**EXPLANATORY STATEMENT**
**Select Legislative Instrument 2008 No. 125**

Issued by the authority of the Assistant Treasurer

*Insurance Act 1973* and
*Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*

*Insurance Amendment Regulations 2008 (No. 1)*

Section 132 of the *Insurance Act 1973* (the Act) provides, in part, that the Governor-General may make regulations, not inconsistent with the Act, prescribing all matters that are required or permitted by the Act to be prescribed, or are necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Section 3A of the Act provides that the regulations may specify insurance contracts that are not considered to be insurance business.

Item 7 of the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007* (the DMF/DOFI Act) is a transitional provision that provides that regulations may specify entities, or classes of entities, that item 6 of the DMF/DOFI Act does not apply.

The Regulations relate to the regulation of direct offshore foreign insurers (DOFIs) and are consequential to the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007* (the DMF/DOFI Act), with the relevant provisions in Schedule 2 of the DMF/DOFI Act commencing on 1 July 2008.

DOFIs are foreign general insurers currently offering general insurance products to Australians without being authorised in Australia because they are not considered to be 'carrying on insurance business in Australia' under the *Insurance Act 1973*.

The DMF/DOFI Act requires DOFIs operating in the Australian general insurance market to be authorised insurers and subject to Australia's prudential regime. It will be an offence for a DOFI to carry on insurance business in Australia without being authorised and for an Australian Financial Services Licence (AFSL) holder to deal in general insurance products that are not issued by an authorised insurer or a Lloyd's underwriter, unless an exemption applies.

The DMF/DOFI Act provides for a limited exemption to enable insurance business that cannot be appropriately placed in Australia to be supplied by a DOFI. The purpose of the Regulations is to set out these exemptions.

The Regulations have been the subject of extensive consultation with a range of stakeholders. In 2003, the *Review of Discretionary Mutual Funds and Direct Offshore Foreign Insurers* (the Potts Review) was conducted. After further consultation, a Treasury discussion paper was released in 2005 seeking stakeholders views on how to implement the review's recommendations. Treasury conducted ongoing consultation with industry in the development of the DMF/DOFI Act.

Following passage of the DMF/DOFI Act, a discussion paper *Regulation of Direct Offshore Foreign Insurers – Exemption Discussion Pape*r, which outlined the proposed exemption arrangements, was released by Treasury for public consultation. Over 30 submissions were received from a range of stakeholders, including Australian insurers, offshore insurers, insurance brokers and Australian insureds.

The Regulations specify that the following circumstances are not insurance business:

- a contract of insurance with a high-value insured;
- a contract of insurance for an atypical risk;
- a contract of insurance for other risks that cannot be reasonably placed in Australia; and
- a contract of insurance required by a foreign law.

This means that the Act will not apply to those contracts of insurance and that the insurance business can be placed with an offshore insurer without that insurer needing to be authorised in Australia.

The Regulations will not ordinarily allow retail general insurance business to flow offshore as it will not normally meet the criteria of the customised exemption.

Details of the Regulations are set out in the Attachment.

The Act specifies no conditions that need to be satisfied before the power to make the Regulations may be exercised.

The Regulations are a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulations commence on 1 July 2008, to coincide with the commencement of Schedule 2 of the DMF/DOFI Act.

Authority: Section 132 of the *Insurance Act 1973* and Item 7 of the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*

**ATTACHMENT**

**Details of the *Insurance Amendment Regulations 2008 (No. 1)***

Regulation 1 – Name of Regulations

This regulation provides that the title of the Regulations is the *Insurance Amendment Regulations 2008 (No. 1)*

Regulation 2 – Commencement

This regulation provides for the Regulations to commence on 1 July 2008, to coincide with the commencement of Schedule 2 of the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*.

Regulation 3 – Amendment of *Insurance Regulations 2002*

This regulation provides that the *Insurance Regulations 2002* (the Principal Regulations) are amended as set out in Schedule 1.

Schedule 1 – Amendments

**Items [1] and [6] – Headings**

These items insert Part Headings into the Principal Regulations to aid in navigating the regulations.

**Items [2] and [3] – Definitions**

Item 2 amends the heading of regulation 4 from 'Definition' to 'Definitions'. Item 3 inserts the definition of an 'unauthorised foreign insurer' to which the exemptions will apply. An '**unauthorised foreign insurer**' (UFI), is an offshore insurer:

- which was not, or was not required to be, authorised under the Insurance Act before 1 July 2008; and
- to which sections 9 and 10 do not otherwise apply; and
- which has not, or an associated entity of which has not, applied for authorisation and is not the subject of transitional relief under regulation 12.

**Item [4] – Part 2 (Regulations 4A to 4E)**

This Part specifies the insurance contracts that are not insurance business for the purposes of section 3A of the *Insurance Act 1973*.

*Regulation 4A*
This regulation limits the application of the exemptions set out in Part 2 to contracts of insurance with an 'unauthorised foreign insurer', that is, an UFI. This will prevent unauthorised insurers based in Australia from writing business in Australia under the exemptions.

*Regulation 4B*
This regulation exempts an unauthorised foreign insurer writing insurance contracts with a high-value insured from the prohibitions set out in the Act and the *Corporations Act 2001*. If at least one of the policyholders on the insurance contract meets the definition of high-value insured, the insurance business can then be placed with an UFI without the UFI or Australian Financial Services Licence (AFSL) holder being in breach of the prohibitions.

'**High-value insured**' is defined to be a policyholder who, either alone or as part of a related group, has:
- operating revenue derived in Australia of $200 million or more; or
- gross assets in Australia of $200 million or more; or
- employees in Australia of 500 or more.

For the purposes of this regulation:

'**policyholder**' is a person that has or proposes to have a contract of insurance with an UFI; and

'**related group**' means a partnership or two or more associated entities within the meaning of section 50AAA of the Corporations Act.

This means that only the revenue, assets or employees of a policyholder, and not any beneficiaries, will be included in determining whether an entity is a high-value insured. For example, where a policy is bought by a corporation but specifies a joint venture partner as a beneficiary, only the revenue, assets or employees of the corporation will be considered. If the corporation is a high-value insured then the contract is exempt and the beneficiary will be covered even if the beneficiary itself is not a high-value insured. In the case of a trust, the trustee is the policyholder and if, for example, the assets held on trust by the trustee exceed $200 million then the trustee will be a high-value insured.

The thresholds are calculated by averaging the revenue, assets or employees at the end of each of the previous three financial years. The policyholder and/or their AFSL holding intermediary will self-assess against these thresholds.

The high-value insured exemption will allow Australia's largest businesses and global companies headquartered in Australia to use UFIs as part of their risk management frameworks and to cover their global risks. It recognises that high-value insureds are likely to be sophisticated purchasers of general insurance with complex risks that may not be able to be covered solely through authorised insurers.

*Regulation 4C*
This regulation exempts an unauthorised foreign insurer writing contracts of insurance for atypical risks from the prohibitions in the Act and the Corporations Act. If the insured is seeking a policy that corresponds to one of these lines of insurance, the business could then be placed with an UFI without the UFI or AFSL holder being in breach of the prohibitions.

The policyholder and/or their AFSL holding intermediary will self-assess against the list of atypical risks.

**Atypical risks** are defined to be:

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| Nuclear | loss or liability arising from the hazardous properties (including radioactive, toxic or explosive properties) of nuclear fuel, nuclear material or nuclear waste |
| Biological | loss or liability arising from the hazardous properties of biological material or biological waste |
| War | loss or liability arising from war or warlike activities (within the meaning given by subregulation 2(1) of the *Insurance Contracts Regulations 1985*) |
| Terrorism | loss or liability arising from a terrorist act (within the meaning given by section 5 of the *Terrorism Insurance Act 2003*) |
| Medical clinical trials | liability arising from health-care related research |
| Space | loss of, or liability arising from the operation of, a space object (within the meaning given by section 8 of the *Space Activities Act 1998*) |
| Aviation liability | liability arising from the ownership or operation of an aircraft (but not loss of the aircraft or its cargo) |
| Protection & indemnity for ships other than for pleasurecraft | liability and expenses arising from a person owning, chartering, managing, operating or being in possession of a vessel other than a pleasure craft (within the meaning given by subsection 9A(2) of the *Insurance Contracts Act 1984*) |
| Equine other than equestrian packages | loss or liability arising from equine mortality or fertility and related risks<br><br>An equestrian package is an insurance policy that covers risks such as personal injuries and veterinary fees associated with the ownership or use of a horse, and loss of or damage to saddlery, tack and horse floats. |
| Incidental cover | loss or liability incidental to other atypical risks set out in paragraphs (a) to (i) inclusive.<br><br>An incidental risk being covered by the contract must be of lesser importance than, and covered in conjunction with, the other atypical risks. |

This regulation recognises that there are a number of limited specific atypical insurance risks that currently cannot be placed, on a stand-alone basis, with authorised insurers. Some risks are offered in a global market by a very limited number of global insurers. For other risks, while there may be limited cover available, there may not be

sufficient capacity to satisfy local demand or the cover may only be available if bundled with other risks.

Subregulation (3) applies the exemption to a contract of insurance only to the extent that the contract deals with an atypical risk.

*Regulation 4D*
This regulation exempts contracts of insurance for other risks that cannot reasonably be placed in Australia from the prohibitions set out in the Act and Corporations Act.

An assessment will be made in writing by an insurance broker to determine if a specific risk cannot reasonably be placed with an authorised insurer. If the insurance broker is satisfied that the risk cannot reasonably be placed with an authorised insurer, the business could then be placed with an UFI without the UFI or AFSL holder being in breach of the prohibitions.

The insurance broker, in making their assessment, must be satisfied that:
- there is no Australian insurer that will insure against the risk; or
- the terms (including price) on which any Australian insurer will insure against the risk are substantially less favourable to the insured than the terms on which the unauthorised foreign insurer will insure against the risk; or
- there are other circumstances that mean that insurance with an Australian insurer is substantially less favourable to the insured than with the unauthorised foreign insurer.

The insurance broker's determination needs to be reasonable and be based on a reasonable level of investigation and market analysis.

The insurance broker must also keep written records of its inquiries, its decision and reasons for its decision. If asked by an insured, the broker must provide the insured with a copy of the certificate which certifies that the insurance broker has made an assessment that the risk cannot reasonably be placed in Australia. This will allow an insured to use another intermediary, for example, an insurance agent, to place their business with an UFI without breaching the prohibitions. The certificate from the insurance broker is required because only an insurance broker can make an assessment under the regulation.

Assessment of the exemption will be made at the time an AFSL holder deals in an insurance product, for example, when an AFSL holder arranges to acquire the product for the client.

An '**insurance broker**' is defined to be a person who holds an AFSL who is permitted under section 923B of the Corporations Act to use the expression 'insurance broker' or 'general insurance broker'.

This regulation recognises that there will be a further range of circumstances where a business or consumer has a unique risk that cannot be placed with an authorised insurer or with an UFI under the previous two limbs of the exemption (that is, high-value insured and atypical risk). This may include where an authorised insurer does not offer the necessary terms and conditions to cover a particular risk or where the capacity of the Australian market in a particular line has been exhausted (for example,

for environmental impairment) or where there are benefits that accrue to an insured through a longstanding on-going relationship with an insurer.

*Regulation 4E*
This regulation exempts arrangements with an UFI that are required by the law of a foreign jurisdiction from the prohibitions set out in the Act. For example, an Australian business operating in Country A that is required by the law of Country A to take out workers' compensation insurance with an insurer authorised in Country A will be able to place this business with the UFI in Country A without the UFI or an AFSL holder being in breach of the prohibitions.

**Item [5] – Regulation 7**
This regulation replaces the current regulation 7 to redraft the provision into two paragraphs. This will clarify that a body corporate who has applied for authorisation must advise APRA of the date when it commences carrying on insurance, if it commences carrying on insurance business in Australia at some point after APRA has issued its authorisation. An authorised insurer must also tell APRA the date on which it ceases to carry on insurance business in Australia.

**Item [7] –Regulation 12**
This regulation sets out transitional arrangements that will apply to an UFI, or an associated entity of the UFI, that has applied for authorisation from APRA before 1 July 2008 but has not received this authorisation or had the authorisation denied by 1 July 2008.

This will mean that an UFI subject to transitional arrangements will not be in breach of the prohibitions and an AFSL holder that deals with an UFI subject to the transitional arrangements will not be in breach of the prohibitions.

This regulation is made under item 7 of the *Financial Sector Legislation Amendment (Discretionary Mutual Funds and Direct Offshore Foreign Insurers) Act 2007*.

**Item [8] – Schedule 2**
This item prescribes classes of insurance to which the Insurance Act does not apply under paragraph 5(2)(c) of the Act.

*Item 4 of Schedule 2*
This item prescribes insurance business carried on by an unauthorised foreign insurer that relates to a contract of insurance entered into before 1 July 2008, which has not been renewed or extended and the terms of which have not been varied on or after 1 July 2008.

This means that an UFI who is only carrying on run-off business in Australia after 1 July 2008 does not need to be authorised to undertake such activities. An AFSL holder who undertakes activities in relation to this business would also not be in breach of the prohibition in the Corporations Act as they would not be dealing in an insurance product.

*Item 5 of Schedule 2*
This item prescribes insurance business carried on by an UFI that is an entity specified in proposed subregulation 12(1), that relates to a contract of insurance that was entered into while the UFI is subject to the transitional arrangements in regulation 12 and where the contract has not been renewed or extended or the terms of the contract varied before the end of the appropriate transition period.

This means that, if the UFI does not become authorised, undertaking run-off business of insurance contracts entered into while subject to the transitional arrangements is not insurance business and the UFI is not in breach of the Insurance Act. An AFSL holder who undertakes activities in relation to this business would also not be in breach of the prohibition in the Corporations Act as they would not be dealing in an insurance product.