of all of the Boards and of the senior management representatives of each of the individual subsidiary companies. The Regulation Impact Statement has not considered the costs associated with applying this requirement to each of the subsidiaries of NOHCs.

D. Directions

Clause 136 of the Bill amends section 230B of the Life Insurance Act to provide APRA with broad powers to direct a NOHC. The grounds on which APRA can make such directions are various, and a number of them are quite speculative. For example, APRA can make a direction if it believes that there might be a sudden material deterioration in the NOHC's financial condition, or APRA believes the NOHC is conducting its affairs in an *'improper or financially unsound'* way.

There is no requirement that APRA be satisfied that policy owners are adversely affected by the event or that the direction is necessary to protect policy owners. Similarly, there is no requirement that the direction be limited to actions that will protect the interests of policy owners.

The decision to issue a direction is not a reviewable decision unless it is made under subsection 230B(1) a), b), c) or d). The examples provided above, where APRA believes that there might be a sudden material deterioration in the NOHC's financial condition, or the NOHC is conducting its affairs in an *'improper or financially unsound'* way are not made under these subsections, and APRA's decision is not reviewable.

Failure to comply with a direction is a strict liability offence. If a NOHC refuses to comply with a direction, APRA can seek an injunction. Even if the court rules in favour of the NOHC and refuses to grant the injunction, an offence has still been committed.

Some of the directions APRA is able to make, such as to remove directors and senior managers, to prevent borrowings, and to prevent the payment of dividends, are very significant and unreasonably invasive for a listed company. In many cases the directions, and the reasons for them, would not be understood by domestic and international shareholders, and have the potential to cause significant reputational damage. Such a direction could affect all aspects of the company's operations in Australia and overseas, and could have a significant impact on the share price of a listed NOHC. Despite the potential for such significant consequences for a listed company, the NOHC is denied procedural fairness, and is unable to challenge the direction.

If section 230B of the Life Insurance Act is to be amended, AXA APH submits that APRA should only be able to make a direction to a NOHC where APRA is satisfied that the direction is necessary to protect the interests of policyowners of a life company subsidiary of a NOHC.

AXA APH further submits that all decisions to issue a direction should be reviewable.

This is consistent with Proposal 2.5 of the Streamlining Prudential Regulation: response to rethinking regulation" Proposals Paper released in December 2006 (Proposals Paper), which recommended that APRA's capacity to act decisively be balanced with expanding the availability of merits review.

Clause 146 of the Bill amends Section 230D of the Life Insurance Act. Under this section APRA 'may' publish a direction in the Gazette. The Life Insurance Act provides no guidance for APRA in relation to its discretion to publish.

As stated above, a decision to publish could have significant reputational damage, and AXA APH submits that directions should only be published where review of the direction is not sought by the NOHC.

5. Definition of Non-Operating Holding Company

The definition of Non-Operating Holding Company prohibits the company from carrying on a business other than a business consisting of the ownership or control of other bodies corporate. The definition is unnecessarily narrow and inflexible. It is an unreasonable restriction on the right of a company to choose the type of business it conducts and how it structures its operations.

While there may be some business activities which the NOHC of a life company should not undertake, there are equally many activities that a NOHC could undertake which would not have an adverse impact on policyowners.

'Carry on a business' is not defined in the Bill. It has been considered in other contexts by ASIC, as set out in its Regulatory Guide 121. A company will be deemed to carry on a business in Australia where:

- it has a place of business in Australia;
- the company establishes or uses a share transfer office or share registration office in Australia; and

- the company administers, manages or otherwise deals with property situated in Australia as agent, legal personal representative, or trustee, whether by employees, agents or otherwise.

The courts have interpreted *'carrying on a business'* as importing the notion of *'system, repetition and security'*, but a more specific or objective test does not appear possible. It is a question of fact, in which all of the circumstances surrounding the company and its activities are taken into account by the Court on a case by case basis. It is also important to note that a one-off transaction, if substantial, could also be seen by the courts as carrying on a business in Australia. (An example provided by ASIC is an offer of securities to wholesale investors.)

These tests and definitions are not particularly helpful in determining whether these *"other activities"* are deemed to be more than *"carrying on a business other than a business of consisting of the ownership or control of other bodies corporate."* Using such a definition in legislation will cause significant uncertainty as to which activities are permitted and which are prohibited.

AXA APH carries on business that could be described as more than just operating as a holding company. AXA APH is a joint venture partner with Alliance Bernstein; has agreed to assume the liabilities of NMLA as employer sponsor of the staff superannuation plan; is an employer; and guarantees or provides undertakings to various business enterprises within the AXA APH Group of companies.

It is not clear whether these activities must cease under the Bill. If this is the case, AXA APH is likely to incur significant cost (and adverse tax implications) in restructuring its businesses.

AXA APH submits that the prohibition on *'carrying on a business other than a business consisting of the ownership or control of other bodies corporate'* should be removed from the definition of Non-Operating Holding Company.

In the event that some type of restriction is required, AXA APH submits this could be dealt with on an exception basis. APRA would be able to impose a condition on the registration of a NOHC that prohibits the NOHC from undertaking specific types of business activity where APRA is satisfied that allowing the NOHC to undertake those types of business activity would pose a material threat to policy holders of the NOHC's life company.

6. Enforceable Undertakings

It is notable that the Bill does not propose to amend section 133A of the Life Insurance Act, under which APRA has the power to accept an enforceable undertaking from a life company. **AXA APH submits that the Committee may wish to consider whether it would be appropriate to amend this section to include a power for APRA to accept an enforceable undertaking from a NOHC.**

7. Criminal Penalties

Both the current and the previous government have reviewed the role of sanctions in the corporate sector and in relation to the protection of consumers.¹ These reviews broadly support two key points that the Bill seems to have ignored. These are:

- the removal of strict liability criminal offences, whilst supporting the existence of criminal sanctions in extreme circumstances; and
- introducing a general defence for directors, which could provide certainty to them about the *"legality of their actions"*, and *"could assist in better focussing the attention of directors on advancing the interests of the company"*.

AXA APH considers that strict liability criminal offences do not promote business taking sensible commercial risks, but rather, are more likely to lead to a risk-averse and overly-cautious approach by life companies and their NOHCs.

Failure to comply with a direction is a strict liability offence. If a NOHC refuses to comply with a direction, APRA can seek an injunction. Even if the court rules in favour of the NOHC and refuses to grant the injunction, an offence has still been committed.

AXA APH submits that the findings of these reviews are highly relevant to the proposals set out in the Bill and ought to be considered in relation to the use of any criminal penalties in the Bill.

AXA APH submits that refusal or failure to comply with a direction under s 230B to a NOHC or a life company should not be a criminal offence.

8. Development and Consultation

The Rethinking Regulation Report outlined six principles for good regulatory process. Three of these principles are:

- Governments should not act to address 'problems' until a case for action has been clearly established.
- A range of feasible policy options, including self-regulatory and co-regulatory approaches, need to be identified and their benefits and costs, including compliance costs, assessed within an appropriate framework.
- There needs to be effective consultation with regulated parties at all stages of the regulatory cycle.

In the case of the Bill, AXA APH does not consider that any of these three principles have been followed. The case for action has not been clearly established. There is no evidence that alternative feasible policy options have been considered, and a rigorous cost-benefit

¹ *Review of Sanctions in Corporate Law June 2007 and An Australian Consumer Law February 2009*

analysis of the outcomes produced by the Bill does not appear to have been undertaken. Further, there has also been no consultation with regulated parties.