

Submission by Pacific Re Ltd

**REVIEW OF THE GENERAL INSURANCE INDUSTRY IN
PAPUA NEW GUINEA**

OVERVIEW

The content of the Issues Paper are indeed extensive and penetrates to the core of the industry in many respects. The question that we would ask is: *Does the ICCC believe that more competition is required thus result in reduced pricing and improved terms and conditions????*

In summary Pacific Re considers the following matters to be most important for ensuring a strong viable and responsible insurance market that is best able to service the needs of insured's and maintain the capacity to meet all current and future liabilities:

- 1) Maintain the legislative and prudential controls, if anything enhancing the resources of the regulator to supervise the industry members;
- 2) In particular, maintain the requirement for all insurance to be placed with onshore insurers and reinsurers, subject to the existing exemption process;
- 3) The Insurance Act and investment guidelines as detailed are acceptable. The key factor is with the application of the law rather than the terms of the Act itself.

Pacific Re considers that there is adequate competition in the market. Recently, the Office of Insurance Commissioner has licensed a number of entities:

General Insurers:	Four
Brokers:	Two
Loss Adjuster:	One

By the mere presence of newly formed companies much more competition exists now than has been the case in previous years.

The market has witnessed competitive pricing in recent times, due to the issue of new licences to four general insurance companies. However, it is very important that pricing not be reduced too low, as insurers must provide reserves for future losses. Insureds that purchase insurance protection can be prejudiced by their insurers not recovering sufficient premiums and thus not being able to meet their liabilities.

The reason for the market within Papua New Guinea being as solid as it is, is through the application of the requirements of the Insurance Act 1995.

Every general insurance entity must be licensed before they are able to commence transacting business within Papua New Guinea and must comply with minimum capital and prudential requirements at all times.

Section 36 of the Insurance Act provides that all risks situated in Papua New Guinea must be insured with licensed Papua New Guinea resident insurers and reinsurers.

Without the requirement in Section 36, insurance transactions could be placed offshore freely to the detriment not only to the insurance industry in Papua New Guinea, but would be a major impact on the entire economy of the Country as funds have travelled offshore.

The Insurance Act and the present regime enable the Commissioner to monitor insurance companies and review their position as regards solvency and ability to meet their liabilities. The regulator is unable to do this with offshore companies that are not subject to his jurisdiction.

Overall Comment - Reinsurers

Pacific Re was not consulted regarding any of the information contained in the Issues Paper, therefore is unable to supply commentary on the content detailed in it.

It is apparent from the content of the Issues Paper that the information was obtained from the Office of Insurance Commissioner, AXCO report dated 2007 and possibly other sources.

Pacific Re generates substantial income from offshore, as well as from Papua New Guinea. Pacific Re thus generates the significant importation of foreign currency as well as keeping reinsurance premiums in the country. This foreign currency is held in Papua New Guinea and not repatriated overseas. Pacific Re's shareholders are companies domiciled in Papua New Guinea.

The company is a Papua New Guinea company and accordingly registered with IPA.

The investments held by the company are held within Papua New Guinea.

The retained earnings of the company are held in Papua New Guinea.

As this review progresses on behalf of Pacific Re I would request a meeting with the authors of the paper to explore the comments contained in it together with the ongoing process.

Insurance Act 1995

Pacific Re considers the Act in its current form does afford an appropriate legal and prudential framework for the industry to operate within. As with all Acts there is a requirement to ensure that the current issues of the day together with the continual

review of prudential requirements are incorporated within the body of the Act by way of amendments.

The Act has the mechanism to require of entities operating within Papua New Guinea to compel them to operate in circumstances in which those insurers will be able to meet all liabilities. The law is there, and it is only a matter of strictly applying it.

The Office of Insurance Commissioner regularly meets with the industry or alternatively with the individual entities on a needs basis. The purpose of these meetings is many fold. One reason is to foster a relationship with the Regulator. The main purpose of the meetings is to share information in both directions.

To provide an insight into a market outside of Papua New Guinea, we reviewed the report by the Reserve Bank of Fiji – Insurance Annual Report and quote:

“In 2005, I met individually with insurance underwriters for the first time. I found these bilateral meetings, which replaced our annual collective meeting with the industry, very fruitful and I intend to continue this in future”.

The above demonstrates that within the Papua New Guinea Market open dialogue is held on a frequent basis with our regulator compared to that of Fiji, which is once per annum.

The release of statistical information to the industry may be hampered by the delay caused by entities not providing information to the Office of Insurance Commissioner in a timely manner.

The Act deems that the participants in the insurance industry are to be regulated.

There is no doubt that the Act rewards companies that are prepared to invest in Papua New Guinea, by way of investing significant capital to commence and maintain business entities. This creates the opportunities to employ resources, to develop resources to ensure that the true potential of the individuals are attained. The Act requires on shore capital.

The industry in general spends more than the training levy to train people in allowing those resources to obtain suitable qualifications that are required together with skills to enable a high degree of expertise to be provided to consumers. The resources obtain valuable skills and knowledge.

The Papua New Guinea Insurance Institute, is the industry body purely designated to train people in the industry.

The training offered through the Institute now spreads outside of the industry, into other commercial sectors of business, the legal fraternity, banking and elsewhere.

The Institute in the main receives its funding from within the insurance industry.

The contributions to the Internal Revenue Commission from the industry in terms of company taxation, withholding taxation, stamp duty, goods and services taxation, non resident insurers taxation, training levy, interest withholding taxation, salary & wages taxation, dividend withholding taxation together with foreign premium taxation are very significant.

Licensed entities operate in Port Moresby, Lae and other centres around Papua New Guinea.

Apart from those matters mentioned above, there are many other benefits that would be lost if the market was opened up to non-admitted and non-resident entities.

If the market were open to any offshore entity to transact business in Papua New Guinea, this, without doubt would put severe pressure on the companies that currently operate within Papua New Guinea.

Purely in terms of capital invested together with the amounts expended per annum to enable the business to operate. It may be that there is little or no incentive for the companies that currently operate with in the market to remain in their current format.

Should companies withdraw from the market this would have a major impact on the economy of the country, with loss of opportunities for people, loss of revenues for the government to name only two. Certainly jobs would be lost in Papua New Guinea.

The offshore companies would not need the onshore infrastructure requirements that current entities presently require and business could simply be transacted through the various media available without the need to establish an operation in Papua New Guinea. They could operate a call centre in India and have a small agency to collect premiums. The larger insurance programmes written at the top end of the market would probably not even require an onshore agency, therefore no resources would be employed onshore.

Further, if the market were open to non-admitted non-resident entities offshore, there could be no quality control or prudential supervision of the companies transacting business. Therefore cover placed with insurers would not be protected as currently is the case.

The current licensing requirements are such that there are controls together with certain criteria to be met prior to the granting of a license. For example, there are minimum capital requirements and the Office of Insurance Commissioner must approve reinsurance programmes as adequate.

In Section 18 (2) the Act provides as follows:

“The Commissioner shall not issue or renew a licence under Subsection (1), unless he is satisfied that the licensed corporation or licensed person shall at all times maintain within Papua New Guinea capital at least to a minimum level determined by the Commissioner by notice in the National Gazette.”

The authority is vested with the Commissioner to amend these requirements at any time provided the correct processes are followed.

The requirements have been increased as circumstances change. In fact the last time the requirements were altered the Office of Insurance Commissioner was in constant dialogue with industry participants to ensure that a smooth process was achieved and that companies understood the new requirements. This was achieved very effectively.

Section 19 (3) of the Act provides as follows:

“An application for a license under Subsection (1) or (2) shall –

(a) be in writing; and

(b) contain such information as is prescribed, and such additional information as the Commissioner, either generally or in any particular case, requires.”

The Commissioner is empowered to determine the level of information required to either issue a new license or renew an existing one.

Providing the above requirements and the full requirements of the Act together with the administration of the Act is the same for all entities, this is not an impost to our company. In fact this provides an opportunity to review the company in detail at least on an annual basis. The opportunity is also provided to the Office of Insurance Commissioner to review each entity on an annual basis including the financial standing of the various companies.

For new entrants this allows the Office of Insurance Commissioner to review the standing of the applicant to ensure that all of the requirements are met. It also helps prevent sub standard companies from entering the market.

It may be attractive to some for there to be cheap premiums available for a period of time, but if an insurer is wound up then the consequences can be disastrous, particularly in the case of long-tail risks. The problems with HIH in Australia were caused not so much by the failure of the law, but perhaps inattention of the regulator.

It is quite evident that the current requirements that are to be met are not an impediment, with the licensing of a number of new entities recently.

The issuance of provisional/temporary licences under certain circumstances, providing it is non-financial concerns by an entity should continue.

In the past Pacific Re was issued with a temporary licence for purely non-financial reasons. It was simply for the provision of certificates for Term Deposits and the full wording of our Retro programme. The period was only a matter of days.

Had a temporary licence not been issued, Pacific Re would be required to cease trading for that period with bad consequences for both the cedant and the company..

Common sense prevailed as there was no problem with solvency or any prudential concerns.

Alternative methods of licensing could be explored, but caution should prevail when moving forward.

Section 36 (1) of the Act provides as follows:

“All risks situated in Papua New Guinea and for which Insurance, including re-insurance, is required shall be insured with a licensed insurer unless exemption is granted under Section 37.”

The above provision is very clear and unambiguous.

There are known cases whereby insurance is placed offshore in breach of this section. There are instances in which non-licensed brokers transact business, reinsurance placements are made offshore, loss adjusters assess losses, all in breach of section 36 and without a thought to applying for an exemption on the narrow grounds available, the parties simply ignore the law and place business offshore.

One can only estimate the volume of business being placed offshore. Lloyds do not declare Financial Accounts of business written for Papua New Guinea based risks, therefore the income lost to Papua New Guinea is unknown.

This is the same scenario for reinsurance business placed offshore together with broker based business.

Under the Insurance Act 1995, no mention is made for Re-Insurance Brokers, where currently no such entities are licensed, therefore when the services of a broker is required this is sourced offshore.

The industry has worked extremely closely with the Office of Insurance Commissioner to produce documentation to assist with the exemption process to ensure as far as possible that this requirement under the Act is followed at all times.

One sector of business that may be missing the exemption process is Global Insurance Programmes, this is an area that requires to be reviewed. Typically larger multinationals will be certainly insured by say, Lloyds or another larger insurer and thus the market in Papua New Guinea misses out on this business.

The key factor to ensure that the market is regulated in accordance with Act is the vigilant administration by the regulator.

Where breaches arise then the penalties as prescribed within the Act must be imposed to arrest any irregularities that may exist.

Proposed Legislation

At this point in time the following are being reviewed for introduction, they are:

Insurance Contracts law – Papua New Guinea

The introduction of this Act if should be progressed only on a consultative basis with industry members.

The Act should not be introduced simply on the format of legislation that is in operation in other centres around the world.

It is ironic that a majority of imposts imposed by such legislation serve to increase the cost of business and may cause premiums to rise.

Risk Based Capital

There are many merits in progressing the concept of Risk Based Capital forming part of the prudential requirements of reinsurers and underwriters.

The review currently underway by the World Bank, will determine the level of information that is currently captured, what information/data is required to be captured, the maturity of the market, together with the requirements to introduce this method. In principle this methodology is utilised by many regulators throughout the world of insurance.

There are a number of different options available one being, risk based capital on the total portfolio and another being risk based capital based on each class of business written.

It is understood that the World Bank will be delivering a paper to the Office of Insurance Commissioner for discussion with all stakeholders.

Insurance Complaints Tribunal

This is another example of the Office of Insurance Commissioner working together with the Industry to bring to fruition a workable procedure and process that will work efficiently and effectively to deal with complaints by consumers and others.

The final stage is on hand with the introduction latter in 2007 being a target date. The Insurance Complaints Tribunal will ensure a smooth process for insureds to have their complaints dealt with quickly.

The introduction of the tribunal will assist with the handling of complaints by an independent body.

Reinsurance

The reinsurance market in Papua New Guinea is unique. Pursuant to section 36 all reinsurance placements must first be sought from a licensed reinsurer. The only licenced reinsurer is Pacific Re. If the Reinsurer is unable to accept the placement then Section 37 of Act provides that an entity may then seek reinsurance offshore.

The Papua New Guinea market comprises 12 insurers (including Lloyds of London) and all companies under the Act are required to have treaty reinsurance programmes in place.

Facultative placements are optional and at the discretion of the insurer whether or not this form of protection is required.

The major rationale behind purchasing reinsurance is the protection of shareholders funds. Each company forms an opinion as to their risk appetite, hence the level at which their reinsurances attach as well as the upper limit of cover that is purchased, particularly in respect of catastrophe covers.

Actuarial and Financial Modelling is a process to assist underwriters in decision-making. It is a tailored approach and is more than simply plugging numbers into a standard model. The individual circumstances of insurers are taken into consideration as well as looking to understand more than just the numbers.

The risk appetite of individual companies is a major factor, compared to the level of capital invested compared to the strength of the balance sheet.

This appetite can either increase the opportunities available for reinsurance protection or decrease them, depending of the size, capital and maturity of the company.

In Pacific Re's view under the strict interpretation of Section 36 of the Insurance Act there are instances of reinsurance placements being transacted with non-admitted Reinsurers.

As indicated previously the industry has worked closely with the Office of Insurance Commissioner to produce a suite of documents together with guidelines to ensure compliance with the Act is obtained.

The introduction of this documentation will assist entities to comply with the Act. From the Office of Insurance Commissioner's perspective this will enable the office to monitor the exemptions whilst ensuring the correct procedures and process are followed by applicants seeking exemptions to place the reinsurance offshore.

The guidelines will cover both Treaty and facultative placements.

The information is due to be released by the Office of Insurance Commissioner in the near future.

In our view with the licensing of Lloyds of London does cause loss of business opportunities for reinsurance.

When business is placed with Lloyds the opportunity to provide reinsurance within Papua New Guinea does not exist.

Existing Markets

The market currently has twelve Underwriters together with six Broking Houses and five Loss Adjusters, one of those being based offshore.

The market has witnessed the granting of new licences for Insurers, Broking and the Loss Adjusting sector of the industry.

By the simple fact that more licensed entities have been introduced there is more competition. The industry has witnessed an increased level of activity with many large, medium and small commercial lines of business changing from one broking house to another and similarly with consumers changing insurers.

There is no doubt that the levels of competition within the market has increased in particular in the past 12 months with the introduction of two new general insurance and one Loss Adjusting being granted a licence.

This increase in competition has flowed through to the end user by way of reductions in premiums and in the actual terms and conditions of cover.

Another form of competition is in the form of the terms and conditions provided for coverage, whereby one insurer may not provide a particular peril to be insured whereas an alternate insurer will provide the cover.

Prior to recent additional general insurance licenses being granted the market had shrunk with mergers and acquisitions over the years. This was further compounded by two companies ceasing to transact business in Papua New Guinea altogether.

The question really is what is the correct number of licensed entities for this sized market that the companies operate within.

In real terms there has been modest growth in the premium pool, there is not a large premium in flow from actual new business opportunities, rather the existing business being transferred from one underwriter to another.

When tasked with the opportunity to increase capacity this can be achieved by utilising alternative methodologies, such as:

1) Purchasing additional vertical cover per risk

This would entail an insurer reviewing their current capacities to understand if they are sufficient to cover not only the current writings but what business they wish to write in the immediate future.

The purchase of additional cover does come at a cost, as the rate on line may not be economically viable to write the additional business

2) Purchasing additional vertical catastrophe cover

The protection required in the event of a catastrophic event-taking place, whereby an insurer has a large aggregated exposure must be considered.

This must be reviewed in line with current and future writings, again the purchase of additional protection comes at a cost to the insurer.

The rate on line for this additional cover may far out weigh the premium writings.

3) Sideways Cover

The amount of sideways cover is largely driven by the cost of the cover.

An alternative to reduce the cost involved, in some instances the purchase of sideways cover, can be on a “drop down” methodology basis.

Insurer’s risk appetite is a dominant factor in this cover. The recovery from reinsurers for the first recovery after the retention will not impact the balance sheet or solvency margins.

Under normal circumstances this cover is required when the insurer increases the net retained level.

4) Alternative Risk Transfer

The techniques basically offer new, diverse and as the name implies alternative methods of providing protection to the insurer.

In the main the ATR’s are not traditional insurance contracts and they are not deemed to be a true banking product.

Again costs are a major factor in purchasing this protection together with the question of whether or not there sufficient volumes of premium that will be underwritten to embark upon an ATR programme.

5) **Facultative Placements**

This under normal circumstances is the most simplest and most effective manner of increasing the capacity of an insurer.

A Reinsurer can provide additional protection for a price on a “one off” basis, rather than the circumstance in which the insurer is up for a complete treaty programme when the premium writings will not achieve the minimum and deposit premiums.

This method alleviates the need for an insurer to expose the shareholders funds and purchase a treaty programme when reinsurance cover is required for only a few specific risks.

The above is dependant upon the risk appetite of the insurer, its capital structure together with the strength of the balance sheet.

Conclusion

The review of the General insurance industry is a positive initiative in particular for compliance with the Insurance Act 1995 and the resultant impact on the industry.

A review such as this, it is the total understanding of the insurance industry, the nature of and the value each individual sector contributes together with the roles that they play.

We look forward to the future dialogue with the Independent Consumer & Competition Commission as the journey continues.