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16 November 2005

FSAC Secretariat
C/- Financial System Division
Department of the Treasury
Langton Crescent,
PARKES ACT 2600

Dear Sir

QBE response on Financial Sector Regulation

I refer to Mr Newman's letter to the Insurance Council of Australia (ICA) dated 23 September 2005. Further to the response provided to you by the ICA with QBE's input, QBE's response on particular issues affecting QBE is set out at Attachment A.

QBE's business is affected by a broad range of regulation both in Australia and in 40 overseas countries in which it operates. QBE's overseas operations represents $7.5 billion of premium income or 75% of its worldwide business. We welcome the opportunity to assist you in identifying efficiency gains with practical suggestions to improve the operation of financial sector regulation in Australia.

QBE supports regulatory reform that encourages the promotion of a stable and robust financial services industry in Australia. However, QBE is concerned that much of the recent regulation falls well short of achieving that objective and in fact is likely to have the opposite effect by making companies more compliance focussed and therefore risk averse, by significantly increasing costs and encouraging the proliferation of non regulated products in the Australian market place which has significantly increased in the past 2 years.

In its first round of regulatory reforms introduced in 2002, APRA made significant improvements to the prudential supervision of general insurance in Australia. The first significant improvement was to introduce a risk based capital requirement that included a requirement, inter alia, for significant prudential margins to be held by all insurance companies. The regime also introduced standards in respect of risk and reinsurance management. The situation in which HIH found itself prior to its collapse would be extremely unlikely under the prudential requirements proposed by the new regime.

However, since 2002, APRA has proposed a number of changes to the prudential regime that the industry considered to be very prescriptive in nature as well as overlapping with other regulators including ASIC and ASX. It is important to note that, in the past six weeks, APRA appears to have heard the message from industry and others about effective regulation vs over regulation and has moved back from more prescriptive standards to a more principles based approach. Some of the detailed changes are not yet available from APRA and there is still much detail to be worked through, but QBE is encouraged at APRA's apparent change of direction in respect of prudential supervision.

There are a number of areas of concern for QBE and these are set out in our response in Attachment A. Some of these may disappear as a result of APRA's change of direction but are included until the final outcome is clearer. However, there are three issues that I particularly wish to draw to your attention.

The first is the increase in compliance costs for Australian financial services companies in recent years. QBE estimates that it now spends almost $60 million per annum in compliance costs. Further, we have estimated that APRA's recent proposals would add between $7.5 and $10 million to our compliance costs. These costs are ultimately borne by policyholders without any additional benefit to them in terms of increased protection. Even with the recent change of direction signalled by APRA, the proposed changes in respect of actuarial peer review and financial condition reports are likely to increase our compliance costs by $2.5 to $5 million.

The second is APRA's seeming unwillingness to recognise that QBE's general insurance companies in Australia can be effectively ring fenced from the impact of our overseas operations to the extent that APRA could focus its regulation more on the Australian operations of multi national groups. Much of what APRA is currently doing and proposing to do increases its regulation of overseas operations that do not affect Australian policyholders of QBE. Further, these operations are already subject to the requirements of their local regulators and much of what APRA is doing is pure duplication. In this regard, I include at Attachment B, C and L APRA's detailed agendas for overseas visits to the UK (in May 2004) and the US (proposed for June 2006). QBE received reports from APRA following the visits in 2004, which raised no major concerns, copies of which are available to FSAC upon request. APRA's proposed reforms would place even more onerous requirements on our overseas operations, in addition to the local regulation with which they must already comply.

The third item relates to Treasury's failure to date to implement the recommendations of the HIH Royal Commission in respect of state and territory regulation, taxation of the general insurance industry and a policyholder support scheme (recommendations 49 to 61). These items, and particularly recommendations 40 to 60, would go a long way to achieving a level playing field and alleviating some of the regulatory burden on Australian general insurers.

These last two items are of such significant concern to QBE that, if we cannot agree on a more sensible level of prudential supervision that still achieves the government's, APRA's and QBE's objectives, our board will have to consider moving QBE's domicile offshore.

Finally, although Attachment A touches on QBE's main areas of concern, there are other matters we have raised with APRA and Treasury and these are included as Attachments B – L as set out below.

Description of correspondence:

- APRA's draft agenda dated 27 April 2004 for prudential consultation with QBE's European Company Operations (Attachment B)
- APRA's draft agenda dated 27 April 2004 for prudential consultation with Limit Underwriting Limited (Attachment C)
- Letter from QBE to the Federal Treasurer dated 19 May 2005 in relation to Direct Offshore Foreign Insurers and the recommendations contained in the Pott's Review (Attachment D)
- Letter of reply from the Minister for Revenue and Assistant Treasurer, The Hon Mal Brough dated 11 July 2005 in relation to QBE's letter to the Federal Treasurer dated 19 May 2005 (Attachment E)
- Letter from QBE to Mr G Brunner, General Manager Policy, Research and Statistics, APRA dated 29 July 2005 attaching QBE's responses to APRA's Stage 2 reforms on:

    - Risk and Financial Management (released 3 May 2005); and
    - Governance (released 16 May 2005) (Attachment F)
- Letter from John Cloney, QBE Group Chairman to Dr John Laker, APRA Chairman dated 24 August 2005 in relation to the Proposed APRA Prudential Standards and Guidance Notes for General Insurers (Attachment G). **This document is confidential and marked "Commercial in Confidence"**.
- Letter from QBE to Senator Grant Chapman, Chairman, Parliamentary Joint Committee of Corporations and Financial Services dated 29 September 2005 in relation to APRA's stage 2 reforms (Attachment H)
- Letter from QBE to Mr G Brunner, General Manager Policy, Research and Statistics, APRA dated 19 October 2005 in relation to APRA's prudential approach to adoption of IFRS –2 – Tier 1 Capital and Securitisation released 31 August 2005 (Attachment I)
- Letter from QBE to Mr S Somogyi, APRA Commissioner dated 24 October 2005 attaching QBE's response to APRA's stage 2 reforms on Prudential supervision of corporate groups involving authorised general insurers (Attachment J)
- Letter of reply from Senator Grant Chapman dated 25 October 2005 to QBE's letter of 29 September 2005 (Attachment K)
- APRA's draft agenda dated 9 November 2005 for prudential consultation with QBE's America's Operations in June 2006 (Attachment L)

QBE would be pleased to assist with any further information you may require. If you have any questions or need further information, please call me or Gayle Tollifson or (02) 9375 4102.

Yours faithfully

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cc Gayle Tollifson

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QUESTION 1.

What particular aspects of the existing financial sector regulation present the greatest challenge for your industry grouping or business (please note where challenges are transitional)? what impact does this have on the efficiency of your business and the financial sector as a whole?

1.1 Volume of regulation

QBE is concerned with the volume of new and, in some respects, poorly constructed regulation introduced in recent years.

While much of our discussion throughout this submission will refer to APRA, our prudential regulator and whose prudential standards have a significant impact on our day to day operations, many of the issues discussed can be applied to QBE's other Australian regulators.

Within the past 5 years, QBE has allocated significant human and financial resources to comply with the introduction of GST, amendments to the Privacy Legislation, the Financial Services Reform Act, and ongoing reforms from APRA in the form of new and revised prudential standards. Ultimately these costs are passed on to policyholders

Some reform appears to be ill-considered and merely additive to existing legislation and practice, with little or no consumer testing to establish whether it is required and/or effective. For example, APRA's corporate governance proposals repeat many concepts already in CLERP 9 and the ASX Corporate Governance Council's recommendations.

As a result of the continued focus on complying with new regulations, QBE is hindered from making improvements which would benefit its policyholders. For example, a review and restructure of our policy wordings would assist policyholders to better understand the terms and conditions of their insurance cover, but we have not had the additional resources to carry out such a review.

1.2 Level of prescription

QBE is concerned at the level of prescription contained in current regulation and the apparent lack of flexibility and/or discretion on the part of some regulators to alter their approach depending on the risk a company poses. As discussed below, we believe the focus of regulators should be to provide principles based, as opposed to prescription based regulation.

In particular, QBE is concerned at the level of prescription that would be imposed on licensed insurance companies by APRA's recent draft prudential standards and guidance notes relating to risk and financial management, governance, requirements and the supervision of corporate groups involving authorised general insurers.

These draft documents and their accompanying discussion papers contain an unreasonable level of prescription, and apply broadly across corporate groups, placing APRA in a pseudo-management role.

Examples of over-prescription:

1.2.1 Outsourcing Offshore

Within APRA's draft Prudential Standard on Outsourcing (GPS 221 at paragraphs 13 and 14) and draft Guidance Note (GGN 221.1 at paragraph 33), APRA seeks to introduce a requirement that a licensed insurer "must consult" APRA prior to outsourcing a material activity offshore. This raises a question as to what is meant by the term "must consult" and if an insurer fails to do so, what sanctions would apply?

QBE believes this requirement puts APRA in a management decision making capacity. While QBE acknowledges that there are additional risks to be considered when making a decision to outsource overseas, we do not believe that any such arrangements should require APRA's prior approval.

These paragraphs provide APRA with unnecessary authority to intervene in the management of the business and to alter previously approved board arrangements.

1.2.2 Outsourcing – Risk Management

Further, the Outsourcing Prudential Standard and Guidance Note referred to above also include very specific requirements relating to the risk management framework for outsourcing, the outsourcing agreement and monitoring of outsourced arrangements. (GPS 221, paragraphs 24, 26, 30; GGN 221.1, paragraphs 9, 10, 14-27, 32, 34 & 35). While QBE has no issue with the content of the requirements from a risk management perspective, we believe they are too prescriptive in form.

As discussed below, APRA's prudential standard and guidance note should be principles based in how they require the outsourcing policy and risk management framework to address these areas. Otherwise, specifics which have not been detailed, or those which arise as expectations in this area and expand over time, will fall outside of the requirements. However, two particular areas of concern are APRA's requirement for prior notice of termination of outsourcing contracts and unfettered access to outsourced service providers.

1.2.3 Guidance Notes

The guidance notes provided by APRA are framed as requirements rather than guidance. The outsourcing guidance note GGN221.1 at paragraph 2 states "*these requirements [in the GGN] are imposed to ensure insurers are aware of, and adequately address, the risks which arise from outsourcing material activities*".

As these are guidance notes, they should not be described as requirements, nor be imposed. QBE has suggested to APRA that the wording be amended to: "APRA encourages that best practice be adopted by insurers in relation to the management of outsourcing arrangements to ensure they are aware of and adequately address the risks which arise from outsourcing material activities. The content of this guidance note outlines the practices insurers should apply in order to demonstrate they meet best practice".

While this suggested wording is specific to GGN221.1, we believe it should be adapted to apply to all guidance notes issued by APRA, in order to minimise the impact of the introduction of new regulation to the industry and ensure a smoother transition.

1.2.4 Governance

APRA's discussion paper and draft prudential standards on governance for general insurers (GPS 510) and non-operating holding companies ('NOHC') (GPS 511) create a further set of governance requirements.

While QBE broadly supports the principles and requirements contained in both prudential standards, and acknowledges a softening of APRA's proposed requirements in recent discussions, we are disappointed that APRA has not adopted the 'if not, why not approach' to governance for general insurers where APRA's proposals differ from those of the Corporations Act or the recommendations of the ASX Corporate Governance Council.

1.2.5 Governance – independence of the chair

APRA's proposed reforms (GPS 510 at paragraph 23 and GPS 511 at paragraph 20), are inconsistent with the Corporations Act and recommendations of the ASX Corporate Governance Council. They also seek to impose a restriction on executives of a company becoming the chair of an insurer or NOHC within three years of being employed in an executive position.

These proposals focus entirely on independence without giving any credence to corporate memory or experience. QBE believes insurance boards need successful insurance executives and that in-depth knowledge and expertise, in particular in directing and managing an insurance company, are critical attributes for such directors.

QBE recommends that these requirements be removed from the draft prudential standards. Should APRA continue to insist on restricting the ability of executives becoming the chair, QBE believes the draft standards should at least be made more flexible by providing APRA the discretion to consider and respond to a proposal submitted by the board of an insurer or NOHC requesting to have such an individual as its chair.

QBE also believes this proposal focuses too much on the chair. Different to the US, it is not common in Australia to have an executive chair. A chair in Australia usually does not have a casting vote. A more important safeguard is a majority of independent, non-executive directors.

1.3 Legislating "Best Practice"

With regulators providing detailed levels of prescription as to how to apply their regulations, it appears they are seeking to legislate what they deem to be "best practice". The activities which constitute best practice will differ for each company and will depend upon the circumstances of the relevant company from year to year.

The legislation of the concept of best practice could create problems both for the insurer and the regulator. A prudent insurer may choose not to follow best practice as it does not meet its businesses needs, but then find itself in dispute with the regulator and/or possible breach of regulations leading to sanctions. Conversely, if an insurer was to follow the regulator's best practice and an in insolvency occurred despite following best practice, this would create problems for the regulator.

1.4 General insurance industry too heavily taxed

The general insurance industry is currently one of the highest taxed industries in Australia. Taxation reporting requires corporates to devote a lot of resources including systems, accounting and specialist tax staff. QBE has to manage the following taxes in Australia:-

- Australian Income Tax and CGT
- Stamp Duty
- Superannuation Surcharge/Guarantee
- NSW Insurance Protection Tax
- Fire Services Levy (All States)
- Interest Withholding Tax
- Payroll Tax
- Land Tax
- Goods & Services Tax
- Fringe Benefits Tax
- PAYG Withholding

Some of these taxes have different rules applying in each state and territory, which adds to the complexity. Some taxes like GST and Stamp Duty are a tax on a tax. Either way, significant amounts of resources are devoted by QBE to tax compliance. The same revenue could be collected far more efficiently without the need for the significant resources devoted to this area.

1.5 APRA's Jurisdictional Limits/Application of APRA's prudential standards at 'group' level

QBE is concerned with APRA's attempt to extend its jurisdiction to QBE's overseas subsidiaries which are already regulated by the local regulator in their home country and which do not play any role in the operation of the Australian regulated entities. They do not need to comply with all of APRA's requirements, nor should they. QBE believes that APRA's jurisdiction should be limited to QBE's Australian regulated entities.

QBE believes that as a body established by the powers of the Commonwealth of Australia, APRA's jurisdiction cannot extend beyond Australia.

In sections 5.3 and 5.4 of APRA's discussion paper on the supervision of corporate groups involving authorised general insurers, it states that the following prudential standard and draft prudential standards will in due course be applied at both insurer and group levels:

- GPS 222, business continuity *[5.4]*
- draft GPSs 510 and 511, governance *[5.3]*
- draft GPS 220, risk management *[5.4]*
- draft GPS 221, managing outsourcing arrangements *[5.4*]

More specifically, the:

- board of the head company will have to ensure that adequate policies, systems and controls are in place to monitor compliance with APRA's regulatory requirements on a group-wide basis *[5.4]*;
- requirement for insurers to provide a declaration to APRA in relation to the risk management systems will be extended to apply to the head company of the group *[5.4*]; and

- auditor will be required to report on the effectiveness of group systems to ensure compliance with APRA's prudential requirements on a group basis and any non-compliance *[5.4*].

The declaration under the current prudential standard on risk management requires the boards of licensed insurers to provide an opinion that the insurer has systems in place to ensure compliance with the *Insurance Act 1973*, *Insurance Regulations 1974*, prudential standards, authorisation conditions and directions. If these requirements are extended to apply at a group level, all entities within a consolidated group will need to comply in order for the board to sign such a declaration.

QBE strongly opposes APRA effectively extending the jurisdiction of Australian legislation to entities outside of Australia, particularly for no benefit to Australian policyholders. This is impractical and will result in duplication of the legislative and regulatory requirements being placed on overseas entities.

1.6 Insurance Contracts Act

The *Insurance Contracts Act 1984* has been the subject of two reviews and numerous submissions to Treasury from various interested parties over the past two years, with the final report and the Review Committee's recommendations handed down in June 2004.

To date, Treasury has not released any draft legislation showing how the recommendations are to be incorporated into the Insurance Contracts Act. With almost 18 months having elapsed since the date of the report, QBE is concerned that because of the delays to the Insurance Contracts Act amendments, and the intervening refinements to the Financial Services Reform Act, a clash could occur between the two Acts, resulting in a number of inconsistencies.

For a company the size of QBE, this may prove very costly, particularly if we are required to redesign/reprint Product Disclosure Statements and associated documents. The additional design and printing costs alone, could be in the hundreds of thousands of dollars.

QBE recommends that any proposed amendments to the Insurance Contracts Act be deferred until Treasury is able to ensure that there will not be any overlap or inconsistencies between the Insurance Contracts Act and the refinements to the Financial Services Reform Act.

1.7 Direct Offshore Foreign Insurers (DOFIs)

As detailed in Attachment D, QBE agrees with the option of providing an exemption from prudential regulation for DOFIs marketing insurance in Australia which are domiciled in a country APRA considers to have comparable prudential regulation, such as QBE's subsidiary in London.

However, this is on the basis that those DOFIs writing Australian risks will not only be subject to comparable prudential regulation, including reporting requirements, but also to equivalent taxes on the business written in Australia. Policyholders must pay the total amount, including relevant taxes and not have the competitive advantage of avoiding payment of such taxes.

QBE is concerned about the significant tax advantages enjoyed by DOFIs. As a major Australian insurer and top 20 Australian listed company, QBE is keen to have fair price and other competition, and ensure all insurance policies covering Australian risks, whether insured by an Australian insurer or a DOFI, are subject to the same level of tax enforcement.

While a number of state and federal taxes are imposed on Australian insurance business written offshore by DOFIs, we understand that when compared to business written by Australian resident insurers, there is a disparity in relation to the collection (as opposed to the imposition) of such taxes, both from the DOFI and the insured. These taxes include federal income tax, state stamp duty, fire services levy, GST, withholding tax and the NSW Insurance Protection Tax.

As these tax regimes are strictly enforced on Australian resident insurers, we suggest that DOFIs be required to pay the same taxes as resident insurers, and that a monitoring and audit regime be introduced to ensure that these taxes are collected.

QBE also notes that after 18 months since the Potts recommendations were published, Treasury is yet to provide any draft regulation and/or other legislation to demonstrate how these important issues will be addressed.

QUESTION 2.

What proportion of your firm's administrative processes and resources are devoted to compliance activities that it would not undertake if the regulation did not exist? please distinguish from procedures and activities (eg accurate record keeping) that would likely occur without regulatory stipulation?

2.1 Administrative process allocation

It is difficult to provide exact figures in relation to processes and resources surrounding compliance activities. However, some guidance can be drawn from QBE's implementation costs associated with the full transition to the Financial Services Reform Act prior to July 2004, which totalled $7 million. We also estimate that the continuing compliance costs surrounding FSRA will be $2.5 million per annum. This relates to the ongoing costs of maintaining a large number of authorised representatives, regular updating of product documents and other regulatory amendments.

With the prescriptive and detailed draft prudential standards and other APRA proposals for the general insurance industry, QBE believes that the cost of compliance for our Group will increase by a further $7.5 to $10 million per annum. These increases in compliance costs will ultimately lead to higher costs for policyholders. QBE also believes that there will be a significant overhead for APRA in reviewing the new information being requested from the industry and an increase in the current turnaround time for APRA to provide insurers with the various approvals being proposed.

In addition to the compliance costs mentioned above, QBE is liable for annual APRA levies for its three APRA licensed insurance entities and non-operating holding company. Those levies are $1,002,000 for QBE Insurance (Australia) Limited, $221,388 for QBE Insurance (International) Limited, $221,543 for MMIA Pty Limited and $10,000 for QBE Insurance Group Limited.

QUESTION 3.

Have you identified any of the following features which may impact on the efficiency of financial sector regulation?

(a) Overlaps between regulatory requirements, both in terms of meeting legal and administrative requirements (eg between two or more of the following: APRA, ASIC, ACCC, RBA, ASX, ABS, etc…)

3.1 Corporate Governance

As discussed above, APRA has proposed a series of governance reforms which are prescriptive and do not provide any discretion as to how or when such requirements need to be met by all authorised entities under APRA's jurisdiction.

These proposals overlap (and in some instances conflict) with the requirements of the Corporations Act administered by ASIC and the recommendations of the ASX Corporate Governance Council, thereby creating a further set of governance requirements.

3.2 APRA v Overseas Regulators

As a global organisation with numerous subsidiaries located overseas, QBE is subject to multiple regulatory regimes. It is apparent from APRA's proposed regulatory reforms affecting the general insurance industry that they are seeking to extend their jurisdiction beyond QBE's Australian authorised entities to its subsidiaries located overseas.

If this were to occur, it would create an overlap for QBE by forcing us to comply with APRA's requirements both locally and overseas, whilst also having to meet the requirements of the local overseas regulator. This is an untenable scenario due to the significant costs of complying with two sets of overlapping, but different regulations in different jurisdictions and again, with no benefit to Australian policyholders.

As mentioned above, QBE strongly opposes APRA extending the jurisdiction of Australian legislation to entities outside of Australia.

3.3 Privacy – Federal v State

Due to the large amount of personal information QBE collects, it can be subject to requests for information or complaints lodged by policyholders and/or other interested parties under both federal and state Privacy legislation.

While the intention of the Privacy Act 1998 was to have a single overriding Federal Act to protect individual's privacy, various state governments have now started to proclaim other Acts relating to privacy of health and/or employee records. This has introduced a further layer of regulation which QBE believes is unnecessary.

Given the extensive amendments to the Federal Privacy Act in 2001, QBE supports the concept of a single Act, the principles of which can be followed by all organisations irrespective of the types of records to be kept. Therefore, QBE believes the Federal Privacy Act 1988 should be the prevailing legislation relating to all privacy issues in Australia.

(b) Inconsistencies between regulatory requirements.

3.4 Corporate Governance (b)

Please refer to our comments above in sections 1.2.4, 1.2.5 and 3.1.

In addition to those comments, QBE wishes to highlight the inconsistency which exists between the CEO and CFO declarations relating to the company's financial statements, under the ASX Corporate Governance Council recommendations and those required under the CLERP 9 changes to the Corporations Act.

Recommendation 4.1 of the ASX Corporate Governance Council Guidelines recommends that the CEO and CFO state in writing to the board that the company's financial reports present a true and fair view, in all material respects of the company's financial condition and operational results and are in accordance with relevant accounting standard. If QBE chooses not to prepare the declarations, it must explain why under the 'if not, why not' scenario.

CLERP 9 requires each of the CEO and CFO of listed companies to make a written declaration to the board of directors that, in the person's opinion, the annual financial statements are in accordance with the Corporations Act and accounting standards, the statements present a true and fair view of the company's financial position, and the financial records have been kept in accordance with the Corporations Act.

While the Corporations Act does override the ASX Council Guidelines, this inconsistency and overlap means that as part of the preparation of QBE's 2005 Annual Report (for the financial year ending 31 December 2005), QBE will be required to prepare two CEO and CFO declarations for essentially the same purpose.

Recent discussion with APRA suggests a softening stance of this issue, however, the amended draft standards have not been provided to enable agreement and acceptance of the amendments.

3.5 Termination Benefits – ASX Listing Rule 10.18

Listing Rule 10.18 prohibits termination benefits that may payable to an officer of a listed company or its subsidiary in the event of a change in the shareholding or control of the company or its subsidiary.

In the proposed amendments to the Listing Rules, ASX stated that it would delete 10.18 on the basis that this is not a matter for the Listing Rules as takeover matters are dealt with in Chapter 6 of the Corporations Act. However, on 12 October 2005, ASX advised that Listing Rule 10.18 will not be deleted and will remain in force. QBE supported the original decision by ASX to delete 10.18 in order to avoid the inconsistency and overlap between Listing Rule 10.18 and Chapter 6 of the Corporations Act.

3.6 APRA's approach to supervision of corporate groups

QBE agrees with the principle of 'ring fencing' and the need for Australian insurers and Non-Operating Holding Companies (NOHC) to be able to demonstrate that contagion risk from related entities is being appropriately managed. QBE also agrees with the need to demonstrate that the "overall group is financially sound" through meeting APRA's capital adequacy requirements at a group level.

However, APRA's approach to regulating corporate groups is inconsistent. The "ring fencing" mechanisms that are being offered to commercial groups and financial services groups that include general insurance companies are not being made available to homogenous general insurance groups like QBE, for which approximately 75% of our operations are overseas. This is not rational, it discriminates against QBE relative to most of its peers in the Australian general insurance industry and puts QBE at a competitive disadvantage in Australia and overseas due to the increased cost of compliance for no benefit to Australian policyholders.

APRA's proposals, if applied to international corporate groups like QBE, would result in a significant amount of regulatory duplication with the requirements of overseas regulators as well as possible conflicting requirements. QBE believes this approach is unwarranted particularly as, under the conditions of the NOHC licence, APRA can direct the QBE Group board to direct QBE entities overseas.

QBE believes that effective ring fencing of Australian regulated entities can be achieved and that this would be preferable to the current alternative. We would be happy to assist APRA to investigate potential solutions. At a minimum, further analysis is required to determine the level within a corporate group that prudential requirements can be best applied in addressing related risks.

(c) Regulation that is out-of-date due to industry trends

QBE has not identified any regulation which it considers to be out of date.

Within this submission, QBE has focussed on regulations that we consider require amendment or deletion. The issue being relevance and appropriateness.

(d) Regulation that is hindering the introduction of new products, working against industry developments or creating inappropriate barriers to entry.

3.7 Regulatory Fatigue

While QBE acknowledges that APRA has attempted to be less prescriptive in some recent drafts of it proposals, QBE is still concerned at the level of information the industry will have to provide (for little or no obvious policyholder benefit) and believes that in order to keep compliance costs to a reasonable level, APRA must consider ways in which such requirements can be limited.

The regulatory overload and changes have changed the general insurance industry in many ways. Outcomes of recent changes have evidenced the reduction and the number of participating general insurers. It could be argued that by default, the current regulatory practices have encouraged and facilitated the continued development and expansion of DOFIs in Australia.

QBE is concerned that a number of requirements in the draft prudential standards infringe upon an insurer's power to manage its own business. For example, APRA must be advised prior to terminating an outsourcing arrangement. QBE respects APRA's right to place such requirements on an insurer on an exception basis where deemed necessary, but considers that subjecting all insurers to this requirement on an ongoing basis is unnecessary. QBE believes that APRA must be conscious not to over involve itself in the day to day running of insurers' businesses.

Through effective use of its risk based supervisory evaluation tool 'PAIRS' together with the risk based capital approach introduced by APRA in 2002, QBE believes APRA should have sufficient comfort that companies are being well and prudently managed. If they are not, 'PAIRS' can be used by APRA to determine where the introduction of more stringent requirements for such companies is necessary. Due to ongoing regulatory reform, QBE, and we believe other insurers, are unable to devote appropriate time and resources to properly consider the impact and/or merits of such reform, and how best to implement those changes. It is generally the case that resources are devoted to simply complying with the requirements in order to meet regulatory timeframes.

As a result of the continued focus on complying with new regulations, QBE is hindered from making improvements which would benefit its policyholders, such as restructuring policy wordings to assist policyholders to better understand the terms and conditions of their insurance cover. Therefore, we recommend that APRA's prudential standards be further reviewed and the wording amended to ensure regulatory requirements are applied only as required to address areas of material risk and to remove the unnecessary level of prescription that can otherwise be enforced by APRA on a needs basis.

QUESTION 4.

Can you suggest ways of improving the ongoing operation of particular aspects of the regulation in practice? what role can the regulator(s) play in this?

The insurance industry is an important sector of the wider financial community in Australia. It plays a major role in facilitating a stable operating economy in all areas such as legal, banking and the financial markets.

In our capacity as a major international insurer, QBE has made a number of recommendations for regulatory improvement throughout this response and within the attached detailed submissions. Further to those recommendations, we offer the following suggestions:

4.1 Principles based regulation

QBE strongly believes that regulation should, where possible, be principles based, rather than prescriptive. In QBE's view, principles based requirements ultimately provide a higher benchmark for compliance, promote a strong risk management culture and require companies to keep abreast of industry standards and best practices as they arise rather than only when the regulation is amended.

A good example of principles based regulation is the 2001 amendments to the *Federal Privacy Act 1988*. These amendments provided a set of 10 National Privacy Principles (NPP) which explained the essence of the Act and how the legislation was to be applied. Each NPP was accompanied by an easily understood guidance note, some of which provided guidance for compliance and what would be considered 'reasonable steps' to compliance.

4.2 APRA Discretionary Powers/Charter

QBE does not believe it is APRA's intention to inhibit legitimate commercial transactions that neither undermine policyholder or insured party interests. Hence, similar to ASIC and ASX, APRA should have the ability, under the *Insurance Act* or the capacity in a prudential standard, to grant an exemption, or at least modify compliance with a prudential standard, or part thereof, for a good reason in particular cases. Such discretion would provide a more flexible and commercial operating environment, whilst still maintaining appropriate standards. Ultimately, if required, APRA has the very flexible power under the Insurance Act to include a condition on a particular insurer's licence.

It is our understanding that under section 8(2) of the APRA Act, APRA's purpose in performing and exercising its functions and powers is to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality.

Without a transparent regulatory framework that is easily understood and sufficiently flexible to meet the needs of all market participants, we believe that APRA's purpose of balancing these objectives, particularly efficiency and competitive neutrality, will not be easily achieved.

4.3 Clear understanding of regulator objective/motivation

QBE believes that often regulation is released for which the regulator's objective/motive is unclear. It would assist market participants in implementing the regulations to understand whether the regulation is aimed at consumer/policyholder protection, or protection of fair competition or some other objective. It would also assist market participants if the regulator were to demonstrate how the proposed changes meet the stated objectives.

As mentioned above, QBE is concerned at the increased level of information the industry is being asked to provide for little or no obvious policyholder benefit and believes that in order to keep compliance costs to a reasonable level, APRA must consider ways in which such requirements can be limited. If there are specific objectives APRA or any other regulator needs to achieve, such objectives and their reasons need to be clearly articulated to insurers so that the regulator can achieve 'buy-in' from all affected parties.

4.4 Communication between regulators

QBE believes all regulators are seeking to achieve a stable and robust financial services industry in Australia which promotes and facilitates fair competition by all market participants. However, a fundamental barrier to achieving this goal is the current lack of communication and cooperation between regulators.

This lack of communication manifests itself primarily through overlaps and inconsistency between the regulators' requirements, examples of which have been provided above.

Once an overlap or inconsistency does occur, there needs to be efficient and effective liaison between the relevant regulators to address this issue. The responsibility for addressing overlaps and inconsistencies should rest with the regulators.

4.5 Ensure industry differences are understood and recognised (i.e. One size does not fit all)

In line with communication between regulators is the need for recognition that each industry for which the regulator has jurisdiction will have different needs and objectives.

As a result of the FSRA reforms, the general insurance industry has to deal with an additional level of regulation to its already extensive prudential requirements. To assist general insurers, QBE recommends that each regulator acknowledge the industry's differences and ensure that the regulator's allocated representative has a clear knowledge of the industry and the key issues which the industry has to deal with on a day to day basis.

4.6 Cost/Benefit Analysis

QBE takes it compliance obligations seriously and is willing to comply with necessary changes that will assist policyholders and other beneficiaries. However, QBE recommends that, prior to regulation being introduced, meaningful cost/benefit analysis is performed by regulators to justify regulation being introduced and to confirm that there is a defined benefit or required protection to the policyholder.

QUESTION 5.

Have you received any complaints or positive feedback from your stakeholders that relate specifically to your compliance with the particular financial sector regulation (eg from clients, creditors, third party service providers, shareholders, etc…)?

5.1 Feedback received

Anecdotally, our business units have received negative feedback both from insurance intermediaries and customers in relation to the extra documentary burden resulting from the detailed disclosure requirements under the FSRA regime, and their resultant lack of clarity.

QUESTION 6.

What have been your experiences dealing with the regulators and treasury on the particular financial sector regulation?

QBE strives to maintain a good working relationship with all regulators with whom it deals. On that basis, we believe QBE's experiences have so far been positive and dealt with in a spirit of cooperation. However, that is not to say improvement is not required.

As our prudential regulator, QBE's most frequent contact is with APRA. This relationship is on two levels, one being through consultation in regard to the formation of regulation and the other through our ongoing relationship on day to day prudential matters. We have found APRA to be consultative, but determined in their approach depending on the issue being discussed. Through QBE's allocated liaison officer at APRA, our contact with APRA is on a personal level and generally through phone contact and meetings.

Our dealings with ASIC, on the other hand have tended to be on a more formal basis conducted through written correspondence. We believe there is a reluctance on the part of ASIC to meet with their clients and discuss issues. If ASIC was prepared to allocate a liaison officer for QBE and adopt a more relaxed approach through personal meetings, we believe a more effective working relationship could be achieved, leading to better communication and understanding of each parties needs and earlier resolution of issues.

Two areas in which our relationship with ASIC could be improved are:

6.1 Communication from ASIC to QBE

There have been instances, primarily with ASIC where QBE has complied with a Notice to produce documents or provide information, and has either not received a reply to advise that ASIC has no further issue, or a reply has only been forthcoming after a considerable amount of time has passed. QBE believes in due course, ASIC should always provide a response clarifying that it has no further issues to be addressed.

6.2 Meeting with ASIC

In the instances where ASIC requires documents or information from QBE, much time and cost could be saved for both parties, if ASIC were prepared to meet with QBE prior to issuing their Notice and discuss their requirements. At that meeting, both parties would gain a clearer understanding of the other's needs and be able to focus resources more efficiently. For example, the broadly drafted Notices issued by ASIC in their recent enquiry undertaken into Brokers Commissions involved many hours of locating documents and much correspondence with ASIC to try and establish exactly what material they were seeking.

QUESTION 7.

Please provide any additional comments that you may wish to make relating to the particular financial sector regulation.

7.1 Additional Comments

We refer you to attachments B through to L, for a more detailed description of the issues QBE believes have the potential to adversely affect our business.

In addition we also draw your attention to those recommendations from the HIH Royal Commission, which were intended to improve the regulatory environment, but are yet to be implemented. QBE believes implementation of the particular recommendations listed below will assist in removing the gaps, overlaps and regulatory conflicts that undermine economic efficiency within existing financial sector regulation:

- Equal regulation of all insurance. (Recommendation 49)
- Removal of overlaps between State and Federal prudential regulation. (Recommendation 49)
- A light touch safety net to support policyholders of insurance companies in the event of failure of an any insurer. (Recommendation 61)
- Removal of a number of state taxes on insurance. (Recommendations 55 - 58)