INSURANCE AMENDMENT BILL 1983

Date Introduced: 10 November 1983
House: House of Representatives
Presented by: Hon. C.R. Hurford, M.P., Minister Assisting the Treasurer

Purpose

To increase statutory minimum financial requirements of companies engaging in general insurance and to augment supervision of their operations by the Insurance Commissioner.

Background

Commonwealth legislative capability in respect of insurance, other than intrastate State insurance, is assured by paragraph 51(xiv) of the Constitution. Legislation for licensing, regulation and supervision of brokers in marine and general insurance was introduced in Queensland by the Insurance Act 1960 but became inoperative in respect of general insurance following the Insurance Act 1973 (Cth.); the Federal provision rendering inconsistent State provisions invalid. Life insurance had been regulated by Federal legislation since 1946.

The present Bill is similar to the Insurance Amendment Bill 1982 [see Bills Digest] which was later amended on 9 December 1982 but lapsed with the dissolution of Parliament.

There are several alternative schemes for regulation of the insurance industry. Regulation may comprise requirements for bona fides of the firm's principals, and ongoing requirements for the security of investments and maintenance of a margin between assets and expected or potential liabilities. These requirements may be supervised by further requirements as to filing of accounts, or audit at yearly or more frequent intervals, together with a power of investigation should any material change occur.

The more extensive scheme of policyholder guarantees is reflected in the Policyholders Protection Act
1975 of the United Kingdom. The scheme establishes a fund by levies on insurers, out of which claims on an insolvent insurer to a level of 90 per cent may be met. Levies may not exceed 1 per cent of the net premium income of insurance companies.

The Law Reform Commission referred to the need for such guarantees and saw them as both a natural extension of present systems of control and as a measure which will be less likely to be resorted to if investment controls were augmented[1]. The scheme was considered by the Campbell Committee of Inquiry into the Australian Financial System and thought unnecessary if other investment solvency controls were introduced. The system was considered to subsidize imprudent firms at the expense of better managed firms[2].

The life insurance industry is perceived by the public to be quite homogenous, even though competitive, so that a failure by one firm may damage the public standing of the industry as a whole. The Campbell Committee referred to the more serious consequences to individual policyholders of a life office failure as a reason for greater regulation than in the case of the general insurance industry[3]. The Committee referred to and endorsed the recommendations of a Treasury paper circulated to the industry in late 1978 for an increase in the minimum paid up capital from $200,000 to $500,000 and a solvency margin of the greater of $1 million (now $100,000) or 20 per cent of premium income (now 15 per cent). The paper also suggested asset portfolio limits of 15 per cent as to direct investment in real estate and a further 15 per cent in registered first mortgages over real estate. The Campbell Committee accepted and itself recommended the suggestion that no single asset should account for more than 5 per cent of total assets in all asset requirement calculations[4].

The Insurance Act 1973 establishes the office of Insurance Commissioner and regulates insurance in Australia from 1974, except life insurance which has been regulated since 1946 by the Life Insurance Act 1945. The viability of insurance companies is secured by two requirements; first as to the solvency margin, and secondly as to provisions for reinsurance, by which some of the risk accepted by the underwriting firm will be passed on to specialised, frequently multinational reinsurers. Often the reinsuring company will not be authorised under the Australian legislation. In general, the Insurance Commissioner does not permit more than 50 per cent of a risk premium to be ceded to unauthorized insurers.
The method of calculation of solvency margin may act as a disincentive to increase premiums, since the margin is in most cases proportionately related to the level of premium income. The five years prior to 1981 were of substantial competition in the market. The Insurance Commissioner regarded "rate cutting" as an insufficient explanation and found "conscious management decisions to set premium rates which have little or no regard to prudent minimum rates". Accumulated deficits on underwriting account in the period 1973-74 to 1979-80 were $471 million, with a record $261 million deficit in the 1980 calendar year[5]. A record $486 million underwriting deficit ensued in the 1981 calendar year, although the Insurance Commissioner has recently reported a levelling off in the level of deficits of direct underwriters, together with a 24 per cent increase in premium income in the 1982 calendar year. Even at existing margin rates, this would require an increase in the amount required to maintain the solvency margin. The Commission reported that the "current solvency standards imposed by the Act are minimal on any objective test"[6].

The amendments to the Insurance Act are associated with proposals to regulate the insurance broking industry and the terms of insurance contracts. The Insurance Contracts Bill follows an Australian Law Reform Commission reference[1]. The Insurance (Agents and Brokers) Bill was lobbied for by a self-regulating body in the industry, the National Insurance Brokers Association[7]. The matter was also investigated by the Law Reform Commission[8]. Substantial losses to policyholders may follow failure of a broker holding large sums in premiums not yet forwarded to the insurer. An intention to proceed with enactment of paragraph 15(1)(d) of the 1982 Bill, which would limit the inclusion of such premiums in insurer assets for solvency calculation purposes, has been indicated[9].

Main Provisions

Apart from requirements in clause 24 for quarterly lodgment of information amounting in detail of its coverage to balance sheet data, and amendment to subsection 113(4), the Bill would commence 28 days after Royal Assent.

Solvency margin requirements in section 29 are amended for a minimum paid-up share capital of $500,000 (previously $200,000) and a margin of assets over liabilities of the greater of $1,000,000 ($100,000) or 20 per cent (15 per cent) of premium income during the last preceding financial year (clause 15). In both cases, the interim provisions of Part III (clauses 45-48) permit a gradual increase over a four-year period to the increased
levels. An authority to carry on insurance business in Australia is also conditional on appropriate reinsurance arrangements under section 34.

The Bill augments the reporting requirements under the Act and makes provisions for review of administrative decisions under it (clauses 29, 30).

For further information, if required, contact:

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References

3. op.cit., para. 20.149.
4. op.cit., para. 20.173.