



John Trowbridge
MEMBER

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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 Financial Sector Legislation Amendment
(Enhancing Supervision and Enforcement) Bill 2009**

APRA welcomes the opportunity to make a submission to the Inquiry into the Financial Sector Legislation Amendment (Enhancing Supervision and Enforcement) Bill 2009 (*the Bill*). APRA has closely liaised with Treasury in the development of this Bill.

The proposed legislation amends two main areas of APRA's prudential framework:

- supervision of non-operating holding companies (NOHCs) of life insurance companies; and
- APRA's power to seek a court injunction relating to life insurance companies, general insurance companies, superannuation entities and approved deposit-taking institutions.

Supervision of NOHCs

APRA considers that the amendments to the *Life Insurance Act 1995* proposed in the Bill provide powers that are essential for the prudential supervision of life companies and the protection of policyholders in the circumstances in which many life companies are nowadays structured, i.e. as parts of conglomerate groups. Moreover, they are critical to the development of a consistent and workable regulatory framework for the supervision of conglomerate groups which may include one or more life companies as part of their business.

The details of the powers in relation to the supervision of life insurance NOHCs which the Bill seeks to introduce are equivalent to APRA's supervision powers over NOHCs authorised under the *Banking Act 1959* and the *Insurance Act 1973*. The proposed changes in this Bill therefore do no more than align the life insurance industry with the ADI and general insurance industries.

Please see the attachment to this letter for further comments on particular aspects of this Bill.

Proposed amendments to court injunctions

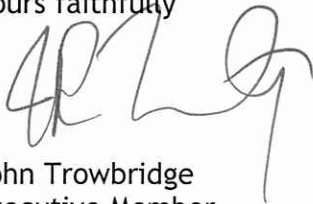
APRA has also been involved in the development of the proposed amendments to APRA's powers in relation to seeking court injunctions.

APRA already has powers to seek injunctions under the four prudential Acts: the *Banking Act 1959*, the *Insurance Act 1973*, the *Life Insurance Act 1995* and the *Superannuation Industry (Supervision) Act 1993* (SIS Act).

The proposed amendments operate to replicate the court injunction powers under the SIS Act in the other prudential acts, increasing the effectiveness of APRA to respond to material risks, focusing on contraventions and intended contraventions of the prudential acts. APRA agrees with the view expressed in the Explanatory Memorandum¹ that it '...is expected that this power will only be used in very serious cases and where other enforcement powers are insufficient.'

In summary, APRA endorses the contents of the Explanatory Memorandum and fully supports the Bill.

Yours faithfully



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¹ *Financial Sector Legislation Amendment (Enhancing Supervision and Enforcement) Bill 2009 Explanatory Memorandum* page 25

Attachment

Further comments on the Financial Sector Legislation Amendment (Enhancing Supervision and Enforcement) Bill 2009 relating to NOHCs of Life Companies

Introduction

Prudential supervision of NOHCs and their encompassing corporate groups was a recommendation to come out of the HIH Royal Commission², and was also previously identified in the Wallis Report. Prudential supervision of NOHCs authorised under the *Insurance Act 1973* (Insurance Act) has been in force since 2002, and under the *Banking Act 1959* (Banking Act) since 1998.

More recently, the leaders of the G20 agreed that all systemically important financial institutions, markets and instruments should be subject to an appropriate degree of regulation and oversight. In particular, large and complex financial institutions require careful oversight given their systemic importance. Accordingly, they committed to:

- ensuring that national regulators possess the powers for gathering relevant information on all material financial institutions, markets, and instruments in order to assess the potential for their failure or severe stress to contribute to systemic risk; and
- reviewing and adapting the boundaries of the regulatory framework regularly to keep pace with developments in the financial system and promote good practices and consistent approaches at the international level.

The proposals in the Bill are part of the fulfilment of these commitments in relation to the supervision of conglomerate groups.

Stand-alone life companies are subject to prudential requirements on statutory funds, that quarantine policy owners' funds, and on directors to give priority to policy owners' interests. However, life companies are often part of corporate groups. As such, they may be exposed to risks that stem from other companies within the group. Furthermore, within such structures, decisions that potentially affect the operation of the life company, and ultimately the policy owners, may be made by the parent entity i.e. the NOHC. These risks can be mitigated through the prudential supervision if the parent NOHC is subject to prudential supervision.

The recent circumstances of AIG in the United States, requiring US government support, are a case in point. The difficulties faced in the AIG group were outside the control of AIG's insurance companies and their supervisors. In the Australian context, to mitigate against similar risks, APRA is seeking the power to regulate NOHCs of life insurers. This will enable APRA to supervise a group as a whole, where it is appropriate to the interests of policy owners. APRA already has this power for general insurers and ADIs, and considers that the inability to supervise NOHCs for life insurers is a significant gap in its powers.

Proposed provisions for NOHCs

The proposals are consistent with the purpose and objectives of the *Life Insurance Act 1995* (Life Act).

The provisions in the Life Act that this Bill extends to NOHCs are aimed at mitigating the above risks in a way that is not overly burdensome to the NOHCs or life companies. The majority of the proposals relate to circumstances where risks to policy owners have already emerged or been identified and remedial action needs to be taken. Under normal

² Recommendations 38 and 39, HIH Royal Commission

circumstances, where risks to policy owners are being well controlled and managed, registered NOHCs will be minimally burdened by the proposed legislation.

Particular proposals are outlined below.

1.1 Registration of NOHCs

The proposed provisions for the registration of NOHCs of life companies will allow APRA, to assess the NOHCs of life companies on a case-by-case basis and, if necessary, enable APRA to require the registration of a NOHC. The proposed provisions only apply to those NOHCs that are registered.

APRA proposes to exempt NOHCs from registration in certain circumstances. Some conglomerate groups containing life companies are already headed by companies that are subject to APRA supervision (e.g. those headed by a Bank). Some groups have multiple NOHCs above the life company (and in such circumstances APRA most likely will only require one NOHC to be registered). This is consistent with risk-based supervision, and will also avoid unnecessary overheads for both industry and APRA. The proposed provisions in the Bill for registration of life NOHCs give APRA the flexibility to require relevant NOHCs to be registered.

The proposed provisions for the registration process are consistent with, and modelled on, the provisions for the 'authorisation' of NOHCs of ADIs and general insurers. Currently there are two authorised NOHCs of ADIs and 15 authorised NOHCs of general insurers.

1.2 Auditors of registered NOHCs

The majority of obligations on auditors of registered NOHCs will only operate when a potential risk to policy owners has emerged - e.g. requirements to report matters will only eventuate when the matter 'may affect the interests of policy owners'.

1.3 Monitoring and Investigation of registered NOHCs

The majority of the specific powers proposed are intended to be available to APRA only when risks to policy owners have already been identified. For example, breach requirements exist only for breaches that satisfy certain criteria; the breach would need to be 'significant' as defined in the Life Act or to it materially and adversely affect the financial position of the registered NOHC.

The investigation powers in relation to NOHCs are also constrained by the investigation procedure that APRA must already follow in relation to life companies and which is outlined in the Life Act. This includes the requirement for APRA to issue a show cause notice before commencing an investigation. These requirements are actually more constraining than those that apply to other industries and may need to be reviewed in future if the regulatory framework is to cope adequately with potential failures in a timely manner. However, such a change is beyond the scope of the current policy proposal.

Whistleblower protection imposes requirements on registered NOHCs only if a person makes a disclosure that satisfies the criteria listed in the Act, i.e. the information must concern misconduct or an improper state of affairs in relation to the registered NOHC.

1.4 Prudential Standards and Directions

APRA will be able to issue prudential standards in relation to registered NOHCs, and through them the rest of the group. These standards would impose additional requirements on registered NOHCs and could potentially include reporting obligations, compliance with risk management procedures and the holding of minimum levels of capital.

All prudential standards issued by APRA, being legislative instruments, are subject to their own due process that involves:

- a period of public consultation of the regulatory proposals and the proposed wording of the legislative instrument;

- a cost benefit assessment by APRA that satisfies the requirements of the Office of Best Practice Regulation, where APRA assesses the compliance costs and benefits for relevant stakeholders, including industry participants; and
- a period of time where the prudential standard, once issued, will be available for examination and can be disallowed by Parliament.

APRA will also be able to issue a direction to a registered NOHC. This power is necessary to be able to enforce the above requirements. It is also constrained by the requirement that the direction may only be given in certain circumstances as set out in the legislation. The circumstances that would enable a direction again relate to situations where risks to policy owners have emerged.

1.5 Disqualification

Disqualification of certain persons in relation to registered NOHCs is limited in scope by the criteria listed in the Life Act. The following criteria already exist for disqualifications under the *Corporations Act 2001*:

- conviction of a dishonesty or fraud offence; or
- filing for bankruptcy or insolvency.

APRA may also seek to disqualify an individual who is not fit and proper to hold a position in relation to a registered NOHC, but the final decision to disqualify will rest with the Federal Court of Australia.

Conclusion

In summary, APRA believes that the proposals in this Bill relating to life company NOHCs are essential to the sound supervision of life insurance companies in a modern context. They are essential to the development of a cohesive and consistent regulatory framework for the supervision of conglomerate groups containing life companies, ADIs and general insurers. They are consistent with APRA's policy development program and Australia's international commitments. Without them life insurance policyholders will remain exposed to risks arising from unsupervised related parties over which the life company has inadequate control, and the supervision of conglomerate groups which contain life insurance companies, and particularly where life insurance is the dominant component of the group's business, will be severely hampered.

APRA believes that its inability to supervise NOHCs of life companies is a significant gap in its powers. APRA considers that the Bill addresses this gap and that the proposals in the Bill align APRA's powers relating to NOHCs of life companies with those it has for NOHCs of general insurers and ADIs.