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Dear Mr Mahony

### **APRA'S CRISIS MANAGEMENT POWERS**

The Insurance Council of Australia<sup>1</sup> (Insurance Council) appreciates the opportunity to comment on the exposure draft of Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Bill 2017 (the draft Bill), which would expand APRA's crisis management powers in relation to banks and insurers. We note from the Explanatory Memorandum that the decision to consult on the draft Bill has largely been triggered by the Government's response to the recommendations of the Final Report of the Financial System Inquiry (FSI) and more recent developments in global financial regulation.

The Insurance Council recognises that in its response to the FSI, the Government agreed that regulatory settings should provide regulators with clear powers in the event that a prudentially regulated financial entity fails<sup>2</sup>. We also note the global developments in insurance crisis resolution since 2012, particularly the release of the Financial Stability Board's (FSB) updated Key Attributes on Effective Resolution Regimes (Key Attributes) in 2014 to address insurance considerations<sup>3</sup> and the International Association of Insurance Supervisors' (IAIS) current consultation on its revised Insurance Core Principle 12 on insurance resolution<sup>4</sup>.

Additionally, the Insurance Council understands from the FSB's July 2017 report on the implementation of resolution reforms<sup>5</sup> that Hong Kong, Japan and the United States have in place insurance resolution regimes that are in line with the FSB Key Attributes, and that other FSB jurisdictions – France, India, Netherlands, Singapore and South Africa – have also

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<sup>1</sup> The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2017 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$45 billion per annum and has total assets of \$124.9 billion. The industry employs approximately 60,000 people and on average pays out about \$135 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

<sup>2</sup> Government [response](#) to the Financial System Inquiry, response to *Inquiry Recommendation 5 – Crisis management toolkit*, page 10 refers. Released 20 October 2015.

<sup>3</sup> FSB [Key Attributes](#) of Effective Resolution Regimes for Financial Institutions, released 15 October 2014.

<sup>4</sup> IAIS [consultation](#) on revised Insurance Core Principles (ICPs) and ComFrame material integrated with ICPs. Crisis resolution: revised ICP 12 (Exit from the Market and Resolution) and ComFrame material integrated with ICP 12.

<sup>5</sup> FSB [Report](#), *Ten years on – taking stock of post-crisis resolution reforms*, released 6 July 2017, pages 18-19 and 30-32 refer.

initiated similar regulatory reforms that will bring their insurance resolution regimes closer in line with the FSB Key Attributes.

While the Insurance Council acknowledges these developments since 2012, they do not justify the expansion of APRA's crisis management framework without adequate opportunities for public consultation. In this regard, the Insurance Council is disappointed with the unreasonably short 3 week consultation timeframe provided, particularly given the complexity of the proposed reforms and the fact that there is close to 500 pages of material to be reviewed.

It is unclear as to why a decision was made to provide stakeholders such a limited consultation timeframe. The Explanatory Memorandum suggests that consultation on the draft Bill essentially follows from the then Government's 2012 consultation paper on strengthening APRA's crisis management powers<sup>6</sup> – which was put on hold pending the 2014 FSI – and briefly notes that the draft Bill excludes the then less resolution-centric or financial market infrastructure-related proposals.

However, the limited consultation timeframe has materially constrained our ability to properly assess the implications of the proposals and provide in depth comments on the draft legislation. The Insurance Council is concerned that there may be provisions in the draft Bill that differ from the proposals in the 2012 consultation paper and we have been unable to verify that the draft Bill reflects accurately the proposals as set out in the Explanatory Memorandum.

We also have not had the opportunity to ensure that the draft Bill is consistent with international standards. For example, if the legislative amendments exceed international standards, regulators in foreign jurisdictions may take pre-emptive steps or measures (e.g. ring-fencing) to ensure that APRA's powers would not displace their local powers in a crisis; as the Treasury would appreciate, this could materially impact general insurers with foreign operations.

In view of the limited consultation timeframe, the Insurance Council has provided general comments on the proposals as set out in the Explanatory Memorandum – these are at the Attachment and are arranged to align with the chapters in the Explanatory Memorandum.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or [janning@insurancecouncil.com.au](mailto:janning@insurancecouncil.com.au).

Yours sincerely



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Executive Director and CEO

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<sup>6</sup> Treasury [consultation paper](#), *Strengthening APRA's Crisis Management Powers*, released September 2012.

## **COMMENTS ON THE PROPOSALS**

### **Overview of Crisis Management – Chapter One**

The Insurance Council and its members continue to urge the Treasury to take full account of the differences between individual financial services sectors and the way they interact with the other component parts of the financial system.

It is widely recognised that, if despite a stringent regulatory regime, a general insurer gets into financial difficulty, it is not susceptible to sudden collapse as a bank would be. There is time to take recovery action and, if this is ultimately unsuccessful, to manage the insurer's orderly resolution.

The impact of a failure of a general insurer has less severe and more delayed consequences for the economy than of a bank so the need to guard against failure is lower – there is time to take recovery action and, if this is ultimately unsuccessful, to manage the insurer's resolution in an orderly fashion.

The Insurance Council continues to submit that the general insurance sector does not require the same regulatory approach as that applied to the banking sector, which is heavily influenced by the goal of promoting systemic stability.

### **Statutory and Judicial Management – Chapter Two**

#### **Power to appoint a statutory manager to an authorised NOHC and other companies in the group**

- The Insurance Council is not convinced that APRA requires this proposed power in addition to existing tools that can be applied in general insurance. Given the manner in which a general insurer begins to fail, the risk of delay is not a material factor and does not support the proposal. The proposal is even more unjustified to the extent that it applies to a NOHC and other group companies that are financially sound. The Insurance Council notes the pre-conditions and safeguards that would be in place for appointing a statutory manager to ensure it is triggered only under certain circumstances<sup>7</sup>.

#### **Management of insurers in a crisis**

- Given the differences between a general insurer and bank in financial distress, the Insurance Council is not convinced that there is a need to provide for statutory management of an insurer. A court should be able to respond with a sufficient speed in relation to matters of judicial management.

### **Directions Powers – Chapter Three**

#### **Clarifying directions powers**

- The Insurance Council does not support the proposal that APRA's 'catch-all' directions powers should extend to issues that have no connection to APRA's responsibility for promoting financial system stability. An appropriate safeguard tying

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<sup>7</sup> Pages 34-36 of the [Explanatory Memorandum](#) to the draft Bill refers.

the use of the catch-all directions power to APRA's prudential responsibilities would make this proposal more acceptable.

- The Insurance Council is not convinced that APRA's directions powers can in practice be extended to the overseas subsidiaries of Australian insurers. There is potential for difficulties for example where:
  - compliance with an APRA direction conflicts with a local (host jurisdiction) requirement; or
  - there are common directors on both group and subsidiary boards and they are put in a position of conflict due to regulatory action being taken on one of those entities.
- The Insurance Council is concerned by the implications for corporate governance that the issuance of confidential directions may have impacts for continuous disclosure obligations in Australia. Putting these concerns aside for the sake of better overall outcomes in terms of crisis resolution, there remains potential complications where a direction is issued in respect of an overseas regulated subsidiary but the host jurisdiction regulator cannot be advised.
- The Insurance Council assumes that where questions of international supervision arise, APRA will co-ordinate action with its fellow regulators through the relevant supervisory college.

#### **Directions on pre-positioning for resolution**

- The extent of what would be seen as 'pre-positioning' for resolution is unclear. The Insurance Council disagrees with the proposal because it would appear to provide APRA an unwarranted direction power, given the scope of the power would be broad. The Insurance Council submits that the establishment of appropriate safeguards tying the use of additional powers to APRA's prudential responsibilities would make this proposal more acceptable.
- Additionally, this power may unnecessarily impose significant expenditure and operational constraints, depending on the nature of a pre-positioning direction (e.g. an inability to streamline/share functions between entities within a group).

#### **Confidentiality of certain directions**

- Careful consideration needs to be given to the potential impact that a confidential direction may have on communications between: a general insurer and any of its domestic or foreign operations; the group or general insurer's foreign operations and their local (host state) regulators; and APRA and any foreign local regulators. It would be important that a confidential direction does not unnecessarily impede any of those communication channels.

#### **Transfer Powers – Chapter Four**

##### **Widen the scope of application of the Business Transfer Act to related entities of general insurers and life companies**

- The Insurance Council opposes this proposal as it has material reservations about APRA's ability to make better, more informed commercial decisions than an insurer's Board about the placement of related entities. Careful consideration needs to be

given to the impact, if any, of proposed transfers on reinsurance and subordinated debt arrangements.

## Foreign Branches – Chapter Seven

### Appointing a statutory manager to the Australian business of a foreign branch

- Consistent with our responses above, the Insurance Council does not see the need to apply a statutory management regime to general insurance.
- The Insurance Council is not persuaded that APRA's power to appoint a statutory manager can be extended in practice to a foreign branch. Difficulties for example could arise where:
  - compliance with an APRA appointment would conflict with a home jurisdiction requirement; or
  - there are common directors on both group and subsidiary boards and they are put in a position of conflict due to regulatory action being taken on one of those entities.
- As mentioned above, the Insurance Council assumes that where questions of international supervision arise, APRA will co-ordinate action with its fellow regulators through the relevant supervisory college.

### Directing a compulsory transfer of business to or from a foreign branch

- The Insurance Council considers that APRA's ability to require the transfer of an insurance business needs to be tightly limited to when both the head office and the branch of the financial institution are in financial difficulties. In all other situations, the power should be restricted to the Federal Court.

## Resolution Planning – Chapter Ten

### Refinement and simplification of the definition of 'prudential matters'

- The Insurance Council is concerned that the broadened definition of 'prudential matters' lacks sufficient connection to APRA's responsibilities and may dilute its focus. For example:
  - Regarding "*protect the interests of policyholders of any general insurer*"<sup>8</sup>, this provision has the capacity to permit APRA to intrude into areas covered by the *Corporations Act 2001*. By broadening the definition, a duplication or clash could be created between the financial services provisions of the *Corporations Act 2001* and ASIC Regulatory Guides and APRA's Prudential Standards.
  - Broadening supervision to groups generally and also to any "*particular member or members*"<sup>9</sup> of a group, especially in part (b) of the definition, spreads APRA standards beyond any link to financial services. Consequently, a retailer or miner, for example, could be impacted with APRA unable to judge whether they are conducting their affairs with integrity, prudence and professional skills.

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<sup>8</sup> The [draft Bill](#); 7 Subsection 3(1) (definition of prudential matters), page 77-78 refers.

<sup>9</sup> Ibid.

### **Enabling APRA to require a NOHC of a regulated entity to be authorised**

- The Insurance Council opposes this proposal, as it is unnecessary in general insurance and potentially would require the restructuring of a simple group. An example is a medical indemnity insurer that has a mutual at its head. There would be considerable costs and little gain in terms of regulatory efficiency if the mutual was required to set up an authorised NOHC.
- The proposal would be more acceptable if there were an explicit pre-condition on when APRA could exercise its power to give notice, so that insurance groups are aware of what issues or concerns might cause them to be required to restructure, or on what basis they could seek an exemption.