INSURANCE COUNCIL OF AUSTRALIA

Mr Anthony Johnston
Commissioner of State Revenue
NSW Office of State Revenue
The Lang Centre, 132 Marsden Street
PARRAMATTA NSW 2150

4 April 2016

Dear Mr Johnston

TREATMENT OF RISKS COVERED WITHIN PI INSURANCE POLICIES

The Insurance Council of Australia[1] (the Insurance Council) is writing in response to the NSW Office of State Revenue's (OSR) recent interpretation of Section 233 of the *Duties Act 1997* NSW (the Act), which classifies types of general insurance policies for the purpose of charging duty.

The Insurance Council understands that the OSR has taken a view that a number of occupational indemnity risks – to date treated as "Type B insurance" under paragraph 233(2A)(d) of the Act and attracting a 5 per cent duty – should be treated as "Type A insurance" under subsection 233(2) of the Act, which attracts a 9 per cent duty.

On this view, the OSR considers that the following occupational indemnity risks (the risks) should be treated as Type A insurance: libel and slander; dishonesty; loss of documents; infringement of intellectual property rights; breach of fiduciary duty; fidelity; and breach of any trade practices of fair trading legislation, including the *Competition and Consumer Act 2010*.

The approach which the OSR has put to several of our members is that these risks arise out of the actions of a professional, not from the provision of a professional service, and on that basis should not be treated as '*Type B insurance*', as provided under paragraph 233(2A)(d):

> "… *occupational indemnity insurance, being insurance covering liability arising out of the provision by a person of professional services or other services, or* …"

The Insurance Council strongly disagrees with the OSR's interpretation.

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. December 2015 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $43.4 billion per annum and has total assets of $119.3 billion. The industry employs approximately 60,000 people and on average pays out about $121.9 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

Firstly, we consider that the OSR's position conflicts with the general principles of statutory interpretation. The relevant provisions of Section 233 of the Act were introduced by NSW in 1989 to harmonise its treatment of stamp duty with other Australian jurisdictions. Importantly, the intention was lower administration costs for insurers and the OSR, and to end discrimination against professional indemnity insurance by applying to those products a lower duty rate (with no limitations or exceptions).

Given the purpose of the changes, we believe that the scope of paragraph 233(2A)(d) should be taken broadly. This position is strengthened by the paragraph's reference to "other services", which captures risks that arise from or are in connection with the provision of professional services.

Furthermore, the OSR's interpretation conflicts with longstanding market practice that has been accepted by the NSW government for over 26 years. It is customary that professional indemnity insurers not charge extra for the risks; they are captured within the scope of a standard professional indemnity policy and do not attract a separate premium.

The OSR's interpretation would create uncertainty and unnecessary complexity, leading to unnecessary administrative costs for Australian professional indemnity insurers and ultimately higher insurance prices for professionals.

For these reasons, the Insurance Council submits that it should be accepted that all the risks covered by a policy of professional indemnity insurance fall under paragraph 233(2A)(d). The Attachment sets out the detailed reasoning for our position.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director and CEO

ATTACHMENT

REASONS WHY THE OSR'S INTERPRETATION IS MISGUIDED

Legislative intent

The Insurance Council notes that in interpreting provisions within an Act or statutory rule, regard should be had to the underlying purpose of the legislation or to any contextual material that points to its purpose. These are key principles of statutory interpretation.

Section 33 of the *Interpretation Act 1987* provides that regard should be had to the underlying purpose of an Act:

> *"In the interpretation of a provision of an Act or statutory rule, a construction that would promote the purpose or object underlying the Act or statutory rule … shall be preferred to a construction that would not promote that purpose or object."*

However, it is not clear whether the OSR has considered the underlying intent of paragraph 233(2A)(d) of the Act or relied on any contextual material in arriving at its interpretation.

The definition of occupational indemnity insurance under paragraph 233(2A)(d) uses the same wording from Section 86 of the Stamp Duties Act 1920 (NSW)[2]. It is therefore important to consider the intent[3] of that legislation, which was to:

- harmonise the treatment of duty in NSW with other Australian jurisdictions;
- reduce administrative and compliance costs for insurers and the OSR;
- overcome discrimination against certain types of insurance, including occupational indemnity insurance; and
- facilitate the further conduct of insurance business (locally and internationally).

Section 86 of the former Stamp Duties Act 1920 (NSW) was amended on 24 August 1989 by the Stamp Duties (Amendment) Act 1989 No. 113[4]. One of the main purposes of that amendment was to bring NSW into line with other Australian jurisdictions by assessing duty on the basis of a percentage of premiums received rather than on each policy being individually assessed as a percentage of the sum insured (the previous NSW system).

In his second reading speech[5] of the Stamp Duties (Amendment) Bill 1989 at the NSW Legislative Assembly in July 1989, the Minister for Industrial Relations and Employment and Minister Assisting the Premier, the Hon. John Fahey, explained that:

> "*The bill, therefore, is a significant step in providing harmony in the imposition of stamp duty on insurance policies by bringing New South Wales into line with the rest of Australia in this regard*."

In addition to being inconsistent with other jurisdictions in Australia, the previous NSW system was also criticised as being time consuming, and the new system was therefore

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[2] Paragraph 86(1)(d) of the former Stamp Duties Act 1920 (NSW); this Act was repealed with effect from 2 July 2008.
[3] Stamp Duties (Amendment) Bill 1989 second reading speeches and associated statements to the: NSW Legislative Assembly on 25 July 1989; and NSW Legislative Council on 2 August 1989.
[4] The NSW Stamp Duties (Amendment) Bill 1989 was debated in the NSW legislative assembly in July 1989 and in the NSW legislative council in August 1989.
[5] Stamp Duties (Amendment) Bill 1989, second reading speech to the NSW Legislative Assembly on 25 July 1989 by the Hon. John Fahey (Southern Highlands), Minister for Industrial Relations and Employment and Minister Assisting the Premier.

praised, given its intent to reduce administrative costs for insurers. This feature of the legislation was also outlined by Mr Fahey in his second reading speech:

> "*The advantages of the percentage of premium system are several. First, it is simple … At present … this may involve painstaking analysis in examining each policy to determine the correct duty, and this increases compliance costs for insurers*."

In a similar vein, that amendment was also to reduce unnecessary administrative costs for the NSW government by simplifying audit procedures for NSW Office of State Revenue, as also highlighted by Mr Fahey:

> "*This aspect* [of a percentage of premium system] *also makes much simpler the auditing of insurers by compliance officers of the Office of State Revenue.*"

Significantly, another major and intended advantage of that amendment was to overcome discrimination against certain types of insurance – including occupational indemnity insurance – by introducing the split rate system. This broadly applied a lower rate to occupational indemnity insurance with no exceptions or limitations; its broad intent was explained[6] as:

> "*The last major advantage of the percentage of premium system … is that it overcomes the discrimination of the present system … This necessitated the split rates … a lower rate of … for motor vehicle, aviation, disability income and occupational indemnity insurance.*"

Supplementing that explanation, the Hon. Edward Pickering importantly added that the amendment would harmonise legislation to the benefit of industry as it would "*facilitate further the conduct of insurance business*"[7]. This indicates that the amendment was intended to help facilitate trade of Australian-issued insurance products (locally and internationally).

On that basis, the Insurance Council submits that the intention was to give the definition of occupational indemnity insurance under paragraph 233(2A)(d) a broad scope, in order to achieve its jurisdictional uniformity and administrative efficiency objectives. It is also clear from the parliamentary reading speeches that no limitations or exceptions to the lower rate for occupational indemnity insurance were intended; the split rate was intended to overcome discrimination of occupational indemnity insurance (and other insurance) more broadly.

Accordingly, it is apparent that paragraph 233(2A)(d) was intended to capture risks that arise from or are in connection with the provision of professional services or other services.

Indeed, the paragraph's reference to "other services" demonstrates its intention to capture risks associated with services beyond those 'strictly regarded' as professional services. It would be unnecessary for each risk to be explicitly identified in the paragraph to justify its coverage.

Therefore, the Insurance Council firmly submits that paragraph 233(2A)(d) captures all of the risks the classification of which has been questioned by the OSR: libel and slander;

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[6] This intent was reiterated by both the Hon. Edward Pickering, Minister for Police and Emergency Services and Vice-President of the Executive Council and the Hon. John Matthews, Member of the NSW Legislative Council at the second reading speech of the Stamp Duties (Amendment) Bill 1989 to the NSW Legislative Council on 2 August 1989.

[7] Stamp Duties (Amendment) Bill 1989, second reading speech to the NSW Legislative Council on 2 August 1989 by the Hon. Edward Pickering, Minister for Police and Emergency Services and Vice-President of the Executive Council.

dishonesty; loss of documents; intellectual property; breach and fiduciary duty; fidelity; and breach of any trade practices of fair trading legislation, including the *Competition and Consumer Act 2010*.

Established market practice

The Insurance Council notes that market practice is for professional indemnity insurers not to charge a separate premium for the risks. We consider that this should be taken into account in considering the underlying intent of paragraph 233(2A)(d) of the Act.

Subsection 34(1) of the *Interpretation Act 1987* provides that in interpreting an Act or statutory rule, regard should be given to extrinsic materials that are capable of assisting in the ascertainment of its meaning:

> *"In the interpretation of a provision of an Act or statutory rule, if any material not forming part of the Act or statutory rule is capable of assisting in the ascertainment of the meaning of the provision, consideration may be given to that material… to determine the meaning of the provision … if the provision is ambiguous or obscure, or … if the ordinary meaning conveyed by the text of the provision … leads to a result that is manifestly absurd or is unreasonable."*

We consider that this encompasses how paragraph 233(2A)(d) is applied by professional indemnity insurers.

While the risks may be referred to as 'extensions' by convention, they are generally not optional and there is no specific premium allocation to them. In practice, the risks are treated as clarifications of cover and are captured within the scope of a standard professional indemnity insurance policy; they are not treated as separate insurables.

Market practice is for all risks covered by a standard professional indemnity policy to be underwritten on an aggregate basis; these policies are offered on this basis and this practice is well understood by professionals seeking cover. As this practice is well understood by the legal and judicial profession, it has helped produce consistency and certainty in the application of the Act.

The cost of systems changes required to accommodate a completely different approach to imposing stamp duty on professional indemnity insurance would be significant. It would, at a minimum, require creating new underwriting systems and software.

This would unduly constrain the commercial activities of insurers and deter investment in productive measures that support consumer welfare, such as measures that enhance product/service quality and support competitive pricing and consumer choice.

We consider that the cost of upfront system changes would far exceed the amount of any duty revenue that may be raised. Indeed, the OSR may itself incur substantial costs directly related to the administration of its own interpretation, and these costs alone may exceed any revenue that may be raised.

For these reasons, Insurance Council submits that any departure from established industry practice should be undertaken with an awareness of the likely consequential inefficiencies – these concerns are highlighted in the following sections.

Detriment to consumer welfare and competitiveness

The Insurance Council submits that the OSR has failed to take account of the detrimental impact that its interpretation of paragraph 233(2A)(d) would have on professionals and the competitiveness of Australian professional indemnity insurers.

Firstly, the OSR's interpretation would lead to unwarranted higher professional indemnity insurance premiums; in part, from the higher stamp duty but predominantly from the significant compliance costs associated with implementation (discussed further below).

This would create an unnecessary additional cost for professionals and discourage them from seeking protection – or optimal levels of protection – from professional indemnity insurance offered by Australian insurers.

Secondly, the OSR's interpretation would raise premiums of Australian-issued policies relative to foreign policies, consequently making Australian policies less attractive and diminishing the global competitiveness of Australian professional indemnity insurers.

Stamp duty should be applied based on location of risk rather than the residency status of the insurer. In this sense, duty should be the same for policies written by resident insurers and non-resident insurers alike.

However, our understanding is that foreign insurers are less likely to comply and the OSR is less able to enforce compliance of foreign insurers, which gives rise to our competition concerns. It that regard, Australian professional indemnity insurers will be placed at a material competitive disadvantage to foreign providers.

This would have a material flow on effect to associated industries, as dispute resolution and litigation may then be managed in foreign jurisdictions.

As we pointed out earlier, a key intent of the relevant legislative amendments in 1989 was to "*facilitate further the conduct of insurance business*"[8]; this would encompass encouraging the commercial attractiveness of Australian-issued insurance products as compared to foreign competition. For that reason, an interpretation of paragraph 233(2A)(d) which would diminish the international competitiveness of Australian professional indemnity insurers is inconsistent with that intent.

While some additional duty revenue may be raised in this process, the OSR's interpretation would serve to distort the behaviour of consumers with consequential impacts on the quality and choice of Australian professional indemnity insurance policies.

Policy rationale for change

Any proposed changes to taxation policy should be underpinned by a thorough cost-benefit analysis within a broader process where all stakeholders generally can be seen to benefit from an outcome that promotes the wider community interest. Undertaking this analysis would ensure that there is a net community benefit to be derived from the policy change, and that a net efficiency loss for the community is not generated.

[8] Stamp Duties (Amendment) Bill 1989, second reading speech to the NSW Legislative Council on 2 August 1989 by the Hon. Edward Pickering, former Minister for Police and Emergency Services and Vice-President of the Executive Council.

However, it does not seem that the OSR has performed any analysis of the potential impact of its interpretation. We consider that it is important for the OSR to be able to clearly demonstrate to the community how its interpretation would deliver a net benefit.

Accordingly, the OSR should complete a cost-benefit analysis of the potential impact of its interpretation. If there is any benefit to the community to be gained, the OSR should clearly explain how this outweighs the significant costs. However, the Insurance Council submits that performing such an analysis would reveal that the total costs far exceed any benefits that may be identified.