15 May 2015

Australian Services Exports
Productivity Commission
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Insurance Australia Group (IAG) welcomes the opportunity to make a submission in relation to the Productivity Commissions' Issues Paper – Barriers to Service Exports (April 2015).

IAG endorses the content and sentiment of the submission made by the Insurance Council of Australia.

Who is Insurance Australia Group?

IAG is the parent company of a general insurance group with controlled operations in Australia, New Zealand, Thailand and Vietnam, employing more than 15,000 people. Its businesses collect over $11 billion of premium per annum, selling insurance under many leading brands including NRMA Insurance, CGU, SGIO, SGIC, Swann, WFI and Lumley Insurance (Australia); NZI, State, AMI and Lumley Insurance (New Zealand); Safety and NZI (Thailand); and AAA Assurance (Vietnam). IAG also has interests in general insurance joint ventures in Malaysia, India and China.

IAG have established numerous international service linkages and partnerships in South, Southeast, and East Asia. Such linkages and partnerships are likely to remain the dominant mechanism by which IAG exports insurance services.

The more strategically important of these international linkages and partnerships are the insurance affiliates that IAG owns wholly in New Zealand and Thailand and its strategic interests in joint ventures in Vietnam, India, China and Malaysia. These Asian economies are among the fastest growing economies in the world with a rapidly emerging middle class.

To the extent that IAGs' foreign affiliates are successful, they will generate sales of insurance services in their host markets. They will also, however, become a growing destination for the importation of internal services from IAG in Australia.

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Domestic Barriers to Services Exports

APRA treatment of Capital

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 regulation that balances the objective of promoting financial safety with the need to minimise the adverse effects on efficiency, and competition. APRA's consultation in relation to the Review of Capital Standards for General Insurers and Life Insurers (LAGIC) indicated APRA's assessment of IAG's Asian strategy places greater weighting on the associated risk and lower weighting on the economic value of joint venture investments. APRA excludes almost all the economic value of the joint ventures.

APRA's view of joint venture investments is at odds with Australian Government's vision for the growth in the Australian financial services sector and positioning Australia as a leading financial services centre in the Asia Pacific region. Given the current regulatory requirements in the Asia Pacific region generally only allow minority investments as a first step towards ultimate control and ownership, it is likely any expansion will be more financially difficult for Australian insurance companies compared with European or US Counterparts.

Asia Capable Workforce

Asialink's Asia Capable Workplace Taskforce of which IAG is a member in its submission to the Australian Government's Australia in the Asian Century highlighted the need for a long-term, bipartisan strategy to develop an Asia capable workplace as a matter of national priority.

Asialink identified the need for additional development in the area of Asia capabilities. While an Asia capable workplace will ultimately be primarily driven by businesses according to their priorities, the foundation for business action depends on the crucial role of school education, tertiary education and training initiatives. Government policy is therefore an essential part of achieving and accelerating the development of an Asia capable workplace.

A business-driven national strategy to develop an Asia capable workplace, supported by government will enable Australia to remain globally competitive, enhance productivity and social well-being and sustain a strong foundation for a long-term relationship with Asian Countries (Asialink).

Barriers in Australia's Key Trading Countries

Foreign Investment Limits

In Asia, liberalisation and access to foreign capital and capability has been a key driver for growth and development of insurance markets. However, entry barriers and foreign insurance penetration levels vary significantly across markets. In Singapore and HK, the most open and buoyant insurance markets in Asia, foreign insurance companies operate freely. Yet there are still restrictions in some parts of Asia, such as China, mainly in the form of mandatory joint ventures.

Levels of foreign investment are linked with levels of capability deployed. There is a proportional relationship between the incentive to invest capital and capability with the level of ownership permitted, as there is a greater incentive on foreign investors to realise the returns from a business in which it holds a greater stake. Markets with low levels of foreign ownership, such as China, create a protected environment for their local industries, but do not receive the best outcome from their foreign investment strategic partnerships.

India

Proposed Implementation of Insurance Regulatory and Development Authority of India - Registration of Corporate Agent Regulations 2015

IAG believes there are a number of negative impacts that the proposed *Registration of Corporate Agent Regulations 2015,* if implemented, would have on the current and prospective foreign investment in India. Importantly, the benefits that the change in FDI limits was designed to achieve as a result of the proposal may not be realised.

The amendments, as proposed, will require banks to appoint up to three General, Life and Health insurers if they wish to provide insurance products to their customer base. Furthermore, the regulations propose that caps be placed on the banks in terms of the volume of premiums that can be placed with any one insurer, so that after four years a bank cannot place more than 50% of the retail insurance premiums with any one insurer.

The changes proposed will be costly and complicated for the banks to implement and will ultimately work against the Indian Government's stated objective of increasing insurance penetration in India. Under these regulations banks will be required to develop systems, interfaces and processes to deal with multiple insurers. This will act as a disincentive to promote insurance products throughout India, most particularly in the remote rural locations. Bank staff will be required to be conversant with multiple insurance products from multiple insurers thereby significantly increasing the chances of mis-selling. With increased complexity comes increased costs and these costs will ultimately be passed on to customers which will dampen insurance demand due to affordability issues.

IAG believes the capping rules as proposed will curb product innovation in the market place. There will be a significant reluctance on the part of insurers to develop and deploy innovative products and services due to the restrictive nature of the caps. The proposed capping mechanism ultimately restricts the ability for an insurer to grow its book of business and therefore increase insurance penetration, unless the other insurers on the panel of the bank are able to grow and innovate at a similar rate. To a large extent the fate of one insurer would be in the hands of a competitor.

To take this to its conclusion, there will be little incentive for insurers to make significant discretionary investment in products, systems and customer service initiatives when the ability to increase the number of products sold is limited to the ability of other insurers on the panel to achieve the same.

In IAG's view the impact of the proposed regulation on incumbent insurers will also be substantial. As a long term investor in the Indian insurance market, IAG would see the value of its investment in SBI General Insurance reduced appreciably. This has the potential to eliminate the benefits of the recently passed FDI legislation. IAG believes the proposed regulations would act as a deterrent for foreign investors to increase investment in India. Furthermore current and potential foreign investors and their governments may conclude that investments in India carry higher sovereign risk and uncertainty, including the propensity for material and unnecessary changes to be enacted.

In summary the proposed amendments will:

- Increase the cost and complexity for banks in distributing insurance products;
- Disincentivise banks to promote insurance products due to the increased regulatory requirements that will be imposed upon them;
- Result in negative outcomes in terms of product and process innovation and therefore achieve counterproductive outcomes to the government's objective of increasing insurance penetration;
- Create uncertainty and increase risk for current and potential foreign investors in India.
- Negatively impact the carrying value of subsidiary insurance companies in the balance sheets of the banks; and
- Potentially negate the benefits of the recently legislation allowing FDI of up to 49% in the insurance industry.

If you wish to discuss this matter or make further inquiries please contact David Wellfare, Senior Mangier, Public Policy & Industry Affairs

Yours sincerely

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