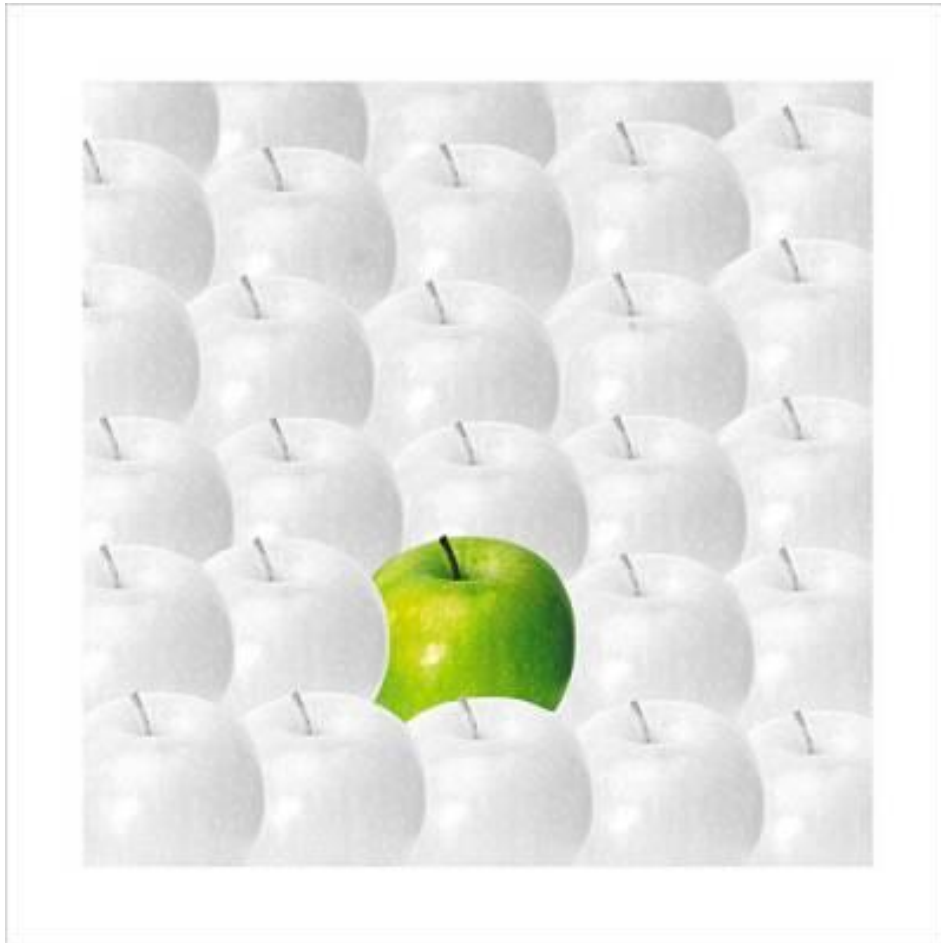


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# **Papua New Guinea Insurance Council Submission**



## **ICCC - Issues Paper on the Review of the General Insurance Industry**

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# Submission on the Issues Paper on the Review of the General Insurance Industry in Papua New Guinea

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## Introduction

The PNG Insurance Council (the Council) is pleased to provide you with a submission on behalf of its members regarding the Independent Competition and Consumer Commission's (ICCC) recent Issues Paper regarding its review of the insurance industry within PNG. The PNG Insurance Council is the peak body representing the interests of the insurance industry. This submission addresses industry specific aspects of the current review and individual members will make separate submission to the ICCC regarding the remaining aspects of the review.

This submission addresses the Council's response to the information presented in the Issues Paper, particularly around the limitations of the data presented and the lack of appreciation for the more detailed operation of the industry. Further, it addresses a number of the direct questions raised in the Issues Paper.

## Sector Analysis

The Council notes that sale of insurance is actually the exchange of contracts between parties to ensure that risk is transferred, minimised, or at the very least appropriately managed. The most difficult aspect of the business of insurance is the underwriting of policies. Using a wide assortment of data, Insurers predict the likelihood that a claim will be made against their policies and price products accordingly. It is not a simple industry that can be assessed against the traditional "cost building block" methodology typically employed by the ICCC in regulating infrastructure related businesses. Rather the exchange of contracts and the consequent exchange of risk embeds a level of complexity that is difficult to appreciate from an external regulatory position. The transfer of risk and the inter-temporal aspects of the industry mean that it is necessary

for both Insurers and the Insured to take a longer-term view of the world that is relatively unique throughout the economy.

However, this discipline enables the remaining participants in the economy to plan with the necessary certainty to ensure longer-term economic growth. As such, the insurance industry provides an important building block in the longer term, sustainable success of the economy.

The Council would caution the ICCC not to rush to make judgements regarding the operation of the insurance industry without fully understanding the broader implication of these judgements throughout the economy. There has been a distinct failure to recognise the reality of the underwriting process and how this affects the operation of the Insurers in accepting or denying risk. There is a need to have a balanced approach to the competing concerns of helping the Insurer transact good insurance business and providing the insurance buying community with the right insurance products at the right price.

The Council is extremely disappointed in the short-term approach outlined in the Issues Paper regarding the profitability of the sector. The Council considers that the information presented in Chapter 4 of the Issues Paper is extremely simplistic and ignores ...

- The longer term nature of the industry;
- The actuarial science applied to premium calculations; and
- The underlying cost structure of the industry.

Concerning the analysis of total general insurance premiums and losses (2002 – 2005) the graphs and data presented in Chapter 4 is limited and does not set out a clear picture of the general insurance business in PNG for the years under review. Graph 4.2 (page 19) is simplistic and hence misleading in its representation and does not indicate whether it is showing premiums and losses by underwriting or accident years.

Within the graphical representation contained throughout Chapter 4 of the Issues Paper, losses are not defined. We have a number of questions reading these graphs, including ...

- Are these paid losses or ultimate incurred losses?
- There is no differentiation between short and long tail classes of insurance. In the case of long tail classes (workers compensation and liability), one needs to identify what claims actually belong to the equivalent underwriting year. Has this exercise been accurately performed?
- Long tail claims should be dealt with separately due to the ongoing nature of payments and the uncertainty in duration and provisioning.
- Have future losses been allowed for?
- Are the loss ratios discounted or undiscounted?
- What about "Incurred But Not Reported" (IBNR) aspects of claims?

Similarly, if an attempt is being made to demonstrate accident year profits, has the premium earned and equivalent losses in each premium year been correctly analysed?

A better representation of premium and losses should show a break down between ...

- Classes of Insurance
- Claims;
- Expenses;
- Reinsurance; and
- Profit

It is a generally accepted insurance industry practice to view the data in this context.

Furthermore, when commenting on profit it is useful to know what the expense ratios (even if not broken down by product type). The Council would like to see greater detail provided on ...

- Reinsurance costs;
- Broker's fees and commissions; and
- Unearned premium reserves.

Reinsurance costs can have a substantial impact on profit; this should be analysis within the context of the above. When looking at profitability and sustainability, one should also consider retention rates. The Council notes that these have not been commented on.

Table 4.10 seeks to show the growth in Papua New Guinea's insurance market between 2000 and 2005. There is insufficient transparency in the way the figures have been presented. Furthermore, it is misleading to show *Gross Premium* and *Net Claims* while ignoring expenses and reinsurance costs. One would need to look at both Gross and Net Claims to appreciate the entire scenario. This should be displayed on an "Earned Premium" basis.

The actuarial science applied to insurance industry is aimed at understanding and quantifying the risks that individual Insurers are willing and able (given capital reserves) to assume these risks and the corresponding premium which is required to adequately insure against these risks.

Capital Risk Theory states that an organisation's ability to address risk requires that they are able to adequately diversify this risk. While insurance entities actively seek out risk in the form of the policies that they underwrite their willingness to assume this risk is dependent on their ability to absorb the cost of this risk should an event occur. This is directly influenced by the business' ability to spread these risks across a portfolio with a collective loss profile that will enable the insurer to generate a return on capital.

In the business of insurance, some policies are winners (i.e. the Insurer pays out less in claims and expenses than it receives in premiums and investment income); and some policies are losers (i.e., the Insurer pays out more in claims and expenses than it receives in premiums and investment income). Insurance is also predicated on receiving a price (premium) today to insure an event, with an unknown cost, in the future. Furthermore, this cost may not manifest itself

for several years (for example liabilities associated with asbestos), meaning the ultimate cost of a policy may not be known by the insurer for decades. The ability of the industry to manage this equation is directly related to the ability of insurers to manage the *long-term* nature of the risks insured.

Importantly, one of the Councils major criticisms of the information presented in Chapter 4 of the insurance industry is the lack of acknowledgement of institutionalised losses that occurred in previous policy periods, which continue to be carried by industry participants. Such major losses include ...

- Rabaul losses AUD172,000,000 (K115,000,000 est. at the time)
- Bougainville losses costing AUD265,000,000
- Ok Tedi losses costing USD500,000,000 est.

Appendix 1 provides a more detailed list of the types of losses that the insurance industry has had to deal with in the past.

The information present in Chapter 4 of the Issues Paper totally ignores this inter-temporal aspect of the insurance industry. At the same time, the Council draws the ICCC attention to the fact that this results in significant complexity regarding the assessment of insurance industry from a relatively small data set.

### Competitive Nature of the Market

Competition in any industry is vital to ensure that there is an appropriate allocation of resources to where they are most valued. At the same time the degree of competition between industry participants results in these resources being appropriately priced as parties compete to win business, resulting in an efficient market driven outcome. Competitive tension within an industry can be measured in a number of ways, including ...

- The ability for parties to enter the market;
- The degree to which businesses are exiting the market;
- The amount of churn between existing market participants;

- The number of participants in the market; and
- The level of price competition between these participants.

In considering the competitive nature of the industry, the Council makes the following points against each of the criteria discussed above.

The ability for parties to enter the market – the ability for new participants to enter the market ensures that equilibrium is maintained as any artificial barriers to enter restrict an important element of competitive pressure in that there would be a weaker deterrent for the existing participants to charge above costs. However, where existing market players are making returns which are in excess of costs (i.e. able to generate a margin<sup>1</sup> on costs) there is an incentive for new participants to enter the market to compete for this margin which eventually drives margins to zero. In the PNG context, there has been a number of new participants enter the market recently suggesting that the market mechanism is effectively operating to ensure that normal competitive pressures are ensuring efficient pricing of premiums.

New indigenous entrants in the market have been partially the cause for the current indifferent pricing, which is possibly due to competitors adopting a penetration pricing policy to achieve market share and critical mass in the short term. Indifferent pricings results where the price charged by Insurers is less than that which is determined by actuarial science. It assumes short term losses will be lower than the long term average and places greater risk on the probability of an event being at the end of the period rather than the start, i.e. a one in five year event is expected in the fifth year and not the first.

The degree to which businesses are exiting the market – while market entry is an important aspect to ensuring the effectiveness of the competitive market so to is market exit. In an environment where there is little movement in terms of market exit, it is easy to assume that margins are high. This is because the market is not at equilibrium, rather firms are able to make margins above those expected. However, in the PNG context there has been both an exit of firms in

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<sup>1</sup> In the case of the insurance industry, this margin is above the margin earned on risks.

the past ten years, and the rationalisation of participants through mergers and acquisitions. This would suggest that the market is operating efficiently.

The amount of churn between existing market participants – the amount of competitive activity in a market can be measured by degree to which there is turnover of the customer base between the various participants (market churn). Within the PNG insurance industry there is considerable churn between the various insurance participants either directly through price competition or the coverage offered at a similar price, and through competition between Insurance Brokers.

The number of participants in the market – the market in PNG is similar in nature to the Australian market in that there are seven major companies present (five major companies present in Australia). As noted, the market also includes (2000 – 2006) two new general insurer entrants, two new captive insurers, two new loss adjustors, and three new insurance brokers. During this period the market lost one insurance broker, three insurers (two foreign owned), and one loss adjustor.

The level of price competition between these players – in the main, the calculation of prices (premiums) are based on an actuarial process described elsewhere in the submission. Data is analysed to project the rate of future claims on a given risk. Actuarial science uses statistics and probability to analyse the risks associated with the range of perils covered, and these principles are used to determine an Insurer's overall exposure. Upon termination of a given policy, the amount of premium collected and the investment gains thereon minus the amount paid out in claims is the Insurer's profit or loss on that policy.

From the Insurer's perspective, prudent portfolio management is predicated on the careful individual selection of risk to ensure that the overall portfolio of risk contains an acceptable exposure, one that does not imperil the ongoing solvency of the entity. The actuarial approach and rating formulas that are used in the PNG insurance industry are consistent with the approach employed worldwide. This approach is supplemented by consideration of relevant local conditions,

including PNG's heightened propensity for natural disasters (e.g. volcanic), and the nature of the market itself. In this latter respect the market consists of a very immature retail sector coupled with a considerably larger but more volatile (from a risk and loss perspective) corporate sector.

As detailed above, there are examples in the PNG market of participants engaging in indifferent pricing. In an insurance context, this is defined as pricing the policy at a level below the actuarially estimated cost. This approach is primarily designed to either retain market share or gain market share. The existence of such pricing is consistent with the operation of a competitive market.

Within the market, each Insurer operates dependent on the portfolio risk they are willing to undertake. That is, it is relatively easy for individual Insurers to segment the market depending on the type and quantum of risk they are willing to insure. Insurers are tasked with optimising their portfolios to ensure that risk is minimised to an acceptable level. Insurers use both reinsurance and portfolio theory to achieve this end. Whereas reinsurance divests the risk to another party, at a cost, portfolio management requires the Insurer to ensure that they are not overly exposed to a specific event. In the PNG context, some Insurers are unwilling to enter the significant risk associated with underground mining or aviation as these events are deemed to be too risky given the likelihood of an event occurring and the ability of Insurers to spread this risk across their portfolios.

This does not reflect an absence of competitive tension in the market; rather it is evidence of insurers managing their portfolio of risk. Entities with a demand to mitigate these risks are able to transfer this risk to foreign insurers with the appropriate risk profile or establish special purpose insurance entities (Captives) to self insure this exposure. Larger organisations in PNG have established such captives which indicate that the market is continuing to develop solutions where there is demand that cannot be met by the current industry participants. The Council includes in its membership representatives of such insurance vehicles recently established in PNG.

## Foreign Entities and Protection

Unlike PNG based Insurers, foreign entities have the ability to spread their risks over a larger number of claims and policyholders. In addition, foreign entities are able to avoid the capital investment costs associated with maintaining a local market presence and the requirement to employ and train local staff. This provides internationally based entities with a cost advantage over local service providers.

The insurance industry believes that without this level of control that the exemption process currently provides it would be unable to compete against offshore companies. While noting the short run economic advantages which may be generated from removing the 17.5% premium applied to foreign based Insurers, it is also important to consider the impact of removing this protection on the locally based industry. In short, removing this protection would open the market to internationally based Insurers who do not have to face the same prudential and regulatory conditions placed on PNG Insurers. We believe that this would have significant impact on the confidence in the insurance industry. Further, we believe that there are significant economic disadvantages which would result in a general reduction in the economic activity across the economy. This is based on the level of training and skills transfer that the industry is committed to. The education of national staff within the insurance industry is a vital component to the insurance industry longer-term commitment to the PNG economy. The industry provides Australian qualifications that are recognised internationally, which is far in excess of what is required from Department of Labour. Through this training, the insurance industry is committed to the nationalisation of roles through training and knowledge transfers. At present most insurance people in PNG have been trained to Australian/New Zealand standards under the ANZIIF and use their knowledge of the insurance industry (in Australia/New Zealand) as a guideline and template to what is considered good practice for the industry in PNG.

The Insurance Act states that all risks situated in PNG are to be insured with licensed Insurers. The Council is concerned that there may be unfairness regarding the application of the exemption process. Problems regarding governance of such exemptions would be greatly improved if the OIC were to provide written reasons for the granting or declinature of an exemption.

In terms of the application of Section 36 of the Act, we would expect that given the degree to which the OIC is funded, (a levy of 1% on all non-workers compensation and life premiums), it would be more than adequately able to enforce the regulatory regime. The Council believes that these funds are aggregated in consolidated revenue and then distributed to the OIC. However, given the lack of transparency and accountability of the collection and expenditure of the Insurance Commission's Levy it is not clear to the Council (or insurance buyers) where this money is going. In particular, the budgetary requirements of the OIC do not appear to be explicitly linked to the size of the tax-levied i.e. this has remained at 1%, while the volume of premium written (and thus taxation revenue) has increased in recent years. The Council would like to see the OIC being accountable for the funds it collects and how these funds are used to regulate the insurance industry.

### Legislative Framework

The legislative and legal framework governing the transaction and conduct of insurance contracts consists of - Common Law, a set of prudential standards administered by the Insurance Commissioner, in addition to the Life Insurance Act (2000) which is administered by the Bank of PNG. There are separate licences for General and Life Insurance. The two regulators are the Insurance Commissioner and Bank of PNG. This model of regulatory framework, we do not wish to alter. However, clearer delineation between the two Acts, and the classes of insurance that are contained within, would be a necessary improvement.

In absence of an indigenous Insurance Contract Act (ICA) PNG Insurers have effectively adopted the Australian ICA as proxy legislation governing the contractual relationship between Insurers and Insureds.

The Council is a supporter of the proposed introduction of an indigenous PNG version of the Australian ICA legislation. Notwithstanding this, the Council is of the view that a more cautious approach with a greater period of industry consultation than has occurred to date is warranted. In particular, the Council raises the following matters that we consider are of concern ...

- The proposed PNG legislation is based on the Australian Insurance Contracts Act. The original Australian legislation is currently in the process of some significant modification and a draft Parliamentary Bill has recently been issued. Although the majority of the industry would agree that the introduction of the ICA has been very positive, the original legislation has proven to be problematic in some areas. The purpose of the draft bill has been to address and clarify a number of deficiencies that have become evident over the period of the Act's introduction. The PNG legislation, currently awaiting release, is based on the original iteration of the Australian Act. As a result the Council is concerned that the impending legislation contains a number of provisions that are potentially problematic for the industry (refer to Appendix 2).
- It is also worth noting that the original Insurance Contracts Act was commissioned and constituted as a piece of consumer protection legislation intended to redress some of the perceived imbalances in the Insurer and Insured relationship. With respect to the latter, it was intended that the chief focus and beneficiary of the legislation would be individual and non-intermediated retail consumers. This sector of the insurance buying public make up 2% of the total insurance buyer market in PNG.

- When the Australian legislation was released, the industry was mature and comprised a significant market of non-intermediated retail insurance products targeted at a large pool of individual consumers. In contrast, the PNG insurance market is typical of other developing economies in that it has a very limited retail consumer market and is heavily skewed towards intermediated corporate business.

We therefore consider that immediate urgency for the introduction of the proposed legislation is largely absent. As Papua New Guinea's economy develops and there is a greater critical mass of middle class consumers, we perceive an increasing need for this legislation. At present however, we strongly consider there is merit in deferring release of the legislation until further dialogue with the industry can take place to address some of the potentially problematic aspects of this legislation.

The Council is concerned with the existing enforcement of licensing provisions and the annual licence review process. Currently Insurers are required to reapply for licences on an annual basis. This is not however presently coupled with an ongoing process of monitoring and review.

The current annual prudential licensing requirements are ...

- Any new general insurance applicant must possess a minimum of K2,000,000.
- Reinsurers are required to possess a minimum of K20,000,000 in capital.
- Insurance Brokers are required to possess a minimum of K200,000.
- Loss Adjustors are required to possess a minimum of K50,000.
- After 12 months and thereafter annually, the Insurer is then required to maintain a solvency margin greater than 15% for the licence to remain valid.
- The Insurer's investment portfolio is also assessed against the recommended mix of instruments that is provided by the Insurance Commissioner.

From an Insurance Brokers perspective, the greater the capital funding held by Insurers - the better. Low capital funding is an impediment to transacting business at an intermediary commercial level. Offshore Insurers would have a greater capital base by comparison to PNG based Insurers, and this sometimes influences the decision to place business offshore, due to a perceived lack of security.

In practice, the annual prudential licensing requirements may not be enforced, referring to the issuance of "provisional licences". It is for example, possible for an insurance entity to comply with the licensing requirements prior to the annual renewal and then subsequently amend its business structure to one not complying with the requirements. Again, given the funding available to the OIC we are unable to understand this lack of monitoring and enforcement. The PNG economy and policyholders suffered the fallout from the liquidation of WMI that in turn tarnished the reputation of the PNG insurance industry.

The Council considers that there may be advantages in moving to a different system in which licences are issued once and then only revoked for subsequent breaches (rather than the current system of reissuing the licence annually). This revised approach could for example consist of a quarterly statement/submission of compliance supplemented by an appropriate audit program.

Maintaining confidence in the robustness, transparency and equity of the licensing and prudential compliance process is vital to ensuring the financial integrity of the industry, protecting consumers, in addition to attracting new entrants and capital investment.

### **Prudential Risk Based Models**

The insurance industry recognises that the security of insurance companies is a matter of public interest. A strong stable and solvent insurance industry is vital to assist the development and growth of the PNG economy.

The Council notes that as part of the ICCC's industry review the appropriateness and efficacy of "risk based" prudential compliance models may be considered.

Risk based prudential regimes require a high level of sophistication to establish the required amount of capital adequacy that an Insurer should maintain to meet its current and future obligations in contrast to more simple single measure regimes (i.e. Insurers are required to maintain a minimum amount of free capital).

Risk based prudential regimes generally require detailed evaluation of the following operational and financial risks to assess the level of capital required:

- Insurance risk (outstanding claims liability);
- Investment risk (a buffer for adverse movements in assets); and
- Concentration risk (degree to which Insurers are exposed to localised events e.g. a catastrophic event in Port Moresby/Lae).

The industry is opposed to the introduction of a Risk Based Capital adequacy regime in PNG at the present time. This position is based upon the substantial lack of available data and the present immaturity of the market. The World Bank website documents a similar opinion on developing countries.

The Council notes that while some data relevant to insurance risk is presently collated (albeit that there are some deficiencies), no information is collated for investment and concentration risk. It is therefore the position of the Council that prior to further detailed consideration of a risk based prudential regime, the OIC should undertake, a lengthy period of data collation and review prior to embarking on any further analysis of the merits of a risk based capital solvency regime.

## Complaints Tribunal

The Council is supportive of the Insurance Commissioner's proposal to introduce an Insurance Complaints Tribunal. The Council's preference is for an organic

and flexible model that avoids excessive administrative cost and complexity. The Council is also seeking the development of an appropriate escalation process to ensure that resources are appropriately deployed while maximising efficiency and consumer outcomes. The OIC and the Council have been involved with lengthy dialogue and consultation on the set-up of the Insurance Complaints Tribunal and this is still a work in progress.

### Use of Benchmarks and Data Collection

As we have detailed previously in this submission, the Council is concerned with the integrity of existing data on the industry. We consider that a number of these issues significantly degrade the efficacy of the information available for this review. Given this, the Council urges the ICCC to act cautiously when relying on this information and to consider the brief précis of our major concerns provided below ...

- Industry-wide loss statistics are significantly distorted due to the exclusion of loss data from a major provider of local capacity, Lloyds of London.
- The existing data incorporates gross written premium and loss data from the statutory entity MVIL. It is the Council's belief that the underwriting model employed by MVIL and accordingly the underwriting profit/loss that is generated is not reflective of the wider general insurance market. As such, we consider reliance on data incorporating MVIL statistics is misleading. MVIL's tariff rated structure is regulated by the ICCC, and therefore does not compete in the free enterprise market place.
- There are significant gaps in historical loss data due to the demise of Insurers in 2000, 2001, and 2003. In some instances, this has significantly complicated the underwriting process for Council members when they have reviewed insurance on entities that have been insured by these insolvent companies. In many instances, Council members have been unable to obtain validated and detailed loss information on potential

Insured's due to the collapse of these Insurers. In some instances, this has distorted the normal underwriting and premium assessment process. The Council requests that the OIC and the ICC consider this fact when it reviews the industry data.

- As detailed previously, the data available for this review lacks significant detail and is provided for a limited period of five years (2000-2005). The Council would prefer that any review considered a minimum of ten years to provide a more comprehensive overview of the industry.

It is the Council's position that the existing method of industry data collation (review of Insurers/Insurance Brokers audited annual reports) increases the likelihood of inconsistency and potential error due to the differing accounting treatments that may be applied. Furthermore, the level of detail provided in these accounts may differ leading to gaps and omissions in the collected data.

The Council therefore strongly supports the development of a structured annual data collation process, whereby all members will provide a pre-agreed suite of key metrics in a standardised format with a consistent accounting treatment. The Council would strongly welcome the opportunity to work with the OIC to develop such an approach.

### Code of Practice

The Council has emphasised through this submission the push for fairer dealings with the insurance buying public and the inter-relationship between all industry sectors. The time is right to introduce a self-regulating "Code of Practice" for all industry participants (both ANZIIF and NIBA in Australia have gone down this path).

It is an insurance industry initiative to develop a self-regulatory Code of Practice (Code) that is embracing the need to go beyond legislation by voluntarily laying down rules for dealing with all parties related to the business of insurance. This

Code would be an efficient tool in the self-regulation of the insurance industry and will assist in increasing the consumer confidence in the insurance industry.

The desired outcome is that the Code will promote good relations between insurance companies, insurance brokers, policyholders and others in the insurance industry, as well as efficiency in transactions by laying out standards of good practice and levels of service that are expected of member sectors.

The Code applies principally to general insurance and reinsurance, but extends to associated services such as risk management, insurance premium funding, surveying, inspection, valuation, and loss adjusting.

The matters that covered by the Code ...

- To act in the best interests of all parties to the insurance contract.
- Provide advice and guidance to enable consumers to make informed decisions on insurance products.
- Provide full and accurate information for effective underwriting of policies
- Respect the confidentiality in relation to all records and information.
- Make available all relevant documentation, policies, certificates, endorsements, and premium calculations, and ensure the validity and accuracy of all documentation.
- Be professional, efficient and responsive in all dealings.
- In the event of a claim, take every step necessary to ensure prompt, efficient and fair settlement.
- Discharge the duties competently and with integrity and honesty.
- Exercise reasonable care and skill.
- Comply with all obligations at law, particularly but not limited to those laws having a bearing upon the placement and sale of insurance products.
- Declaring conflicts of interest as and when they arise.
- Transparency in the declaration of insurance commissions, broker fees, and administration charges. In addition, the timely advice of same prior to incurring those costs.
- Work towards maintaining and enhancing the reputation of insurance industry and its member sectors

The Council is strongly of the belief that a robust and comprehensive industry self-regulatory framework would improve the industry.

### Other Key Industry Participants

It is the Council's view that in general, the market for broking and loss adjusting services is competitive and functions efficiently. The industry contains a mix of indigenous and foreign owned subsidiary entities.

The Council is concerned at the compliance and administrative burden that is currently imposed on loss adjustors. The Council notes that, at present, the regulatory requirements for loss adjustors is comparable to that imposed on General Insurers. For example, loss adjustors are required to possess a minimum amount of capital (K50,000) in addition to submitting an annual audited return to the OIC.

In the opinion of the Council, these are unnecessary requirements that impose an unnecessary burden on this sector of the industry and act as a potential barrier to new entrants. The Council does not believe there is the same consumer protection imperative for the loss adjusting industry as may exist for Insurers and there is therefore limited utility in maintaining the existing onerous requirements.

### Reinsurance

The reinsurance market within Papua New Guinea caters for the requirements of the Insurers on the facultative side either by way of fellow Insurers or Pacific Re. The some treaty requirements are placed within Papua New Guinea whilst others are transacted offshore.

There is no doubt that under certain circumstances facultative placements are not able to be obtained thus are placed offshore. This is mainly for business transaction in the resource, energy and mining sectors.

With the advent of Lloyds of London being a licensed (local) Insurer there are a number of opportunities lost to the reinsurance market.

When an exemption (in accordance with Section 37 of the Insurance Act 1995) is obtained from the OIC for the placement of the business with Lloyds, the business in totality is lost. Hence, the opportunity to participate in PNG based reinsurance is not available and 100% is placed offshore.

Under Section 36 of the Act, no ambiguity arises, as the content is concise and precise, in that all risks situated in Papua New Guinea for which insurance including reinsurance is required shall be insured with a licensed Insurer<sup>2</sup>.

The degree of non-compliance is difficult to understand and quantum very hard to determine. Known cases are available where this has arisen in recent times. The OIC in conjunction with the Council worked closely through a process to produce documentation together with guidelines to assist not only those wishing to apply for an exemption but also the OIC in assessing such applications.

The above will provide the mechanism to drive this initiative forward thus ensuring that all applications are uniform in content, contain the correct information to allow the OIC to make an informed decision on whether the exemption be granted or not.

The OIC will now be in a position to administer the Act in relation to Sections 36 and 37 with clearer understanding from the industry and the regulator, thus ensuring compliance with the Act is achieved. The penalties as outlined in Section 37 can then be enforced to ensure that non-compliance comes at a cost. Since enactment, has a penalty ever been levied against a non-compliant entity?

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<sup>2</sup> The PNG Insurance Act 1995 was enacted prior to Pacific Re being incorporated

The process to achieve the outcome was very fruitful and demonstrates the regulator working with industry in a positive manner. The risk appetite of Insurers verses cost of capital and the strength of the balance sheet are key factors in relation to increasing the capacity of the market.

One of the other factors involved is the cost of purchasing additional protection compared to the additional income streams that will be written, and will it be beneficial to the company. Additional capacity can be sought from the local reinsurance market by way of facultative placements, should this not be available then offshore providers may be available.

### Lloyds of London

The Council has some significant concerns with respect to the consistent regulation of all industry participants. Specifically, the Council notes that Lloyd's, a significant provider of local capacity and participant on a number of prominent local insurance programs, operates under a different regulatory regime to the rest of the domestic industry.

Unlike other industry participants Lloyds is not required to hold capital onshore and does not submit annual audited accounts. As detailed previously, Lloyd's does not submit industry data. In view of their local prominence, this is a significant omission that distorts the accuracy of the aggregated industry statistics.

The Council does not believe there is legitimate consumer benefit to be derived in taking this inconsistent approach. Indeed the current situation materially discriminates against the local industry which has accepted the cost of complying with the existing regulatory regime to the overall benefit of PNG consumers and the economy.

## Conclusions

The Council welcomes this review, however, as noted considers that the ICCC's task should be limited to the competitive nature of the industry rather than the prudential and capital management aspects of the industry. These latter aspects are based on the application of considerable actuarial science and industry expertise which would be difficult to unpick given the size of the task at hand. Rather, if there was a recommendation that this aspect of the industry did require review this should be treated separately as it was when it was last reviewed in 2004.

The PNG insurance industry is a good corporate citizen and contributes in the whole to the benefit of PNG economy and its citizens. The Council assists with this good role model through its direction, and processes. Many of the deeds done by the insurance industry go unheralded, and this is the path chosen by many of the Council members. However, a small snapshot of the activities show the following insight in the "good things" that the insurance industry does - corporate sponsorships and donations of sporting organisations, national representative sides, charities, and NGOs; purchase of fire engines and ambulances; contributions to effective infrastructure improvements; taxes and levies paid to Treasury on all business transacted and profits; and building an educated sustainable workforce to world standards.

In gauging the level of competition in the industry, the Council considers that it is important to canvas all members of the industry. Throughout the insurance industry there is a common complaint from Insured parties which comments on the cost of insurance given the frequency of claims made. This does not necessarily mean that there is any evidence of inappropriate pricing or anti competitive behaviour being undertaken by parties across the industry. Rather it is a reflection of the type of goods that is being sold. Insurance is the backbone of an economy's ability to undertake planning with any certainty

regarding future outcomes. This certainty does come at a price and the value of this certainty is often overlooked by insured parties. The insurance industry attempts to quantify this value and using sophisticated tools to measure uncertainty. There is relatively free entry/exit, within a desired liquidity and prudential range, for insurance providers to enter the market. In addition, there is significant price competition between parties to ensure that margins applied are determined by a market driven outcomes. Furthermore, these outcomes reflect PNG related outcomes and are not readily comparable to international benchmarks. These outcomes reflect the unique structure of both the PNG economy and the maturity of the PNG insurance industry.

The PNG Insurance Council welcomes any initiative designed to enhance the position of all stakeholders in the insurance industry, and as such is pleased to participate in this review. Our position has always been one of cooperation and dialogue with relevant authorities and it is worth noting that a number of the initiatives mentioned in the Issues Paper have been and continues to be the subject of mutual dialogue with the Office of the Insurance Commissioner. Whilst a number remain as work in progress, others have been successfully concluded. Given the generous scope of this review and the underlying complexities involved, we would urge caution and recommend the same full and exhaustive dialogue between all stakeholders in order to achieve satisfactory outcomes for all.

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