

28 March 2013

Mr Sam Watson
Coalition Deregulation Taskforce
c/- Office of the Hon. Tony Abbott MHR
Leader of the Opposition
Parliament House
CANBERRA ACT 2600

Via email: Sam.f.watson@aph.gov.au

Dear Mr Watson,

Insurance Australia Group (IAG) welcomes the opportunity to provide comment in relation to the Coalition's Deregulation Reform Discussion Paper.

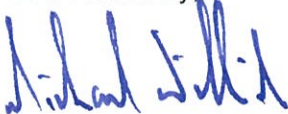
IAG is the parent company of an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. IAG has more than 808,000 shareholders (as at August 2012). IAG's register is the third largest in Australia. IAG employs more than 13,600 people of whom around 9,000 are in Australia. Its current businesses underwrite over \$9 billion of premium per annum and pay over \$6 billion in claims per annum. Across our portfolio of brands IAG insures 7.7 million cars, 2.9 million homes, 103,000 farms, 117,000 employers and nearly 400,000 businesses. IAG had more than 16.1 million policies in force in financial year 2012.

Within Australia, IAG's Direct Insurance business provides personal insurance products as well as business insurance packages targeted at sole operators and smaller businesses in NSW, ACT, Queensland and Tasmania primarily under the NRMA Insurance brand. SGIO is the primary brand in Western Australia, and SGIC in South Australia. In Australia, IAG also has a distribution agreement with RACV (underwritten by Insurance Manufacturers of Australia – owned 70% IAG; 30% RACV) in Victoria. Products are distributed through branches, call centres, the internet and representatives.

Within Australia, IAG's intermediated insurance products are sold nationally, primarily under the CGU Insurance and Swann Insurance brands through a network of more than 1,000 intermediaries, such as brokers, agents, motor dealerships and financial institutions. CGU is also a leading provider of workers' compensation services in Australia.

IAG would be happy to discuss the issues raised in this submission. If you wish to make further inquiries please contact David Welfare, Senior Adviser, Economics & policy on (02) 9292 8593.

Yours sincerely,



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There are a number of structural issues which business will be looking for all parties to address over the next term of the Federal Parliament. Suggested areas for reform are detailed below.

Executive Summary

- Increasing complexity and continual change to superannuation regulations are a disincentive for prospective workers to engage with the workforce. Each time a change is made to superannuation regulations, older people have to factor in how it will impact their tax positions, pension entitlements and ongoing benefits.
- Governments, policy-makers and regulators need to do more in relation to the high regulatory cost burden by addressing inter-jurisdictional overlaps and inconsistencies. In particular, inconsistencies/duplication across State and Territory Government regulatory regimes would be eliminated by a well-designed and administered national system for workers compensation.
- While there is no need for a large-scale review of Australia's financial sector regulatory architecture, there are opportunities for targeted improvements to be made in order to improve efficiency and effectiveness.
- It is increasingly important that Australian prudential regulations don't prejudice the relative ability of Australian general insurers to achieve a commercial presence offshore compared with competitors based in other jurisdictions. Additionally, APRA must take into account the difference between the banking and insurance sector.
- There is a need for a rationalisation of prudential regulation with APRA being the sole prudential regulator and the States and Territories removing overlapping or duplicate requirements in statutory and other classes of insurance.
- It is essential to ensure that the application of Australia's competition laws remain in step with the competitive pressures faced by the Australian economy and businesses. IAG does not support any legislative or regulatory reforms that result in legitimate competitive behaviour/competitive being prohibited or stymied to protect some businesses from facing fair competition.
- There is a clear economic case for reducing state insurance taxes and charges ahead of many other taxes in order to reduce the taxation impost on insurance premiums to businesses and households.
- The Australian Government and its agencies should expand the use of risk-based strategies in the development of regulation and compliance strategies in accordance with OECD principles. OECD Principles promote the use of risk assessment and risk management options in Regulatory Impact Analysis (RIA).
- IAG believes industry self regulation provides Governments with an alternative flexible approach to regulation. Moreover, market forces serve as a powerful and healthy driver of corporate behaviour.

Productivity and Workplace Participation

IAG believes there are a number of legislative and regulatory requirements that act as barriers to workforce participation by older workers.

Superannuation arrangements should not discourage people from remaining in or re-entering the workforce, nor should they discourage employers from employing older workers. Increasing complexity and continual change to superannuation regulations are a disincentive for prospective

workers to engage with the workforce. Each time a change is made to superannuation regulations, older people have to factor in how it will impact their tax positions, pension entitlements and ongoing benefits.

Policies that facilitate staged retirement, flexible work patterns, and the remove barriers to staying in the workforce longer should be encouraged. For older workers wishing to continue working, key factors influencing workforce participation include: health outcomes; educational attainment; the tax transfer system, cultural attitudes; workplace flexibility and access to retraining and support services.

The challenge of how to extend the working lives of older employees in a way that balances the competitive imperative of business with the life realities of older workers presents many opportunities for Australian businesses. By focusing on the development of policies, programs, and employment arrangements necessary to extend the working life of the growing numbers of older employees, business can ensure future supplies of skilled workers, sustain economic growth, and help secure retirement income.

IAG believes that it is important to recognise, however, that supporting the ongoing participation of older workers is a shared responsibility. Individuals must also take responsibility for planning for their financial security and ensuring that they remain productive and valued members of the workforce. This means taking responsibility for, and being pro-active in, maintaining skills and training and overall employability. Disengaging from work and opting out of training or new job opportunities will not enable ongoing participation and tends to reinforce negative stereotypes.

Workers' Compensation Regime

Governments, policy-makers and regulators need to do more in relation to the high regulatory cost burden by addressing inter-jurisdictional overlaps and inconsistencies.

In particular, inconsistencies/duplication across State and Territory Government regulatory regimes add unnecessary costs and compliance burdens and are a major impediment to a common market in Australia.

Increasingly, businesses in the Australian financial services industry have been concerned about duplicated and inconsistent regulation, as many operate across jurisdictions and are already subject to a considerable degree of regulation.

Fundamental to any consideration of reform initiatives is the recognition that a competitive workers compensation and occupational health and safety regime is the best mechanism to reward positive employment practices with affordable premiums and capitalises on the opportunities for reduced risk and accident prevention that are the positive consequence of incentive and innovation.

A well-designed and administered national system for workers compensation can deliver fairer support for injured workers, by eliminating arbitrary differences in entitlements for the same injuries, and better social and health outcomes through better performance measures and better targeting of services. A competitive national market will reward good employment practices with affordable premiums and create real incentives to reduce risks and prevent accidents.

The compulsory nature of workers compensation and its role in the broader industrial relations environment have resulted in a far more intense level of regulation and government intervention than any other insurance product. To date, this regulation and government intervention has been almost entirely state-based in Australia (other than for Commonwealth employees and seafarers). The result is the current patchwork of different schemes for each state and territory, plus specific national schemes for federal government employees and seafarers as well as special schemes such as the coal miners' in New South Wales. Each has evolved largely in isolation with very limited coordination at the national level. While all these schemes are under almost continual review, there has been no

change to the fundamental structure since the 1980s. Provision of workers compensation continues to be dominated by the state public sectors and licensed private insurers remain excluded from direct underwriting in four of the five larger states.

IAG supports nationally consistent frameworks in the key areas of workers' compensation insurance and occupational health and safety; such frameworks would remove unnecessary costs and compliance burdens while at the same time act to deliver optimal outcomes for injured workers and provide employers with a regulatory environment better attuned to modern business practices.

Regulatory Reform – General Insurance Sector

General insurers are subject to the corporate regulatory regime that applies to Australian incorporated businesses generally. This includes the legislative regimes of the *Corporations Act 2001*, the *Competition and Consumer Act 2010* and, for public listed companies, the requirements of the Listing Rules of the Australian Securities Exchange.

General insurers are also subject to a range of industry specific regulations at Federal (eg *Insurance Act 1973*, *Insurance Contracts Act 1984*), State and Territory levels. These regulations subject insurers to prudential supervision. They also deal with aspects of market conduct and consumer protection and the various statutory insurance schemes, which operate in each State and Territory.

IAG supports the Australian Government's objectives in reforming Australia's financial services sector, particularly in relation to the adoption of a uniform licensing regime and an improved disclosure and conduct framework for financial services providers.

IAG appreciates that the Australian Government is mindful of a general policy that has been adopted by successive Australian Governments in recent times, to the effect that where commercial markets, including insurance markets, operate efficiently and effectively on their own, the government should be reluctant to intervene.

Regulation and regulatory frameworks play a critical role in shaping the business environment in which economic activity takes place. Indeed, as the Chairman of Australia's Productivity Commission, Gary Banks (2003) noted:

"Regulation serves a vital role in improving social, environmental and economic standards for Australians. At their most fundamental level, laws — merely a form of regulation — define and enforce property rights, which are the basis for economic exchange. There are also other persuasive rationales for regulation based on the failings of the market. Uninhibited markets can produce undesirable outcomes, such as environmental degradation, unnecessary health hazards, excessive prices and 'unfairness'. By shaping incentives and influencing how people behave and interact, regulation can help societies deal with otherwise intractable problems. At their best, regulations create order, preserve norms and provide a basis for stable progress." (p.2)

The importance of regulation is increasing, as the effects of globalisation and technological development increase, and national economies become more inter-connected and inter-dependent.

As globalisation increases, it is reasonable to expect general movement towards global frameworks to align and improve standards. A consistent regulatory framework becomes even more important. This leads to greater cooperation between global regulators.

Indeed, as the Financial Sector Advisory Council (FSAC) noted in its *Review of the Outcomes of the Financial System Inquiry 1997* (2003):

“Globalisation, convergence and technological change are three important forces that will continue to drive the evolution of the financial system. There is a need for policy development and regulatory structures to keep pace with the inevitable interplay of these forces.” (p. 1)

“Adherence to a principles-based rather than a rules-based framework is seen as one means of limiting the potential for regulation to impact adversely on investment decisions and market entry.” (p.2)

The question is one of balance. The difficult task is to strike an appropriate regulatory balance.

As the Finance Industry Council of Australia (FICA) highlighted to the Australian Government’s Regulation Taskforce (2005):

“... it needs to be recognised that the success of market economies is built on their ability to respond flexibly and in innovative ways to changing circumstances. Rigid regulations can harm this flexibility. Thus, the presumption should be to intervene only where there is a clear need and to do so in ways that minimise costs and distortions. Wherever feasible, policy-makers and regulators should aim to establish the objectives that the policy or regulations aim to achieve and then design regimes that allow these to be carried out in a flexible rather than prescriptive manner” (FICA submission to Australian Government Taskforce on Reducing the Regulatory Burden on Business, November 2005, p. 1).

While the financial sector regulatory architecture in Australia has proven its robustness through the GFC, within this regulatory framework, there are opportunities for improvements to be made in order to increase the efficiency and effectiveness of the system. Indeed, there is also the opportunity to consider the effective timetabling of related or complementary legislative change to avoid the duplication of effort and facilitate a smoother transition in terms of documentation and related requirements.

Specifically, IAG would suggest that Government needs to ensure that regulators (APRA and ASIC) do not overstep their mandate and start to develop policy – this clearly is the realm of Executive Government. In recent years we have witnessed a ‘creep’ in this direction.

Additionally, we continue to see overlap between ACCC and ASIC when it comes to consumer issues for financial services providers. Specifically, IAG’s operating brands NRMA Insurance and CGU underwrite and distribute insurance and consumer issues are clearly under ASIC, when it comes to consumer issues related to managing claims ACCC can also become involved.

While Australia’s financial services regulatory regime is working well and highly regarded, regulatory review is, necessarily, a continuing process.

Prudential Regulation

The worldwide liberalisation of trade and capital markets has resulted in Australian businesses being increasingly exposed to international opportunities and competition in our home markets. As such, it is vital that Australia has a regulatory framework which allows business to respond to challenges and developments in the international marketplace.

For international companies to continue to operate globally it will be important to ensure that any changes to international regulation of groups lead to reduction or elimination of regulatory overlaps and more efficient and fair operation of global marketplace. More consistent application of regulatory regimes will also mitigate against regulatory arbitrage by larger groups.

It is increasingly important that Australian prudential regulations not prejudice the relative ability of Australian general insurers to achieve commercial presence offshore, compared with competitors based in other jurisdictions such as Europe. A competitive disadvantage is created, for example, when the minimum capital requirements in Australia are significantly higher than those of our competitors.

Regulators should be encouraged to take a global view in their deliberations. It is necessary to ensure that Australian regulators do not impose significant regulatory burden and cost on Australian insurers that undermines international competitiveness.

What is needed is an approach to prudential regulation that balances the objective of promoting financial safety with the need to minimise the adverse effects on efficiency, and competition.

We remain concerned about the tendency to transfer regulatory concepts from one sector of the financial services industry to another without differentiating between them. While endorsing harmonisation of prudential regulation across financial sectors, the general insurance industry believes that APRA should take account of sectoral differences.

- General insurance has different risk profile to banking.
- General insurance failures can generally be managed over time. Bank failures occur much faster and have the scope to be more disorderly than insurance failures (there can't be a "run" on an insurance company).
- The failure of a general insurer has less severe and more delayed consequences for the wider economy than of a bank so the need to guard against failure is lower.

National Framework – Insurance Regulation

While a significant amount of regulatory reform has already taken place in the general insurance sector over the last few years, there is the need for a national regulatory framework. In particular, there is a need for the rationalisation of prudential regulation with APRA being the sole prudential regulator and the States and Territories removing overlapping or duplicate requirements in statutory and other classes of insurance.

Under such a national model, APRA could assume responsibility as the sole prudential regulator. This would obviate the need for State or Territory involvement in setting overlapping or duplicate requirements in statutory or other classes of insurance. This would address the current problem of State based insurance monopolies which are antithetical to the notion of open and competitive marketplace in insurance.

Competition Regulatory Balance

The general insurance market in Australia is relatively mature and sophisticated in terms of product offering and risk assessment and management. In this market there is intensive price, service and product competition. Consumers have access to a healthy range of products from which to choose.

IAG believes it is essential to ensure that the application of Australia's competition laws remain in step with the competitive pressures faced by the Australian economy and businesses. The fundamental premise that underpins competition policy is that all sectors of the economy should be subject to competition unless it can be shown that there is a net public benefit not to do so. IAG continues to oppose any legislative or regulatory reform that results in legitimate competitive behaviour/competitive being prohibited or stymied to protect some businesses from facing fair competition.

IAG cautions against legislative or regulatory intervention, no matter how apparently well-intentioned, that has the potential to unduly inhibit market influences.

IAG agrees with the views of the ACCC Chairman:

"... businesses that are unable or unwilling to respond to the, often daunting, challenge of competition, will languish and may ultimately fail. But this is the essence of an open market economy." (Graeme Samuel, "Big Business v Small Business – vigorous or vicious competition? Australian Graduate School of Management Dinner, 4 November 2004).

Moreover:

"... businesses that are able and motivated to take advantage of the competitive environment through innovation, improved efficiencies, keen pricing, quality service standards and other forms of vigorous competition will thrive. And for the most part, small business is able to respond to the competitive environment more quickly and with more flexibility than many of its larger competitors. As stated previously, the corollary is that businesses that are unable or unwilling to respond to the challenge of competition will languish and may ultimately fail".

Importantly, the ACCC Chairman highlights:

"One of the difficulties is that there is not a wide understanding of the difference between protecting competitors and promotion of competition. And while small business will seek for the focus of competition policy to tend more towards a philosophy of the protection of competitors, ostensibly in the interests of the promotion of competition, the voice of the consumer will be constantly heard urging that the focus remain on the promotion of competition with its attendant consumer benefits." (p.11)

Taxation Inconsistencies

The inconsistency across State and Territory Governments in the rate and application of stamp duty as it relates to insurance premiums adds unnecessary costs and compliance burdens and are a major impediment to a common market in Australia. The inconsistency also distorts market efficiency by impacting investment decisions by businesses.

There is a clear economic case for reducing state insurance taxes and charges ahead of many other taxes in order to reduce the taxation impost on insurance premiums to businesses and households.

Consumer Regulation

IAG considers that the consumer regulatory regime has grown substantially since the introduction of the *Financial Services Reform Act in 2001*, and in an ad hoc manner that has added substantially to the cost of the general insurance products without a commensurate increase in protection for customers. The PDS (reaching 80 pages for NRMA Insurance) that resulted from the legislation is clearly failing to achieve its intended purpose of informing customers, and the Government has recently regulated a 2 page Key Fact Sheet for Home Insurance.

As part of any review of the financial services regulatory architecture, IAG recommends that the breadth and depth of consumer regulation needs to be examined to ensure that the intended benefits are indeed being delivered and in a cost effective manner.

Australian governments have recognised that efficient and effective regulation is necessary and desirable to facilitate the smooth functioning of the economy and to ensure that social, economic and environmental aims are achieved. However, excessive, poorly designed and overlapping regulation place a significant cost burden on Australian businesses and consumers. Best practice regulatory

policy requires evidence and rigorous evaluation. It also requires institutional frameworks that encourage, disseminate and defend good evaluation, and that make the most of opportunities to learn. Where evidence is incomplete or weak, good processes for learning, and for progressively improving policies, become even more important.

The Regulation Taskforce (2006) concluded that having rigorous Regulatory Impact Analysis (RIA) processes in place would ensure better regulatory outcomes. The pre-condition for achieving better regulation boils down to ensuring that the case for it is well made and tested, both at the outset and ongoing.

The government adopted the following six principles in good regulatory practice recommended by the Taskforce on Reducing the Regulatory Burden on Business (Banks Review):

- Governments should not act to address “problems” through regulation unless a case for action has been clearly established. This should include evaluating and explaining why existing measures are not sufficient to deal with the issue.
- A range of feasible policy options – including self-regulatory and co-regulatory approaches – need to be assessed within a cost-benefit framework (including analysis of compliance costs and, where relevant, risk).
- Only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.
- Effective guidance should be provided to regulators and regulated parties to ensure that the policy intent of the regulation is clear, as well as what is needed to be compliant.
- Mechanisms such as sunset clauses or periodic reviews need to be built in to legislation to ensure that regulation remains relevant and effective over time.
- There needs to be effective consultation with regulated parties at the key stages of regulation making and administration.

Source: Rethinking Regulation (2006), p. v; Australian Government 2007.

The key challenge, in Australia as well as across OECD countries, is to maintain the momentum of the reform agenda in the wake of the financial crisis. The recovery from the economic effects of the crisis will require economies to be flexible and innovative, and it will be increasingly important that they are not overburdened by unnecessary regulatory impediments that prevent businesses from responding to market opportunities when they emerge. Producing further evidence of the benefits of regulatory policy is a key challenge as part of the recovery programmes in Australia and beyond. These policies require broad support from citizens and business to sustain momentum for reform in the face of often concerted opposition. To do this effectively, the policy message has to be well delivered and understood.

IAG considers that the Australian Government and its agencies should expand the use of risk-based strategies in the development of regulation and compliance strategies in accordance with OECD principles.

The OECD Principles promote the use of risk assessment and risk management options in RIA. The Best Practice Regulation Handbook provides good solid guidance on the assessment of risk when considering a regulatory proposal. There is scope to extend this to the design and implementation of compliance and enforcement strategies. A small group of OECD countries have produced guidelines which could provide a model starting point for expanding the guidelines on risk assessment and management. However, experience suggests that the guidance should be developed in close consultation with regulators to accommodate existing departmental arrangements where they already reflect a culture and practice of effective risk assessment, management and communication.

The Australian government aims to promote innovation and continuous improvement as part of the deregulatory policy agenda. This will require regulators to take account of the features of firms as well as the circumstances of the market when designing regulation. A case by case approach is necessary, but the government should share lessons among regulators about good performance and innovation in regulatory products, and consider how to provide incentives for the identification of innovative solutions so that flexibility and outcome oriented approaches are systematically favoured in the regulatory design.

This could build on the transfer of good existing practices from a number of sectoral agencies in charge of prudential and safety regulation.

Industry Self Regulation

IAG believe industry self regulation provides Governments with an alternative flexible approach to regulation. Industry self regulation provides a benchmark standard. Once this standard is set, there is a strong incentive for individuals companies to exceed the benchmark in order to attract customers and expand market share.

Moreover, IAG considers that market forces serve as a powerful and healthy driver of corporate behaviour. Investor demands can influence a company to consider and integrate corporate responsibility; while at the same time those demands can be flexible enough to enable a company to tailor its approach in a way that meets the demand yet suits the company's operation and culture.

IAG contends that effective and robust corporate governance depends in the long term on corporate culture which values and rewards accountability and transparency and has in place strong and well understood checks and balances. It does not believe that externally imposed rules which are not "owned" by companies and their staff achieve effective governance.

Regulators can and should prescribe minimum standards but they cannot mandate culture or behaviour. Ultimately, Boards and management should be responsible for their own cultures and behaviour, and for openness in company governance