
**Papua New Guinea Insurance Council
Submission**



**ICCC – Draft Report Review
of the General Insurance Industry**

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Submission on the Draft Report on the Review of the General Insurance Industry in Papua New Guinea

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) Draft Report on the general insurance industry within PNG. The PNG Insurance Council is the peak body representing the interests of the general insurance industry. This submission addresses industry specific aspects of the current review and the Council's individual members will make separate submissions to the ICCC regarding the remaining aspects of the review.

This submission incorporates the Council's overall response to the analysis and conclusions presented in the Draft Report. Where applicable, the Council has provided a specific response where the report requested comment from industry stakeholders on a particular finding or recommendation.

Where the Council has responded to a specific request for comment, the relevant report reference has been provided in the section heading.

Scope of the Draft Report & Terms of Reference

The Council is concerned that the scope of the draft report is not aligned with the original Terms of Reference (TOR) contained in the Treasurer's letter dated December 2006. The original TOR was limited to the operation of the Fire and General Insurance Industry in PNG. The Council notes however that some of the report's findings and recommendations include consideration of both the life

insurance and superannuation industries. The Council considers that these aspects of the draft report fall outside the scope of the TOR.

Furthermore, the Council notes that several important elements of the TOR have received extremely limited attention within the draft report. Some elements of the TOR that the Council considers have not been adequately reviewed include; 3B, 3C, 3F in addition to 4C & 4D. The Council is of the view that appropriate consideration and review of these issues is vital to the overall integrity of the report. The Council is also concerned that subsequent legislative changes may be contemplated without sufficient consideration and analysis of these matters.

We have previously stated the Council's position on this matter in our response to the Issues Paper, but it would appear that our observations have not been considered. Ill informed changes based upon incomplete data will inevitably have a negative impact on the industry and wider economy.

Council's View on Report Analysis & Key Findings

The Council is concerned that there are material deficiencies in the underlying analysis contained in the draft report. This appears to be substantially attributable to the unavailability of a comprehensive industry data set. This issue was raised by the Council in its initial response to the Issues Paper. Unfortunately we do not believe that this deficiency has been adequately addressed in the draft report. As a result we are concerned that the report does not provide a sufficiently robust and comprehensive basis for consideration of competition, regulatory or prudential reform.

In addition to this overall view, the Council's additional specific observations and responses are detailed below.

4.1 Reinsurance

The report indicates that "*Section 36* of the Act makes it compulsory for insurance companies to offer all of their outwards treaty reinsurance and facultative risks to locally incorporated reinsurers (i.e. Pacific Re)." Yet it also advises that treaty arrangements "fall outside the scope of *Section 36*". The Council therefore seeks clarification of this apparent contradiction.

The Council is of the opinion that Pacific Re provides a valuable service to the PNG insurance industry in addition to generating export income for PNG through the inward facultative and treaty insurance that it provides throughout the Pacific Islands. The Insurance Act was written prior to Pacific Re being incorporated, and the majority of the industry disagrees with Pacific Re's debate that treaty insurance falls within the ambit of Section 36, and would strongly oppose any change to the existing arrangements.

4.4 Industry Data & Regional Comparisons

The draft report acknowledges the limitations in the data available for this review, "the OIC was only able to provide data from 1997 to 2005 however, data before 2000 was unreliable thus the Commission used the data from 2000 – 2005 for all its analysis".

Despite this acknowledgement, the Council is concerned that the draft report nonetheless draws its findings about the relative competitiveness of the local industry from this compromised and limited set of data. The Council reiterates its position (previously stated in our response to the Issues Paper) that these data problems significantly degrade the reliability of the information available for this review and have a consequent impact on the validity of the findings and recommendations.

Given this, the Council again 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 GWP & 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 skewing the result. 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 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.

In the Council's view it is not apparent that these significant issues have been appropriately addressed or considered in the draft report.

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 (that conforms to international standards). The Council would strongly welcome the opportunity to work with the OIC to develop such an approach.

4.4.2 Market Analysis

The report finds that the PNG insurance industry may be more concentrated (as defined by comparative “concentration ratios”) than markets in Australia, South Africa and other emerging economies. In the Council’s view this analysis is misleading. The current analysis fails to take into consideration the vastly different legal, social, cultural and legislative regimes operating in these comparative jurisdictions. These social, economic and legal dimensions are among the principle determinants of the scope, scale and interaction of insurance providers. Without appropriate consideration of these factors, the Council does not support the conclusion presently contained in the report.

The Council also notes that the report does not define what constitutes “the market” when it makes international industry comparisons. As we noted in our previous submission, the PNG insurance market is typical of other developing economies in that it has a very limited retail consumer market and is heavily “weighted” towards intermediated corporate business. The Council therefore reiterates its previous view that important structural differences must be taken into consideration when undertaking international comparative analysis. As it stands, the Council does not consider that the current comparative market analysis provides a sufficient basis for consideration of policy change.

The Council’s Position on Market Competitiveness

The Council supports the Commission’s view “that the PNG general insurance industry appears to be relatively competitive.” As a general conclusion this view is consistent with those put forward by the Council in its initial submission.

The Commission's view on competition appears to have been formed based on data analysis, benchmarks against peers and market concentration measures (Concentration Ratio and HHI). Whilst the Council agrees with the conclusions reached by the Commission using these tools, it cautions against the use of this information to inform policy or regulatory decisions.

As identified in Council's initial submission there are a number of issues with data and data collection that increase the likelihood of inconsistency and potential errors. These include:

- A short historic time series (5 years)
- Exclusion of Lloyd's of London GWP & loss data
- Exclusion of GWP & loss data associated with the failed Insurers
- Differing accounting treatments
- Level of detail available

Indeed the Commission identifies in its draft report the "perceived need for more sophisticated and secure data processing systems with which to collect, monitor and analyse market data."

Without a greater level of confidence in the underlying data the Council would not support any policy or regulatory action designed to stimulate further competition. Particularly as the available empirical evidence suggests competition is getting stronger as supported by observations on innovation, efficiency and prices.

To this end the Council would prefer to see the Commission focus on strengthening confidence in the market through improving the behaviour and transparency of its participants. The Council cautiously supports the Commission's observations on the need to create greater transparency and market information (subject to further detail), which are both key elements of an efficient (more competitive) market.

The draft report refers to potential deceptive practices by insurance brokers within the PNG insurance industry. This observation appears to derive from a public submission to the ICCC. The Council considers that in the absence of any actual evidence or proof of such practices, this observation should be removed from the final version of the report.

The Council considers that insurance brokers within PNG are a professional and competent resource for insurance buyers. Furthermore, they are comparable to their counterparts in other countries in that they operate under internal codes of practice that prohibit unethical conduct.

The Council notes that the draft report states that some risks are not insured by the industry and that enhanced competition in these areas may be desirable. The Council believes that this is significant oversimplification of a complex matter.

There are a number of reasons why the existing market does not provide these products and the Council does not agree that additional "competition" will necessarily result in the provision of such forms of insurance. The Council considers the following reasons why additional competition is unlikely to produce the desired effect:

- The local market for these risks is immature and characterised by a lack of indigenous demand. The insufficient base level demand will not provide an incentive for local or international insurers to invest capital in the provision such products.
- Global insurance markets do *not* insure some of the risks listed in the report. It is thus extremely unlikely a local provider would have the capacity and / or expertise to provide such covers independently.
- There is a lack of sufficient discrete risk units in the local market that would enable an insurer to form an appropriately diversified portfolio.
- Poor or non existent loss data prohibiting accurate risk pricing.

5.5 Summary

The report indicates that industry returns may be high by international standards but this has not led to large numbers of new players entering the market. The Council disputes both of these conclusions. As we have indicated above, the report contains significant data deficiencies and includes invalid comparative analysis. We do not therefore believe that there is sufficient evidence to conclude that the PNG industry returns are above competitive norms.

Furthermore, the Council draws attention to the fact that there *have* been new entrants into the PNG market. Since 2005 there have been two new locally capitalised entrants into the PNG insurance market, Pacific Assurance Group and INSPAC (PNG) Ltd. During this period a new Loss Adjusting firm, Henry Lloyd & Associates (previously known as Mantons), has also been established

The draft report requests comment on the “transparency” of the industry with respect to the terms of cover and premium offered. Notwithstanding the fact that the draft report provides no evidence or analysis to support its assertion that there is a lack of “transparency” it is unclear by what is meant by this term. For example the “terms of cover” are *fully* articulated in the policy document that is issued to *every* insured party. What then, do the draft report authors refer to when they suggest a lack of transparency relating to policy terms and conditions?

The Council would also stress that the PNG market is dominated by corporate intermediated business. As a result, the majority of PNG insured’s are comparatively sophisticated buyers of insurance who are supported by intermediaries such as brokers. This significantly reduces the possibility that information asymmetries distort the efficient operation of the market.

6.6 Future Regulatory Arrangements

Risk Based Capital methods are referred to within the draft report and it appears to be taken as a “given” that such a regime will be introduced rather than considering the merits of the World Bank report on same. This is not due for completion until November 2007 at the earliest. The Council notes that the World Bank’s own website cites a paper cautioning against the introduction of risk based capital regimes in developing economies/markets like PNG.

6.8 Legal 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 and 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. The Council does not wish to alter this regulatory model, however, clearer delineation between the two Acts, and the classes of insurance that are contained within, would be an improvement supported by the Council.

Insurance Contracts Act

In the 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 Insured’s.

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 in Australia 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 version 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.

- 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 a very small proportion 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.

- A comprehensive set of supporting legislation needs to be in place prior to the PNG Insurance Contracts Act being incepted. Review the Australian experience to see that the ICA is supported by three other legislations that are not in force in PNG currently.

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 domestic 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 insurance industry can take place to address some of the potentially problematic aspects of this legislation.

Licencing

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

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. All PNG insurers are rated by the agencies in accordance with the PNG congruity rating. So even though the reinsurance projection and security of the underwriting paper is "A+ or better". Those domiciled insurers are only rated "B" in accordance with PNG's own rating.

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 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.

7.3 Recommendation for Single Regulator

The report suggests that “the legislation and/or law governing the PNG General Insurance, Life Insurance and Superannuation industries could be amalgamated and be regulated by a single regulator.”

The Council is strongly opposed to such a suggestion. The Council believes that the current system is effective and operates within the confines of the Act in an efficient manner. The Council does however note that recent changes to the administration of government departments have impacted upon the size and technical ability of the current OIC.

The Council is however confident that the government recognises the value of a fully resourced OIC. The Council is therefore supportive of the current OIC provided this department will be correctly resourced to ensure a strong general regulator able to audit and enforce the current Act.

Summary of the Council's Position

The Council is disappointed with this draft report. We are particularly disappointed that our initial comments regarding the Council's ongoing work with the OIC and relevant sub committees, to improve the efficiency of the industry has not been considered.

Notwithstanding this, 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 comment on the Draft Report. 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 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.

