

# *Insurance industry: Regulatory and tax update*

December 2011



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# ***Insurance industry:*** *Regulatory and tax update*

*There have been a number of recent developments across the regulatory and taxation spaces for insurance. Some of the more notable developments since June 2011 are summarised for reference in this paper.*

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1. *Regulatory and legislative developments* 4
  2. *Taxation developments* 12

# Regulatory and legislative developments

<i>Key development</i>	<i>Summary of issue</i>	<i>G</i>	<i>L</i>	<i>H</i>
Life and General Insurance Capital (LAGIC) review	<p>On 9 December 2011, APRA released its Response to Submissions paper as the latest invitation for comment on its proposals to update capital standards for general and life insurers in Australia. At the same time, it has released 7 draft prudential standards each in respect of capital requirements for general insurance companies and life insurance companies.</p> <p>APRA has outlined that the changes to the capital proposals, following the second quantitative impact study (QIS2), aim to simplify some areas of the proposals, to address areas where the initial proposals were overly conservative, and also to reduce some of the pro-cyclical effects. It anticipates that while the proposed capital requirements under QIS2 were typically greater than under the current regime, this will be to some degree mitigated following APRA's latest changes.</p> <p>APRA's timetable anticipates the final standards being effective from 1 January 2013. APRA is seeking written feedback from insurers on the response paper and the draft prudential standards by 24 February 2012.</p>	✓	✓	

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APRA release of consolidated prudential standards	<p>On 12 September 2011, The Australian Prudential Regulation Authority (APRA) released in final form four prudential standards — on governance, fitness and propriety, outsourcing and business continuity management — that will consolidate and replace 12 existing standards across the authorised deposit-taking (ADI), general insurance and life insurance industries.</p> <p>The consolidated standards closely reflect the existing industry-specific prudential standards, with minor amendments to clarify requirements and ensure consistent application across industries.</p> <p>The consolidated standards will be effective from 1 July 2012.</p>	✓	✓	
Natural Disaster Insurance Review recommendations released	<p>On 14 November 2011, Assistant Treasurer Bill Shorten released the recommendations of the Natural Disaster Insurance Review, which encompass flood risk management, insurers' claims-handling and dispute resolution processes, and the provision of flood insurance.</p> <p>Under the review's proposals, every Australian seeking to purchase or renew home and contents insurance will be offered flood cover, but will have the option to "opt out".</p> <p>The recommendations include:</p> <ul style="list-style-type: none"> <li>• A standard definition of flood</li> <li>• All insurers must offer flood cover as part of home building and home contents insurance policies, while giving consumers the opportunity to "opt out" of that cover</li> <li>• The Government will spend up to \$12 million to establish a flood risk information portal</li> <li>• A one-page "key facts sheet" to explain the major aspects of a policy</li> <li>• A reinsurance pool for high-risk properties</li> <li>• Lending institutions to remind borrowers annually of their obligation to be insured</li> <li>• Reforms to the General Insurance Code of Practice.</li> </ul>	✓		

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APRA releases final package for refinements to the prudential framework for general insurance groups	<p>On 5 October 2011, APRA released the final package relating to refinements to the prudential and reporting standards for general insurance groups.</p> <p>The refinements to the prudential framework address minor issues identified since the implementation of APRA's prudential framework for the supervision of general insurance groups in 2009. Refinements to the reporting framework align aspects of general insurance group reporting with the reporting framework for individual APRA authorised general insurers.</p> <p>The refinements reflected in the final prudential and reporting standards are largely consistent with APRA's proposals in the May 2011 discussion paper.</p> <p>The prudential standards are effective from 1 December 2011. The reporting standards are effective for reporting periods ending 31 December 2011.</p>	✓		
ASIC clarifies requirements for telephone sales of general insurance products	<p>On 28 October 2011, ASIC made class order relief to change the time for giving a Product Disclosure Statement (PDS) for a general insurance product when a retail client seeks a quote for the product during a telephone call.</p> <p>Under the relief, the client can choose to receive the PDS, and, if they do, the general insurer or intermediary must give a PDS as soon as practicable after the quote is given. This means that the PDS can be given after the telephone call.</p> <p>The relief given by ASIC does not affect the time at which a PDS must be given if a quote is given during an unsolicited telephone call, or is otherwise unsolicited by the retail client.</p> <p>This relief seeks to balance the consumer protection interest of retail clients with industry concerns about compliance costs.</p>	✓		

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Phase 1 review of financial advice industry practice	<p>On 21 September 2011, the Stronger Super package was announced.</p> <p>The Government's improvements in a number of areas would ensure super fund members continued to benefit from choice, flexibility and competition in superannuation.</p> <p>The improvements to MySuper include:</p> <ul style="list-style-type: none"> <li>• Super funds variable pricing (variable investment fees and variable administration fees) and tailored investment strategies for workplaces of more than 500 employees to reflect workplace profiles and demographics;</li> <li>• Limited flexibility for workplaces of less than 500 employees through flexible administration pricing;</li> <li>• Flexibility and workplace tailoring for insurance; and</li> <li>• No requirement for a separate licence or fund for MySuper.</li> </ul> <p>Other measures announced included:</p> <ul style="list-style-type: none"> <li>• Account consolidation for superannuation balances greater than \$1000; and</li> <li>• Appropriate risk-based capital requirements for super funds.</li> </ul>			✓

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ASIC seeks improvement in CCI sales practice	<p data-bbox="383 282 919 413">On 19 October 2011, ASIC issued a report of findings and recommendations from its review of how consumer credit insurance (“CCI”) is sold. The recommendations cover the areas of sales practices, disclosure, training programs and monitoring systems.</p> <p data-bbox="383 428 808 475">In its review of sales practices, ASIC identified the following risks:</p> <ul data-bbox="383 491 835 826" style="list-style-type: none"> <li data-bbox="383 491 835 538">• Consumers not being made aware that they have purchased CCI or that CCI is optional</li> <li data-bbox="383 555 768 602">• Consumers not being asked whether or not they wish to purchase CCI</li> <li data-bbox="383 619 781 701">• Consumers not being eligible to claim on all components of the CCI policy they have purchased</li> <li data-bbox="383 718 802 765">• The potential for consumers to be pressured or harassed by sales staff, and</li> <li data-bbox="383 782 789 829">• Consumers not understanding the cost or the duration of the CCI policy.</li> </ul> <p data-bbox="383 845 906 944">ASIC has made 10 recommendations to improve the way in which CCI is sold in Australia so consumers are better informed and more confident in deciding whether or not to purchase CCI.</p> <p data-bbox="383 961 916 1117">ASIC plans to conduct a further review of claims handling and insurer practices for CCI, and industry has indicated support for the second stage of the review. The Financial Services Council has committed to produce guidance for life insurers that issue CCI, based on any relevant recommendations arising from both stages of the review.</p>	✓	✓	

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Draft FOFA Legislation	<p>On 29 August 2011, the Assistant Treasurer and Minister for Financial Services and Superannuation, Bill Shorten, released the first tranche of draft legislation of the Future of Financial Advice (FOFA) reforms for public consultation.</p> <p>The first tranche of the draft Bill covers a number of key components of the FOFA reforms, including:</p> <ul style="list-style-type: none"> <li>• biennial 'opt-in' arrangements and annual fee disclosures</li> <li>• an increase in ASIC's power to enforce the new elements of these reforms.</li> </ul> <p>The 'opt-in' measure requires a financial adviser or planner to send a renewal ('opt-in') notice every two years to new clients, as well as an annual fee disclosure statement to all clients. There will be significant flexibility in terms of how advisers are able to discharge the opt-in obligation.</p> <p>This Bill is currently subject to two inquiries – the Parliamentary Joint Committee and the Senate Economics Committee. Submissions to these committees are being accepted by 22 December 2011 and 27 January 2012 respectively.</p> <p>The second and final tranche, released on 28 September 2011 included proposals in relation to:</p> <ul style="list-style-type: none"> <li>• a statutory best interest duty</li> <li>• a ban on conflicted remuneration (including product commissions)</li> <li>• a ban on volume-based shelf-space fees</li> <li>• a ban on asset-based fees on geared funds.</li> </ul> <p>The ban on conflicted remuneration (including the ban on commissions) will not apply to existing contractual rights of an adviser to receive ongoing product commissions.</p>	✓

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Churning in life insurance	<p>The Financial Services Council (FSC) announced on 4 August 2011 that the Council would issue a Standard to address the practice of churning in life insurance.</p> <p>Churning is a practice whereby consumers with an existing life insurance policy are sold a new policy by a financial adviser that has no net benefit for the consumer.</p> <p>Key reforms under this Standard will include:</p> <ul style="list-style-type: none"> <li>• The removal of “takeover terms” (that is, banning the practice of the relaxation of the standard underwriting process for replacement business) for a policy or a group of policies that are transferred by an adviser between insurers; and</li> <li>• The establishment of a consistent adviser responsibility period across the industry of two years – with 100 per cent commission clawback if the policy lapses with an insurer within one year, and 50 per cent commission clawback if the policy lapses with an insurer during the second year.</li> </ul> <p>The FSC aims to have a Standard finalised in 2012. The clear aim of this Standard will be to support the statutory requirement for advisers to act in the client’s best interests, improve the affordability of premiums, and improve trust in the life insurance industry and the advice profession.</p>		✓	

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National Disability Insurance Scheme	<p>On 4 December 2011, the Australian Labor Party announced that the adoption of National Disability Insurance Scheme (NDIS) would be a key policy platform for the Party with a view to implementing the Scheme effective 2018.</p> <p>The Australian Government had asked the Productivity Commission to undertake a public inquiry into a long-term disability care and support scheme. The Commission recommended the NDIS in its final report to the Government on 31 July 2011.</p> <p>The NDIS would provide insurance cover for all Australians in the event of significant disability, funding of which would be a core function of government, akin to Medicare.</p> <p>In addition to funding long-term high quality care and support for people with significant disabilities, some of the other aims of the NDIS would include providing frameworks for linking community and people with disabilities and for supporting best practice among providers.</p>			✓

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# Taxation developments

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Changes to the Research & Development (R&D) Concession	<p>On 24 August 2011, a new R&amp;D tax incentive program was introduced to replace the existing R&amp;D Tax Concession, with a start date of 1 July 2011 (1 January 2012 for December year ends). The new program has two tiers:</p> <ul style="list-style-type: none"> <li>45 per cent refundable R&amp;D tax offset will be available for companies with a grouped turnover of less than \$20 million. This is equivalent to a 15c in the dollar benefit, and</li> <li>40 per cent non-refundable R&amp;D tax offset will be available for companies with a grouped turnover of more than \$20 million. Equivalent to a 10c in the dollar benefit.</li> </ul> <p>The biggest change for the insurance industry is the change to the “multiple sale” rule for computer software development. Under the old rules, computer software development was not eligible unless it was for sale, licence, rent, hire or lease to two or more non-associates of the developer. Under the new rules, computer software development will be eligible unless it is for the dominant purpose of use by the developer for its internal business administration.</p>	✓	✓	✓

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<b>ATO TOFA Compliance Activity</b>	<p>As alluded to in the 2011-2012 ATO Compliance Program, the ATO has recently commenced the pilot of its TOFA Implementation Reviews by sending TOFA questionnaires to a number of taxpayers, seeking information in relation to a range of issues, including:</p> <ul style="list-style-type: none"> <li>identifying taxpayers who meet the TOFA threshold to ensure they are applying the TOFA rules;</li> <li>calculating the balancing adjustment for taxpayers who have made the transitional election;</li> <li>the validity of elections made under the TOFA rules; and</li> <li>the appropriate application of TOFA tax-timing methods.</li> </ul>	✓	✓	✓
<b>Stamp Duty and Life Insurance</b>	<p>The South Australian Court of Appeal handed down its decision in <i>National Mutual Life Association &amp; Ors v Commissioner of State Taxation</i> [2011] SASCFC 106 on 30 September 2011. The Court of Appeal dismissed the appeal of the four insurers against assessments of stamp duty made by the South Australian Commissioner of Taxation. The Court found that the amount of stamp duty payable on “life riders” is the higher rate applicable to premiums “relating to policies of any kind (other than life insurance policies)” and not the lower rate of duty payable on premiums “relating to life insurance”.</p> <p>The relevant insurance duty provisions dealt with in this case was amended prior to the delivery of the decision. The amendments clarified the Commissioner’s position that any premiums relating to life riders are payable at the higher rate of duty applying to general insurance.</p>		✓	

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ATOID 2011/58: The Taxation of “tax preferred” Amounts	<p>In July 2011, the ATO issued ATO Interpretative Decision ATO ID 2011/58. This ATOID indicates that “tax preferred” distributions made by a Managed Investment Trust (MIT) to a general insurance company should be included in the unitholder’s assessable income, as ordinary income.</p> <p>Insurance companies are distinguished from other entities by the fact that they hold their investments on revenue account. The ATOID states that “the investment of funds is as much a part of the business as is the collection of premiums”.</p> <p>‘Tax preferred’ amounts may include:</p> <p>(a) income which is sheltered by non cash deductions e.g. building allowance (<b>tax deferred amounts</b>)</p> <p>(b) capital gains realised by the trustee that are not included as assessable income (e.g. <b>CGT concession amounts</b>)</p> <p>We note however, the industry does not agree with the position adopted in this ATOID. The Financial Services Council has raised this with the ATO.</p>	✓	✓	✓
Goods & Services Tax and General Insurance	<p>In response to the court’s decision in the Department of Transport GST case (which concerned multi-party transactions), the ATO has released a Draft Addendum GSTR 2006/11 which slightly amends the ATO’s previous views in relation to when insurers will be entitled to claim input tax credits (ie GST credits) in respect of certain claims expenses.</p> <p>The ATO’s revised view intends to recognise that insurers may qualify for input tax credits in a wider scenario than was previously accepted by the ATO, however, we note the ATO’s revised view is in draft and practically, we note they appear to be cautious regarding expanding their position too wide.</p>	✓		

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Goods & Services Tax and Life Insurance	<p>The ATO has been undertaking a coordinated 'Phase 1' review of GST Apportionment Methodologies adopted by Life Insurers in order to obtain a better understanding of the spectrum of approaches adopted in the industry. It is expected that the ATO will collate the results of its reviews to date and undertake further activity in this area in the near future.</p> <p>While no specific GST technical developments have occurred in recent times, the significant change in the industry as a result of the Future of Financial Advice Reforms (FoFA) will have significant GST implications. These implications include:</p> <ul style="list-style-type: none"> <li>• technical GST considerations regarding the entitlement to input tax credits on payments made to advisers</li> <li>• operational systems considerations regarding changes to GST coding, distinguishing between pre and post FoFA arrangements, GST accounting issues</li> <li>• compliance considerations in relation to the correct GST commentary regarding PDS disclosures and unit pricing calculations.</li> </ul>		✓	
Goods & Services Tax and Health Insurance	<p>The Department of Transport GST case (which concerned multi-party transactions) has resulted in a significant change in the ATO's interpretation of the existing GST law and has the potential to have a profound impact on the health insurance industry.</p> <p>As a result, the Federal Government's announced in May 2011 that changes will be made to the GST legislation relating to supplies made by health service providers to health insurers.</p> <p>Provided the revised GST law changes are broad enough to address the issues resulting from the Department of Transport GST case, the impact for most health insurers (providing community rated private health insurance) will be limited. However, if the law change is inadequate, the implications for health insurers are likely to remain significant with the potential to adversely impact claims costs and create resulting implications for systems, processes and contract negotiations with suppliers.</p> <p>The revised law change is due to be introduced in the Federal Parliament in November 2011.</p>			✓

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## ***Key contacts***

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