

EXPLANATORY STATEMENT

Select Legislative Instrument 2009 No. 297

Issued by authority of the Minister for Financial Services, Superannuation and
Corporate Law

Insurance Act 1973

Insurance Amendment Regulations 2009 (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 which by the Act are required or permitted to be prescribed, or which are necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The Act regulates insurance in Australia and was amended by the *Financial System Legislation Amendment (Financial Claims Scheme and Other Measures) Act 2008* (the Amendment Act) which put in place the Financial Claims Scheme (FCS).

In relation to banking, the FCS provides a formal, targeted and efficient arrangement to ensure that depositors have timely access to their funds in the event of the failure of an authorised deposit-taking institution. It supplements the longstanding depositor preference arrangements that give depositors a priority claim to assets over all other creditors in liquidation, but under which (in the absence of the FCS) it could take many months or years before depositors receive any funds.

In relation to insurance, the FCS arrangements will facilitate the expedited payment of valid claims for eligible general insurance policyholders. This will mean that, if an institution fails, policyholders (or certain third parties) will continue to receive payment for claims equivalent to the value of their claims less any excess or deductible amounts. Policyholders will also retain 'notional' insurance coverage for a 28 day period to enable them to find an alternative insurer. The Australian Prudential Regulation Authority (APRA) is the administrator of the FCS.

The *Insurance Amendment Regulations 2008 (No. 2)* (the Amendment Regulations) amended the *Insurance Regulations 2002* (the Principal Regulations) to facilitate the practical aspects of the FCS in the event that a general insurer fails. The Amendment Regulations addressed a number of issues, including which insurance policies would not be protected by the FCS, eligibility criteria for policyholders and third parties, and recovery of monies by the APRA in the event of erroneous overpayments to claimants.

The Regulations amend the Principal Regulations to ensure that the FCS, in relation to insurance, would operate in accordance with the Government's policy intent and enable effective cost recovery.

The Regulations address three issues. The first clarifies that the FCS would not cover the policy liabilities that were issued by a foreign general insurer's Australian branch, if the liability was issued before the branch received authorisation under section 12 of the Act to operate as a general insurer in the Australian market. The second amends the period during which a policyholder with a protected policy must make a claim under cover of that policy in order to be eligible for financial assistance from the FCS. The third clarifies that the general insurer retains the ability to recover payment under the reinsurance arrangements or seek equitable contribution where the policyholder has double insurance, that is, two insurance contracts covering an event or risk.

Details of the Regulations are included 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 relating to pre-authorisation liability and the period for making an eligible claim are taken to have commenced on 15 October 2009. The retrospective commencement of these regulations does not contravene subsection 12(2) of the *Legislative Instruments Act 2003*. The Regulation relating to the general insurer's ability to recover reinsurance or seek equitable contribution commence on the day after the Regulations are registered on the Federal Register of Legislative Instruments.

The Government has consulted the Australian Prudential Regulation Authority in making these regulations.

Authority: Section 132 of the *Insurance Act 1973*

ATTACHMENT

Details of the *Insurance Amendment Regulations 2009 (No. 1)*

Regulation 1 – Name of the Regulations

This regulation provides that the title of the Regulations is the *Insurance Amendment Regulations 2009 (No. 1)*.

Regulations 2 – Commencement

This regulation provides that Schedule 1 to the Regulations is taken to have commenced on 15 October 2009.

The Minister for Financial Services, Superannuation and Corporate Law (the Minister) declared that the FCS Policyholder Compensation Facility applies to a general insurer, Australian Family Assurance Limited, on Thursday 15 October 2009. This general insurer has 18 known outstanding claims.

The amendments made by Schedule 1 to the Regulations affect the known outstanding claimants of Australian Family Assurance and ensure that they may receive assistance under the FCS Policyholder Compensation Facility. As such, it is necessary for these Regulations to be taken to have commenced on the date of the Minister's declaration of 15 October 2009. This is a retrospective commencement.

This regulation also provides that Schedule 2 to the Regulations commence on the day after the Regulations are registered on the Federal Register of Legislative Instruments.

Regulation 3 – Amendment of the *Insurance Regulations 2002*

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

Regulation 4 – Amendment of the *Insurance Regulations 2002*

This regulation provides that the Principal Regulations are amended as set out in Schedule 2.

Schedule 1 – Amendments taken to have commenced on 15 October 2009

Item [1] – Pre-authorisation liabilities of a foreign general insurer

Item 1 amends paragraph 7B(b) of the Principal Regulations to limit the type of policy that is not a 'protected policy', that is, cannot be eligible for financial assistance under the FCS.

This paragraph specified that any 'pre-authorisation liability' cannot be a protected policy. However, only the 'pre-authorisation liability' of a foreign general insurer should be excluded from the meaning of a protected policy.

A pre-authorisation liability is defined as a liability that was taken on by a general insurer before it became authorised to conduct general insurance business under section 12 of the Act.

However, different prudential supervision arrangements apply to the pre-authorisation liability of a foreign general insurer's Australian branch and those of an Australian general insurer or a foreign general insurer's Australian subsidiary (together, Australian-established general insurers).

An Australian-established general insurer is required to maintain assets in Australia that exceed its liabilities in Australia. In comparison, a foreign general insurer's Australian branch is required to maintain assets in Australia that exceed its liabilities in Australia, excluding pre-authorisation liabilities. That is, a foreign general insurer's Australian branch is not required to maintain assets to meet its pre-authorisation liabilities.

In accordance with the different treatment of the Australian branches' pre-authorisation liabilities, the FCS is not intended to apply to these liabilities. The FCS is intended to apply to all the liabilities of an Australian-established general insurer, whether the liability was acquired before or after its authorisation under section 12 of the Act.

This item replaces paragraph 7B(b) of the Principal Regulations with a new paragraph 7B(b) to specify that the pre-authorisation liability of a foreign general insurer's Australian branch is not a 'protected policy'.

Item [2] – Period for making claim

Item 2 replaces regulation 7C of the Principal Regulations with a new regulation 7C.

Subparagraphs 62ZZF(1)(b)(i) and 62ZZF(1)(b)(ii) of the Act enable regulations to be made to prescribe the date at which an eligible claimant can lodge a claim under the cover of their protected policies so as to be eligible for payment of their claims under the FCS, and the date at which no further claims under the cover can be made.

This enables the Principal Regulations to set a predetermined period during which policyholders can make a claim under their insurance cover such that their claims can be paid by the FCS. However, under the current subregulation 7C(1), policyholders are only eligible for assistance from the FCS if they make a claim under their insurance policy after the day on which the Minister makes a declaration in relation to the general insurer. Under the current subregulation 7C(2), the final date at which eligible claimants make claims under their insurance cover, so as to be eligible for assistance under the FCS, is prescribed at 12 months from the date that the Minister made a declaration in relation to the general insurer.

This regulation excluded policyholders that have made a claim under their insurance cover in the period before the Minister's declaration in respect of the FCS, up to the day prior to the Minister's declaration. This outcome would not be consistent with the policy intent.

Item 2 replaces these prescribed dates with more flexible prescribed dates that would enable this class of policyholders to receive payment under the FCS, if they also meet the other eligibility criteria.

The new subregulation 7C(1) prescribes two types of start dates for policyholders that are entitled to make a claim under the cover of a protected insurance policy.

The first type of start date would apply to policyholders that have not yet made a claim under cover of their protected policy before the day on which the Minister makes a declaration in relation to the general insurer. The start date for these policyholders would be the day of the Minister's declaration.

The second type of start date would apply to policyholders that have already made a claim under cover of their protected policy before the day on which the Minister makes a declaration in relation to the general insurer. The start date for these policyholders would be the day on which they made a claim under that cover.

The new subregulation 7C(2) sets the final date at which eligible claimants may make claims under the cover of their protected policies so as to be eligible for assistance under the FCS. This would be the day that occurs 12 months after the day on which the Minister made the declaration that the FCS applies to the general insurer.

In the event that the prescribed period under regulation 7C is an insufficient length of time, APRA has the power under section 62ZZA of the Act to extend the final day for making claims under the cover of a protected policy so as to be eligible for assistance under the FCS.

Schedule 2 – Amendment commencing on the day after registration

Item [1] – Reinsurance, double insurance and coordinate liability

Item [1] inserts a new regulation 7EA into the Principal Regulations to specify that, where the FCS makes a payment to a policyholder in respect of a protected policy, the payment is taken to be made by the general insurer for the purposes of reinsurance arrangements and claiming co-contribution from another insurer, where the policyholder has double insurance.

Subparagraph 62ZZM(2)(b)(ii) of the Act enables regulations to be made to prescribe the purposes for which a payment by the FCS, to meet a policy liability of the declared general insurer, is taken to be a payment made by the general insurer.

The new regulation 7EA prescribes two purposes.

Item 1 in the table in the new regulation 7EA prescribes the purpose recovering of reinsurance by the general insurer. This item ensures that where the general insurer would have been entitled to seek payment under its reinsurance arrangements if it met the policyholder's claim, it would still be entitled to seek reinsurance recoveries where the FCS has met the policyholder's claims.

Item 2 in the table in the new regulation 7EA prescribes the second purpose of claiming contribution by the general insurer in respect of double insurance. Under

the equitable principles governing double insurance, where a policyholder has two policies covering an event or risk and one insurer makes a payment to discharge its liabilities, it is entitled to seek an equitable contribution from the second insurer in respect of the liability.

This item ensures that where the general insurer would have been entitled to seek an equitable contribution from another general insurer if it met the policyholder's claim, it would still be entitled to seek an equitable contribution where the FCS has met the policyholder's claims.