



APRA statement on direct offshore foreign insurers (DOFIs) and discretionary mutual funds (DMFs)

Background

The Minister for Revenue and Assistant Treasurer announced on 3 May 2007 a package of measures to enhance the integrity of the general insurance market in Australia. The Minister's announcement has implications for the insurance industry and for buyers of insurance, and also for APRA and its prudential supervision of the insurance industry in Australia.

Authorising DOFIs

The Minister announced that DOFIs will become subject to prudential regulation, through amendments to the *Insurance Act 1973* (Insurance Act) that will extend the definition of 'carrying on insurance'. The Government intends that anyone carrying on insurance business in Australia, either directly or through the actions of another, must become an authorised insurer. As a result, the Insurance Act will apply to DOFIs, including 'captives', foreign insurers and foreign reinsurers operating in Australia as APRA-authorized branches or subsidiaries, domestic insurers and domestic reinsurers.

The effect of these amendments is that DOFIs will need to become authorised by APRA to carry on business in Australia.

APRA's existing enforcement powers will be enhanced to enable investigation of breaches. Persons who breach the requirement to be authorised will be liable to prosecution.

Limited exemptions will apply to enable Australia's largest businesses and those unable to obtain appropriate cover domestically to retain access to international insurance markets. Exemptions will also be available for specialised risks that cannot be underwritten in Australia. The prudential requirements for Lloyd's underwriters will not change.

The Government also intends that offshore foreign reinsurers will not be required to be authorised in Australia. They may, however, be indirectly affected by the regulatory regime through amendments to the prudential standards that apply to insurers.

Modified prudential framework

To complement these changes, APRA will modify its prudential framework to ensure that there is clear recognition in prudential standards of different types of insurers. APRA has been developing proposals to enhance its current risk-oriented approach to prudential supervision of authorised insurers under principles-based prudential standards. The likelihood of new applications for authorisation flowing from the Government's policy on DOFIs, together with submissions on APRA's February 2005 paper relating to the regulation of captive insurers, requires APRA to proceed quickly with enhancements to the prudential framework for insurers.

APRA will refine its prudential standards so that categories of insurers with lower risk profiles will experience less extensive prudential requirements. Insurers may have different risk profiles arising from factors such as customer base, home regulatory environment, ownership structure, reinsurance arrangements and type of business offered. Matters such as these are already considered by APRA in its prudential approach but the refinements will result in an extension of this process and greater transparency.

APRA's modified prudential framework will recognise, for example, differences between 'open market insurers' at one end of the spectrum, who offer cover to the wider consumer and business communities, and 'captive insurers' at the other end of the spectrum, who insure only the risks of their own corporate parent company or corporate group.

APRA will review in particular its prudential standards relating to capital requirements, including recognition of reinsurance, reporting requirements and some aspects of risk management. As a result, some insurers including DOFIs will benefit by APRA's prudential requirements and supervisory activities being more suited to their own circumstances without prejudicing the protection of policyholders.

One of the options for DOFIs that wish to become authorised will be to establish a branch operation in Australia. Requirements for branches are already addressed in the prudential standards and are less stringent in some respects than for companies. For example, currently branches can be authorised to operate with lower capital requirements and less extensive governance requirements than companies.

DMFs and data collection

In addition, the Minister announced that "the Government would subject DMFs to a rigorous and compulsory data collection regime, to better understand their use and operation". DMFs will not be subject to prudential regulation at this stage but will be required to provide data to APRA. This will enable a review of DMFs to be undertaken within three years from the start of the data collection regime to determine whether they warrant prudential regulation. Data will be collected from DMFs through a revision to the *Financial Sector (Collection of Data) Act 2001*.

The next stage

The amending legislation is expected to be passed in 2007 and the changes to the Insurance Act are intended to have effect from 1 July 2008. APRA realises that DOFIs and others in the insurance industry will wish to have certainty as soon as possible about the prudential framework that will then apply.

APRA proposes to publish a discussion paper on its prudential approach in the second quarter of 2007 with a second round of consultation on draft prudential standards in the fourth quarter of 2007. The final prudential standards are intended to be in place by early 2008. This is acknowledged to be a tight but necessary timeframe for the development of these standards.

APRA will also undertake a consultation process during 2007 on the specification and management of data to be collected from DMFs, with a view to commencing the collection of data in 2008.