



**RESERVE  
BANK**

O F N E W Z E A L A N D  
T E P Ū T E A M A T U A

# **Issues Paper: Review of the Insurance (Prudential Supervision) Act 2010**

**March 2017**



## Submission contact details

**The Reserve Bank invites submissions on this *Issues Paper* by 5pm on Friday 30 June 2017. Please note the disclosure on the publication of submissions below.**

The Reserve Bank would appreciate receiving a copy of your submission, in electronic form, to the email address: [jpsareview@rbnz.govt.nz](mailto:jpsareview@rbnz.govt.nz)

Microsoft Word format (.doc or .docx) is preferred as that assists the efficient collation and analysis of comments.

Address submissions and enquiries to:

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## Current information available

Information about the review, including the Terms of Reference, is available on the Reserve Bank website at:

<http://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/review-of-the-insurance-prudential-supervision-act-2010>

## Publication of submissions

*All information in submissions will be made public unless you indicate you would like all or part of your submission to remain confidential. Submitters who would like part of their submission to remain confidential should provide both a confidential and public version of their submission. Apart from redactions of the information to be withheld (i.e. blacking out of text) the two versions should be identical.*

*Submitters who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to section 105 of the Reserve Bank of New Zealand Act 1989, section 54 of the Non-Bank Deposit Takers Act, section 135 of the Insurance (Prudential) Supervision Act 2010 (as applicable); or the grounds for withholding information under the OIA. If an OIA request for redacted information is made the Reserve Bank will make its own assessment of what must be released taking into account the submitter's views.*

*The Reserve Bank may also publish an anonymised summary of the submissions received in respect of this Issues Paper.*

# Table of Contents

Submission contact details .....	3
Current information available .....	3
Publication of submissions .....	3
<b>Table of Contents</b> .....	<b>4</b>
<b>Glossary</b> .....	<b>5</b>
<b>Part 1. Introduction</b> .....	<b>6</b>
1.1 Rationale for review .....	6
1.2 Terms of reference.....	7
1.3 IMF financial sector assessment programme review .....	7
1.4 Review process outline .....	8
1.5 Regard to philosophy of supervision and regulation .....	11
<b>Part 2. Potential issues identified</b> .....	<b>13</b>
2.1 Entities required to be licensed .....	13
2.2 Overseas insurers.....	16
2.3 Statutory funds and enhanced protection of life insurance policyholders.....	20
2.4 Role of key officers and key control functions .....	21
2.5 Enforcement regimes.....	25
2.6 Distress Management .....	26
2.7 Solvency requirements .....	28
2.8 Supervisory processes – regulatory approvals.....	30
2.9 General disclosure and Financial Strength Rating requirements .....	32
2.10 Appropriate regulatory mechanisms.....	34
2.11 Other matters.....	37
<b>Part 3. Have your say</b> .....	<b>39</b>
3.1 Consolidated list of questions .....	39
<b>Appendix 1 Legislative tools factors</b> .....	<b>42</b>
<b>Appendix 2 Licensed insurer gross premium by domicile</b> .....	<b>43</b>

## Glossary

Act	Insurance (Prudential Supervision) Act 2010
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
IPSA	<a href="#">Insurance (Prudential Supervision) Act 2010</a> <sup>1</sup>
FMA	Financial Markets Authority
FSAP	The IMF Financial Sector Assessment Programme
RBNZ	Reserve Bank of New Zealand
Regulations	<a href="#">Insurance (Prudential Supervision) Regulations 2010</a> ) <sup>2</sup>
Review	Review of the Insurance (Prudential Supervision) Act 2010

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<sup>1</sup> Available at <http://www.legislation.govt.nz/act/public/2010/0111/latest/DLM2478115.html?src=qs>.

<sup>2</sup> Available at <http://www.legislation.govt.nz/regulation/public/2010/0454/latest/DLM3424801.html>.

## Part 1. Introduction

1. The Reserve Bank is undertaking a review (the Review) of the Insurance (Prudential Supervision) Act 2010 (IPSA). This *Issues Paper* is the first consultation paper prepared for the Review.
2. The paper is structured as follows. *Part 1. Introduction*, provides an outline of the rationale for the Review, the terms of reference, and the intended process and timeframes for the Review. *Part 2. Potential issues identified*, discusses potential issues that could be considered in the Review identified by the Reserve Bank, and *Part 3. Have your say*, requests comments and submissions in respect of the issues presented, the questions set out within the *Issues Paper* and any other areas that you consider relevant to the Review.

### 1.1 Rationale for review

3. It has been around six and a half years since IPSA was enacted, making it timely to review the effectiveness of the legislation in terms of its initial aims, and in light of the risk-based approach to prudential supervision that has been implemented. A review will provide an opportunity to enhance the efficient and effective operation of the regime taking account of:
  - the experience of the insurance sector, and the Reserve Bank, with the legislation and supervisory framework, including any unexpected compliance or administrative costs, and any inappropriate impediments to competition and innovation;
  - changes and emerging developments in the New Zealand insurance sector and internationally since IPSA was developed, such as the entry and exit of insurers, and the development of new business models and distribution channels;
  - potential concerns with some aspects of the legislative framework raised with the Reserve Bank by some insurance sector stakeholders;
  - changes to international standards and guidance on insurance regulation and supervision e.g. the latest revision of the International Association of Insurance Supervisors Insurance Core Principles, was adopted in November 2015;<sup>3</sup>
  - changes to, or recent reviews of, other relevant legislative frameworks and possible opportunities to improve the consistency of the IPSA framework with these frameworks; and
  - any need for minor or technical amendments to the legislation, such as the removal of redundant sections or drafting clarifications.

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<sup>3</sup> See <http://www.iaisweb.org/page/supervisory-material/insurance-core-principles>.

## 1.2 Terms of reference

4. The terms of reference for the Review were released, following their consideration by Cabinet, in April 2016.<sup>4</sup> The terms of reference set out the objectives of the review as to:

*“Assess the performance of IPSA, in light of its purposes, to ensure that IPSA provides for a cost effective supervisory regime that promotes the soundness and efficiency of the insurance sector. The outcomes sought are that IPSA empowers a regulatory regime that:*

- *provides an appropriate balance between promoting soundness and efficiency;*
- *allows firms to meet requirements cost effectively and does not unduly inhibit innovation or the entry of new insurers;*
- *applies requirements to the appropriate range of insurers;*
- *is flexible enough to adapt to changing circumstances and diverse business models;*
- *allows for a risk-based approach to regulation and supervision by ensuring regulatory requirements and responses are proportionate; and*
- *can be implemented in a way that minimises administrative costs and supports transparency.*

*• Assess the consistency of the regime with international guidance and other legislation administered by the Reserve Bank and consider if further alignment would be appropriate given the nature of the New Zealand insurance sector.”*

5. The terms of reference are intentionally broad to enable the review of the legislation to be comprehensive.
6. The Reserve Bank considers the current regulatory purposes of IPSA remain appropriate. Specifically to:
- a) promote the maintenance of a sound and efficient insurance sector; and
  - b) promote public confidence in the insurance sector.

## 1.3 IMF financial sector assessment programme review

7. In 2016, the International Monetary Fund (IMF) undertook a comprehensive independent review of New Zealand’s financial system, as part of the Financial Sector Assessment Programme (FSAP). An FSAP review assesses the resilience of the financial sector, the quality of the regulatory and supervisory framework, and the capacity to manage and resolve financial crises. New Zealand authorities<sup>5</sup> requested that the 2016 FSAP review include a full assessment of the insurance sector’s regulatory and supervisory framework against the International Association of

<sup>4</sup> Available at <http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/insurers/regulation/Terms-of-reference.pdf?la=en>.

<sup>5</sup> The Reserve Bank of New Zealand, the Financial Markets Authority, the Treasury and Ministry of Business, Innovation and Employment.

Insurance Supervisors Insurance Core Principles (ICPs).<sup>6</sup> The IAIS ICPs provide a globally accepted framework for the supervision of the insurance sector.

8. The FSAP review is an opportunity for New Zealand's regulatory and supervisory framework to be benchmarked against current international standards. The assessment will provide a key input to the objective set out in the Terms of Reference to "*Assess the consistency of the regime with international guidance [...] and consider if further alignment would be appropriate given the nature of the New Zealand insurance sector*".
9. The IMF completed its detailed assessment of the insurance sector during August and September 2016. The assessment included substantial engagement with selected New Zealand licensed insurers, government insurance schemes (e.g. ACC, EQC) and industry and professional bodies.
10. The findings and recommendations of the IMF's FSAP assessment are expected to be published in the second quarter of 2017. The Reserve Bank will consider the recommendations arising from the assessment and factor them into its analysis for the review of the legislation to the extent they are appropriate for the New Zealand regulatory and supervisory framework.

#### **1.4 Review process outline**

11. The intention is that the Review will progress in three broad phases:
  - Phase 1: Identification of issues to be taken forward;
  - Phase 2: Policy analysis and options for change; and
  - Phase 3: Enactment and transition to implementation.
12. The phases and indicative timing are illustrated in Figure 1 (page 10).

##### ***Phase 1: Identification of issues to be taken forward***

13. Phase 1 will focus on the identification of potential issues for consideration during the Review, taking account of:
  - stakeholder submissions to this Issues Paper;
  - the recommendations arising from the IMF Financial Sector Assessment Programme's review of New Zealand's regulatory and supervisory framework for the insurance sector (see section 1.3); and
  - potential issues identified by the Reserve Bank (discussed in Part 2).

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<sup>6</sup> Information about the International Association of Insurance Supervisors (IAIS) and the Insurance Core Principles is available at: <http://www.iaisweb.org/home>.



14. The consultation in respect of this Issues Paper will occur over the first half of 2017. The Reserve Bank will then determine which areas will be taken forward to the next phase of the Review.
15. Where legislative change is anticipated, the Government and Cabinet will need to broadly support the intention to complete more detailed policy analysis in those areas during Phase 2 of the Review.
16. The Reserve Bank may facilitate workshops or other forums over 2017 to discuss the ideas presented in this Issues Paper, subject to demand.

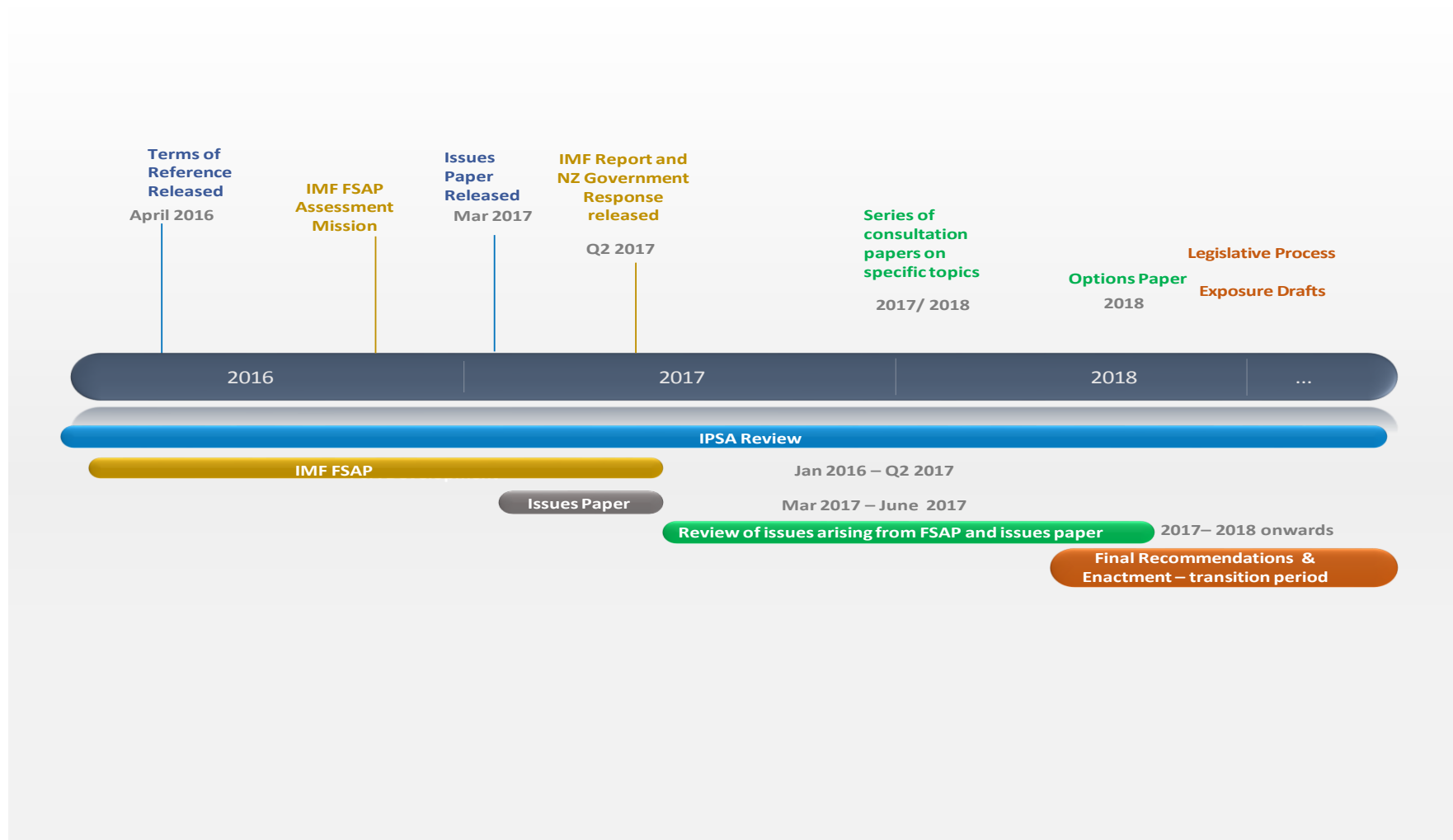
***Phase 2: Policy analysis and development of options to address identified policy concerns***

17. During Phase 2 of the Review, the areas agreed to be brought forward from Phase 1 will be considered in more detail. This work will include developing a deeper understanding of the issues identified and any associated policy concerns. Additional consultation and stakeholder discussions will occur to ensure that areas of potential policy concern are clearly identified and understood, and to help develop proposed solutions to these concerns that are expected to be effective.
18. Phase 2 will take place over 2017 and 2018, with the intention that the key conclusions of this phase are presented in an *Options Paper* for further public consultation. The timing of this phase is dependent on the nature of the issues identified and the priority given to the analysis in each of the identified areas.

***Phase 3: Enactment and transition to full implementation of any changes***

19. In Phase 3 of the Review, detailed specifications for any legislative change proposals arising from Phase 2 will be developed. These will be supported by exposure drafts of amended legislation for consultation following Cabinet approval.
20. Any legislative change proposals are expected to be introduced to Parliament during 2018 at the earliest.
21. Where any proposed legislative changes result in new requirements being placed on licensed insurers, it would be expected that appropriate transition periods would be applied before the new requirements come into full effect. Any transition arrangements will depend on the nature of the change, the significance of the change to the sector and the balance between meeting the prudential policy objectives in a timely manner and the effective implementation of the requirements.

Figure 1: Indicative timeline for the review of the Insurance (Prudential Supervision) Act 2010



## 1.5 Regard to philosophy of supervision and regulation

22. The Reserve Bank, in considering any areas of prudential policy concern identified during the Review, and in developing proposals to address those concerns, will have regard to New Zealand's approach to the prudential regulation and supervision of the financial sector. This approach emphasises the ability of a regulated firm's governance and risk management structures, supported by appropriate market disclosures, to achieve prudential objectives, but recognises that regulatory rules and requirements, with appropriate enforcement, are necessary in some areas.
23. The Review will have regard to the efficiency of the prudential framework by considering opportunities, without unduly compromising soundness objectives, to:
- Modify or remove requirements that are no longer apt, especially where compliance is costly.
  - Allow flexibility in the application of requirements where appropriate.
  - Reduce inappropriate barriers to entry.
  - Support a level playing field.
24. Further background information on New Zealand's approach to prudential regulation and supervision of the financial sector is available on the Reserve Bank website including in recently published articles and speeches.<sup>7</sup>
25. The New Zealand financial sector regulatory framework is based on a "twin peaks" model where market conduct regulation and supervision is separated from prudential regulation and supervision. Market conduct regulation and supervision is generally covered by the Financial Markets Authority and the legislation it administers, and is not within the scope of the Review.
26. The Reserve Bank considers that IPSA, and the prudential supervision framework, has resulted in an improvement in the soundness of the insurance sector whilst not overly constraining efficiency, as:
- the majority of insurers operating in New Zealand are now subject to a legally enforceable set of minimum prudential standards and to on-going risk-based supervision;
  - there has been an increase in the level of independent representation on insurance entity governing bodies as a result of the Reserve Bank's governance criteria for licensing;<sup>8</sup>

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<sup>7</sup> Fiennes, T (2016) 'New Zealand's evolving approach to prudential supervision', speech to the New Zealand Banker's Association, <http://www.rbnz.govt.nz/research-and-publications/speeches/2016/speech2016-09-01>.

Hunt, C (2016) 'A short history of prudential regulation and supervision at the Reserve Bank', Reserve Bank Bulletin, Vol 79. No 14 August 2016, <http://www.rbnz.govt.nz/research-and-publications/reserve-bank-bulletin/2016/rbb2016-79-14>.

<sup>8</sup> See Reserve Bank Governance Guideline at <http://www.rbnz.govt.nz/regulation-and-supervision/insurers/supervision/guidelines-for-insurers>.

- the introduction of a regulatory requirement for a Risk Management Programme has meant a number of insurers have developed, or further enhanced, their risk management capabilities and processes, and gained additional insight of their financial risks through the involvement of the appointed actuary;
  - some insurers have increased the amount of capital they hold or improved the quality of their funding, capital management or risk mitigation approaches e.g. reinsurance arrangements, partly in response to the introduction of minimum regulatory capital requirements (solvency standards);
  - new insurers continue to enter the New Zealand market; and
  - new insurance products continue to be developed including examples that have been supported by new regulatory development.<sup>9</sup>
27. Furthermore the Reserve Bank considers that the importance of a soundly regulated sector has become broadly accepted among the general public.
28. The Reserve Bank considers that a regime that emphasises self and market discipline will support efficiency and keep the cost of the regime relatively low whilst addressing the information asymmetry that can exist between an insurer and market participants in respect of understanding an insurer's financial position and business strategy. This underscores the importance of:
- governance;
  - fit and proper person requirements;
  - risk management requirements; and
  - financial strength ratings and disclosure.
29. Market and self disciplines may not always be adequate to achieve prudential outcomes that have regard to the wider social costs of insurer failures and the associated reduction in public confidence. Two important areas where the Reserve Bank considers that regulatory rules and requirements are needed, and that IPSA currently provides for, are:
- minimum requirements in respect of solvency;
  - ensuring that an insurer failure can be managed effectively.
30. Many of these areas are already recognised within the current IPSA framework. However, the Reserve Bank considers that there is potential for changes to how a number of these policy areas have been addressed to improve the efficiency and effectiveness of the framework. These matters are outlined in Part 2 of this paper.

**Question 1: Do you have any comments to make on the discussion in Part 1 of the Issues Paper?**

<sup>9</sup> For example the introduction of the Solvency Standard for Variable Annuity Business was a response to a new product development and aims to facilitate that development whilst balancing associated prudential concerns.

## Part 2. Potential issues identified

31. The Reserve Bank’s experience with the legislative framework has identified a number of areas where there may be potential to enhance the efficient and effective operation of the regime. For example, it may be possible for the regime to achieve its objectives more effectively while simultaneously reducing costs for both industry and the Reserve Bank, and further minimising barriers to innovation in the market and competition in the insurance sector.
32. In addition, since IPSA was enacted, some insurance sector stakeholders have, from time to time, raised potential concerns with the legislative framework with the Reserve Bank.
33. In this part of the paper, the potential issues identified to date are outlined. For each potential issue, a description of the relevant aspects of the current framework is set out, followed by examples of some potential concerns and possible areas to consider during the Review.
34. The Issues Paper is not intended to fully identify policy concerns or set out any proposals for change. The paper aims to provide an illustration of the types of areas the Reserve Bank has been considering and to provide sufficient context to enable stakeholders to make comments on these areas, and assist in the identification of any further potential concerns there may be.
35. Phase 2 of the Review will entail more in depth analysis and confirmation of any policy concerns, including the development of options to address them.

### 2.1 Entities required to be licensed

#### *Current legislative framework*

36. IPSA requires all insurers that “carry on insurance business in New Zealand” to be licensed.<sup>10</sup> The Act defines what it means to “carry on insurance business in New Zealand”<sup>11</sup> along with the meaning of a “contract of insurance” for this purpose.<sup>12</sup>
37. The legislation intentionally excludes some insurance entities from the scope of the legislation. These entities are typically those where there are other appropriate oversight mechanisms or where the principle risks being addressed by the legislation are either not material for those entities, or managed by other means. For example, the Accident Compensation Corporation and Earthquake Commission currently lie outside the scope of the Act, reflecting these organisations’ separate legislation and oversight and financial support arrangements. There are limited circumstances where the Reserve Bank may declare a person not to be carrying on insurance business for the purposes of the Act.<sup>13</sup>

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<sup>10</sup> IPSA [section 15](#).

<sup>11</sup> IPSA [section 8](#).

<sup>12</sup> IPSA [section 7](#).

<sup>13</sup> IPSA [section 9](#).

38. Similarly, some types of contract are deemed not to be insurance contracts. The legislation provides for regulations to expand the transactions or matters that are deemed not to be insurance contracts (no regulations have been made).<sup>14</sup>
39. The legislation requires that an insurer licensed in New Zealand has at least some New Zealand connection. For a person to be “carrying on insurance business in New Zealand” requires, amongst other things, that the person be liable under an insurance contract to a New Zealand policyholder.<sup>15</sup> In support of this view, a condition of licence requiring a minimum amount or proportion of New Zealand business to be held may be applied.<sup>16</sup> No such conditions of licence have been applied to date. The intention of these provisions is to:
- avoid the risk of a New Zealand insurance licence being used as a “badge of convenience” where an insurer has no or very limited New Zealand connection;
  - recognises the jurisdictional reach of New Zealand law; and
  - to focus New Zealand’s supervisory effort on risks to New Zealand’s economy or policyholders.
40. The legislation is focused on a legal entity basis and on-going requirements generally relate to the licensed insurer as a legal entity.<sup>17</sup>
41. The intention is that IPISA captures within scope all significant insurance activity and applies, where necessary, appropriate prudential measures and supervision to these activities. The coverage of the legislation is intended to be broad and not reliant on any particular corporate form or business model.

### **Potential issues**

42. It is important that the legislation and regulatory framework is applied to the appropriate range of activities and entities. Over time, the nature of the insurance market and market activity can change. It is appropriate, from time to time, to consider whether the legislation still reflects the developing insurance market and continues to apply prudential requirements and supervision to the appropriate range of activities or entities.
43. The criteria related to “carrying on insurance business in New Zealand” or in the definition of an insurance contract are not necessarily clear cut. This can mean that some forms of arrangement may appear to the general public or even policyholders as being insurance contracts provided by entities they may expect to be licensed, when the entities or contracts may not meet the relevant definitions under the legislation. Consumer perceptions may, in part, depend on how such arrangements have been marketed.
44. The legislation may capture or apply requirements to entities or contracts in a manner that is disproportionate to the risk presented to the soundness of the New Zealand insurance sector or public confidence in the sector.

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<sup>14</sup> IPISA [section 7](#).

<sup>15</sup> IPISA [section 8 \(1\)\(a\)\(c\)](#).

<sup>16</sup> IPISA [Section 21\(2\)\(d\)](#).

<sup>17</sup> IPISA does include some powers over wider group companies such as powers to obtain information from or issue directions to an “associated person” of a licensed insurer.

45. Conversely, the Reserve Bank is aware of some concerns that there may be a growing non-licensed insurance sector. An example of activities that currently do not require a licence under IPSA include insurance business written by foreign insurance firms that are not required to register as an overseas company under the Companies Act 1993.<sup>18</sup> Such firms or entities may provide substantial levels of insurance or reinsurance coverage to New Zealand policyholders, directly or indirectly. Entering into a contract of insurance with a New Zealand policyholder is not, of itself, sufficient to trigger a need for registration, irrespective of the size or extent of coverage of an individual insurance or reinsurance policy.<sup>19</sup>

### ***Issues to review***

46. The Reserve Bank considers that it is appropriate for the Review to:
- Consider any areas where the scope of the Act may be too broad and so potentially impose requirements on entities that may be disproportionate to the risks these entities present to achieving the objectives of the legislation.
  - Assess and reduce the possibility that material insurance business is carried on outside the scope of the Act.
  - Consider more formally the degree of New Zealand business a firm should maintain in order to have a New Zealand insurance licence and be subject to, and benefit from, New Zealand regulation and supervision.
  - Consider the appropriateness of extending the legislative scope to include a wider range of entities within an insurer's corporate group. Enabling appropriate consideration of wider corporate groups may enable the Reserve Bank to have a deeper understanding of risks facing a licensed insurer arising from such matters as intra-group funding and reinsurance arrangements.
47. The Review could consider if it is appropriate for some activity that does not currently require a licence to be within some form of notification or data reporting framework if full licensing is disproportionate to the risks presented by the activity.

**Question 2: Do you consider that the Review should assess the current scope of IPSA in terms of the nature of insurance contracts or entities that are subject to the legislation? Please provide commentary in support of your view.**

**Question 3: Do you consider that there are entities where the current provisions of the legislation result in inappropriate compliance costs or inappropriate regulatory obligations relative to the risks being addressed by the legislative framework?**

**Question 4: Are you aware of any currently non-licensed (under IPSA) insurance business activity in New Zealand that you consider should be within the scope of regulation in some form to enhance the effectiveness of the framework?**

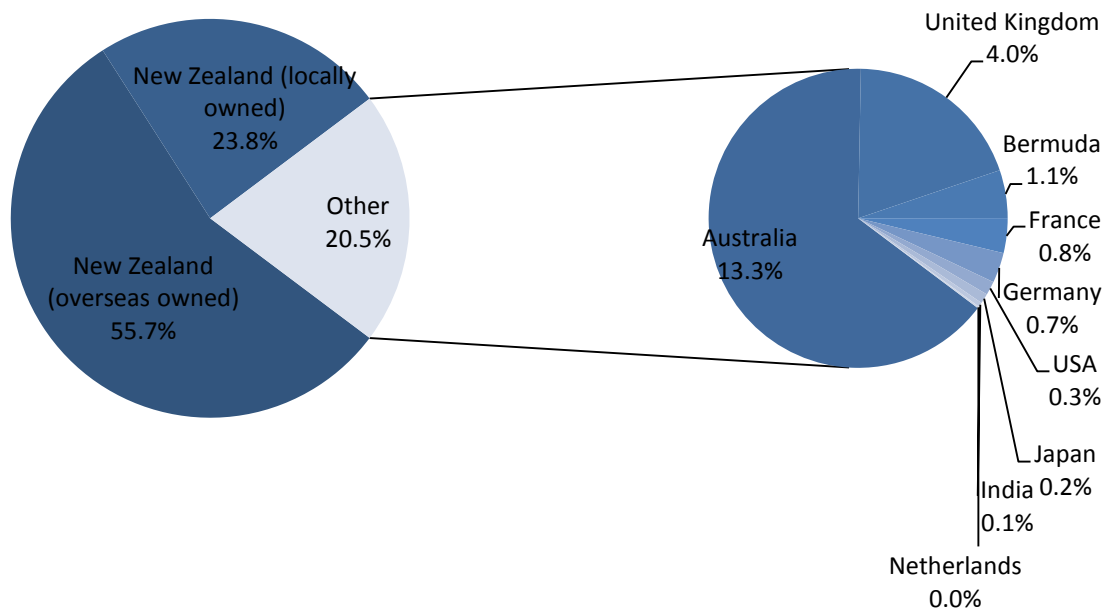
<sup>18</sup> IPSA [section 8\(1\)\(a\)\(ii\)](#) requires registration in order for an overseas firm to be carrying on business in New Zealand.

<sup>19</sup> [Section 332\(b\)\(x\)](#) of the Companies Act 1993.

## 2.2 Overseas insurers

48. The New Zealand insurance industry is strongly supported by foreign insurers through the provision of reinsurance, providing insurance services (such as underwriting support) and management, and through ownership of New Zealand branches and New Zealand incorporated insurers. Foreign insurers may promote healthy competition, and also provide expertise and underwriting capacity in specialist areas not currently served (or under served) by New Zealand incorporated insurers. The following diagram (Figure 2) shows an estimate of the proportion of gross annual premium by domicile of incorporation for licensed insurers. The details of these figures are shown in Appendix 2.<sup>20</sup>

Figure 2: Gross annual premium: proportion by domicile of incorporation of licensed insurer



49. Around 80% of gross premium is attributable to New Zealand incorporated insurers and around 20% is attributable to overseas insurers operating through branch structures in New Zealand. Of the overseas branches, Australian firms represent around 65% of the gross premium with firms incorporated in the United Kingdom taking the bulk of the remainder. Both the life and non-life sectors include firms that

<sup>20</sup> The data is as last reported to the Reserve Bank as at December 2016. The reporting dates are mixed and range over Dec 2015 to September 2016. No adjustments have been made for licensed reinsurers (some elements of gross premium received by reinsurers are also received by the direct insurers so there is an element of double counting). These figures do not capture premiums derived from insurance operations that are not required to be licensed in New Zealand.



represent a significant proportion of the market (top 4 share of gross premium) operating in New Zealand through branch structures.

50. Of the New Zealand incorporated insurers, approximately 70% of the premium is derived in companies with predominant overseas ownership.
51. Not all foreign insurers that provide insurance coverage in New Zealand are necessarily required to be licensed.

### ***Current legislative framework***

52. Within IPISA, an “overseas insurer” refers to an insurer incorporated outside of New Zealand or, if unincorporated, having its principal place of business or head office outside of New Zealand.<sup>21</sup> The term does not include overseas owned, but New Zealand incorporated entities.
53. The legislation aims to be agnostic between the use of branches or New Zealand incorporated entities. In broad terms, the legislative requirements that apply to an overseas insurer (i.e. a branch operation) are the same as those that apply to a New Zealand incorporated insurer. For branches, the insurer as a whole is the licensed insurer, not just the New Zealand branch, and the legislative requirements generally apply to the licensed insurer as a whole.<sup>22</sup>
54. There are a number of features in the legislation that recognise that overseas licensed insurers are subject to regulation and supervision in their home jurisdiction and aim to reduce unnecessary compliance costs or duplication of supervisory resources. For example, for overseas insurers:<sup>23</sup>
  - To obtain a licence, the law and regulatory requirements, and the nature and extent of prudential supervision in the home jurisdiction, must be satisfactory.<sup>24</sup>
  - The Reserve Bank may grant an exemption from compliance with all or part of a Reserve Bank solvency standard where, in broad terms, the requirements and supervision of the home jurisdiction in respect of the matters exempted are satisfactory.<sup>25</sup>
  - The Reserve Bank may grant an exemption from the requirement for the licensed insurer to provide a fit and proper certificate to the Reserve Bank following the appointment of new directors.<sup>26</sup>
  - The Reserve Bank may grant an exemption from maintaining statutory funds under IPISA where there is appropriate separation of life insurance business from other business, no overseas policyholder preference and satisfactory prudential supervision.<sup>27</sup>

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<sup>21</sup> IPISA [section 6](#).

<sup>22</sup> There are some requirements that are more specifically focused on the New Zealand business of an overseas insurer – for example disclosure of financial strength ratings to New Zealand policyholders and the need for Reserve Bank approval of transfers of an overseas insurer’s New Zealand business.

<sup>23</sup> Refer to the legislation for the full wording of these exemptions and the conditions as to when they may be granted.

<sup>24</sup> IPISA [section 19\(1\)\(j\)](#).

<sup>25</sup> IPISA [section 59](#).

<sup>26</sup> IPISA [section 38](#) and [39](#).

<sup>27</sup> IPISA [section 119](#).

55. In addition, the legislation:

- makes provision for appropriate access to information by overseas supervisory authorities;<sup>28</sup>
- requires disclosure where an overseas policyholder preference may exist, i.e. a situation where the laws or regulatory requirements in the home jurisdiction give a material preference to policyholders in the home jurisdiction or are otherwise disadvantageous to New Zealand policyholders in the event of the insurer's insolvency;<sup>29</sup>
- empowers the Reserve Bank to give directions to an overseas insurer where an overseas supervisor has taken or is taking regulatory action against the insurer, or where the law, requirements or supervision assessed during licensing has changed in a manner that significantly reduces the extent to which that law, requirements or supervision are appropriate;<sup>30</sup>
- enables a statutory manager to set up a New Zealand body corporate to acquire the business of the branch of an overseas person;<sup>31</sup>and
- makes special provision recognising the unique nature of Lloyd's of London.<sup>32</sup>

56. Of the exemptions available:<sup>33</sup>

- All overseas insurers have been granted an exemption from the need to provide a fit and proper certificate following the appointment of new directors.
- An exemption from Reserve Bank Solvency Standards has been granted to all overseas non-life insurers and Australian incorporated life insurers.<sup>34</sup> Reporting and disclosure obligations continue to apply.
- All Australian incorporated life insurers have been granted an exemption from maintaining statutory funds under IPSA.

57. The Reserve Bank also aims to utilise supervisory information prepared for the relevant overseas supervisor where possible e.g. where an overseas firm is required to prepare a Financial Condition Report for an overseas regulator, these reports are acceptable for IPSA purposes provided they cover the New Zealand business in sufficient detail.

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<sup>28</sup> IPSA [section 135 \(2\)](#).

<sup>29</sup> IPSA [section 61](#) and [72](#) and regulation [7](#) and [8](#).

<sup>30</sup> IPSA [section 143 \(f\)](#). This is in addition to the listed circumstances when the Reserve Bank may give directions to New Zealand incorporated insurers.

<sup>31</sup> IPSA [section 185](#).

<sup>32</sup> IPSA [section 200 – 212](#).

<sup>33</sup> The exemptions available and the companies they have been granted to are set out on the Reserve Bank's website and included in the Register of Licensed insurers available at <http://www.rbnz.govt.nz/regulation-and-supervision/insurers/licensing/register>.

<sup>34</sup> For other overseas life insurers, New Zealand domiciled custodial arrangements are in place as part of the New Zealand statutory fund with Reserve Bank solvency standards applying to the statutory fund.

### **Potential issues**

58. The current framework has been questioned by some stakeholders in that it may:
- Not place sufficient weight on the risks to New Zealand policyholders should an overseas firm enter financial difficulty. Assets within, or allocated to, a branch operation may be utilised to meet overseas obligations, or a New Zealand branch may be isolated from the financial support of the wider entity. Such risks may materialise from the operation of New Zealand or international insolvency law, the action of overseas regulators or supervisors, or the actions taken by the insurer themselves.
  - Not provide a sufficiently level competitive playing field regarding the overall degree of regulatory requirements and associated costs including differing degrees of New Zealand specific capital, risk management and governance requirements.

### **Issues to review**

59. The Reserve Bank considers that there is scope within the Review to reconsider if the legislation, or the current application of the provisions, provides an appropriate balance between:
- the adequate protection of policyholder and New Zealand interests should an overseas firm enter financial difficulty (a distress that may originate in New Zealand and/or overseas); and
  - recognising that the New Zealand insurance market and the resilience of the New Zealand economy are strongly supported by overseas insurance firms and the reinsurance market in particular.
60. Some of the concerns raised are related to the issue of whether international insolvency laws, regulatory requirements and supervision place appropriate attention on New Zealand risks, and result in a sufficiently level playing field in terms of compliance costs and capital. These issues may be reduced by requirements for insurers to be locally incorporated and subject to New Zealand's regulatory requirements and supervision.
61. The legislation has not opted for mandatory local incorporation. There may well be other means of improving the effectiveness of the framework in adequately protecting the interests of the New Zealand economy or New Zealand policyholders when overseas insurers are in financial difficulty. Ideas such as the development of some form of "assets in New Zealand test", potentially in conjunction with a statutory fund type of arrangement have been suggested.
62. A "one size fits all" approach is unlikely to sufficiently recognise the diversity in size and nature of the overseas insurers operating in the New Zealand market. The Review may therefore need to consider the development of principles to guide the establishment of appropriately tiered requirements that may apply to insurers of different size or nature.
63. The issue of the treatment of overseas insurers touches on a wide range of areas within the legislation, including a number of the areas discussed separately in this Issues Paper. Further considerations for overseas insurers are noted in those sections.

**Question 5: Do you agree that overseas insurers provide valuable support to the New Zealand insurance market? Please provide commentary in support of your view.**

**Question 6: Do you consider that the Review should reassess the application of the legislation to insurers operating as branches? Please provide commentary in support of your view.**

**Question 7: In the context of overseas insurers, what do you consider are the most significant risks posed to the New Zealand economy or New Zealand policyholders that need to be taken into account?**

### 2.3 Statutory funds and enhanced protection of life insurance policyholders

64. Statutory funds under IPSA were introduced to provide a separation of life insurance business from other insurance business that stopped short of requiring separate incorporation of life and non-life insurance firms. In addition the framework provides enhanced protections to life insurance policyholders both on an on-going basis and in the event of an insurer entering financial difficulty. This recognises in part the difficulties life insurance policyholders may experience in obtaining replacement cover should their personal health deteriorate over time.
65. The IPSA statutory fund requirements, and the associated regulations, were strongly influenced by the approach taken in Australia although they are not identical.<sup>35</sup>

#### ***Current legislative framework***

66. The requirements in respect of statutory funds are set out within Part 2, subpart 3, of the legislation, with more detailed requirements on the operation of the funds set out in the regulations.<sup>36</sup>
67. A life insurer is required to have at least one statutory fund in respect of its life insurance business.<sup>37</sup> The legislation defines the meaning of life policy, including provision for “composite policies” where life and non-life benefits are combined under single product lines.<sup>38</sup> The statutory fund to which a life policy is referable must be disclosed in policy documentation.<sup>39</sup>
68. The legislation includes provisions that enhance the status of policyholders of policies referable to a statutory fund if an insurer is liquidated<sup>40</sup> and requirements that the directors of the licensed insurer place priority on the interests of policyholders when dealing with the fund.<sup>41</sup> In addition, in the event of a liquidation of a life insurer, the liquidator is required to continue the life insurance business with a view to transferring the business, as a going concern, to another viable insurer.<sup>42</sup>

<sup>35</sup> In practice, in Australia, authorised life insurers are incorporated in Australia and also have a range of statutory funds making distinctions between Australian and non-Australian business and some classes of insurance (e.g. Unit Linked business is held within its own fund).

<sup>36</sup> [Regulations](#) 15 – 34.

<sup>37</sup> IPSA [section 82](#).

<sup>38</sup> IPSA [section 84](#).

<sup>39</sup> IPSA [section 91](#).

<sup>40</sup> IPSA [section 116](#) and [163](#).

<sup>41</sup> IPSA [section 105](#).

<sup>42</sup> IPSA [section 163](#).

### **Potential issues**

69. In light of the relatively recent establishment of statutory funds in New Zealand, there may be areas where insurers have noted the regulations or legislation could be made clearer or areas where issues have been identified that could weaken the expected effectiveness of the framework. For example, currently it is possible for a single asset to support more than one fund with its value allocated in the records of the insurer between two or more funds. This may mean that where one fund encounters financial difficulty and the asset is required to be sold (potentially at a reduced value), the other fund to which its value was allocated may also suffer a reduced realised value.
70. Currently all life insurance contracts must be referable to a statutory fund but there is no further separation of different types of life insurance from each other such as Unit Linked or Traditional insurances from pure risk protection policies. Similarly, there is no requirement to separate any non-life business types from each other. To the extent that non-life insurance policyholders may also be subject to long term risk there may be arguments to expand the scope of statutory funds to include some classes of non life insurance.
71. A statutory fund type framework may also be able to be used to enhance the protection of New Zealand policyholders of overseas insurers should an overseas insurer enter financial difficulty.

### **Issues to review**

72. The Reserve Bank considers that the Review provides an opportunity to consider the scope of statutory funds and make any amendments that may be needed to clarify the current requirements or enhance the expected effectiveness of the framework.
73. Within the context of overseas non-life insurers, consideration could be given to whether a statutory fund type concept may help reduce exposure of New Zealand policyholders to the financial distress of the insurer.

**Question 8: Do you consider that there is opportunity to clarify or enhance the effectiveness of the statutory fund framework? Please provide commentary in support of your view.**

**Question 9: In the context of overseas insurers, do you consider a statutory fund framework may help protect the interests of New Zealand policyholders? Please provide commentary in support of your view.**

## **2.4 Role of key officers and key control functions**

74. The regulatory and supervisory framework places significant weight on the ability of effective governance (through the governing body and senior management) to ensure licensed insurers are prudently managed as a result of their own incentives, systems and processes (referred to as “self-discipline”).

### **Current legislative framework**

75. The legislation aims to support self discipline by requiring licensed insurers to have:
- A fit and proper policy that governs the qualifications, requirements and other criteria that a person must have or satisfy in order to be appointed, and continue to hold, a position as a director, chief executive officer or chief financial officer.<sup>43</sup>
  - An appointed actuary, with appointees to this role being subject to the firm's fit and proper policy and appropriately qualified.<sup>44</sup>
  - A risk management programme that sets out the procedures for the effective identification and management of specified risks<sup>45</sup> in a manner appropriate to the operations of the licensed insurer.<sup>46</sup>
76. The Reserve Bank has the power to remove a person from the role of director (except of an overseas insurer) or a relevant officer if it has reasonable grounds to believe that he or she is not a fit and proper person for the role.<sup>47</sup>
77. The legislation permits the use of a group risk management programme or fit and proper policy where such policies meet the relevant requirements. This reduces compliance costs from duplication of documentation.
78. The duties of directors are set out generally within the Companies Act,<sup>48</sup> although IPSA imposes some additional requirements in some circumstances:
- Directors have a duty to the policyholders of life policies referable to a statutory fund to take reasonable care and use due diligence to see that in the investment, administration and management of the assets of the fund, the life insurer complies with the requirements of IPSA and gives priority to the interests of policyholders of life policies referable to the fund over the interests of shareholders or members.<sup>49</sup> These requirements override anything to the contrary in the Companies Act or any other enactment.
  - Directors may be found guilty of a range of offences under the Act.<sup>50</sup>
79. The framework requires that the appointed actuary is commissioned:
- to review the actuarial information used in, or in the preparation of, the financial statements and prepare and lodge an associated report;<sup>51</sup>
  - to calculate or review all aspects of the licensed insurer's solvency margin calculations;<sup>52</sup> and

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<sup>43</sup> IPSA [section 34](#).

<sup>44</sup> IPSA [section 34](#) and [76](#) of [section 6](#) definition of Actuary.

<sup>45</sup> IPSA [section 73\(2\)](#) - Insurance Risk, Credit Risk, Liquidity Risk, Market Risk, Operational Risk or other prescribed risks (currently none).

<sup>46</sup> IPSA [section 73](#).

<sup>47</sup> IPSA [section 39 – 43](#).

<sup>48</sup> See [Part 8](#) of the Companies Act 1993 Directors and their powers and duties.

<sup>49</sup> IPSA [section 105](#).

<sup>50</sup> IPSA [section 216](#).

<sup>51</sup> IPSA [section 77 – 79](#).

<sup>52</sup> Set out within relevant Reserve Bank Solvency Standards and as a condition of exemption from Reserve Bank Solvency Standards for applicable overseas insurers.

- to prepare a financial condition report that covers specified matters (primarily focused on risks to an insurer's ability to maintain adequate capital) and complies with relevant New Zealand Society of Actuaries Professional Standards (or relevant actuarial standards for overseas insurers).

80. The requirements discussed above are set out in a number of areas including directly in the legislation, in the regulations, solvency standards or notices.
81. In addition, the Reserve Bank has issued guidance in relation to governance, risk management and fit and proper requirements.<sup>53</sup>

### **Potential issues**

82. In general, the requirements set by the legislation or the Reserve Bank in the area of fitness and propriety, expectations about the role and function of the directors and relevant officers in the context of an insurance firm, and the substance and form of risk management programmes, are not prescriptive. The licensed insurer determines the specific expectations for fitness and propriety and develops its own risk management programme within the overall framework set out by the legislation, standards and guidance.
83. The appointed actuary may be involved in the operation of the licensed insurer to different extents e.g. in some firms the appointed actuary may provide advice on a wider range of matters than in other firms for example, or may have a different degree of authority or responsibility.
84. The legislation, and wider Reserve Bank requirements, make little comment in these areas when considered against the expectations of international guidance. For example, current IAIS Insurance Core Principles<sup>54</sup> note the importance for insurance sector supervisors to ensure that insurers have appropriate corporate governance systems in place with clear expectations established around four key functions (internal control functions):
- risk management;
  - compliance;
  - actuarial matters; and
  - internal audit.
85. The relatively low levels of prescription in the current framework provide a degree of flexibility in the application of the requirements. This may enable the desired outcomes of sound governance and appropriate recognition and management of risks to be achieved in ways that are appropriate to the insurer. However, this approach may also:
- create uncertainty as to the Reserve Bank's expectations of directors and relevant officers in the context of an insurance operation; or

<sup>53</sup> Current guidance notes published by the Reserve Bank <http://www.rbnz.govt.nz/regulation-and-supervision/insurers/supervision/guidelines-for-insurers>.

<sup>54</sup> See IAIS Insurance Core Principles: 7 Corporate Governance, and 8 Risk Management and Internal Controls at <http://www.iaisweb.org/page/supervisory-material/icp-on-line-tool/> accessed 4 January 2017.

- lead to a degree of inconsistency in the application of requirements amongst insurers where there is a lack of clarity as to minimum standards.
86. Some insurance sector stakeholders have raised concerns with the Reserve Bank in relation to:
- Some aspects of the legislation being difficult to apply to overseas insurers appropriately. For example, the practicality of the actuarial review of the financial statements for the whole licensed insurer by the New Zealand appointed actuary, in the context of a branch.
  - The degree of consistency with other frameworks that impose fitness and propriety criteria for certain positions, such as those for some FMA licensing frameworks.
87. The issues that prompted the Australian Prudential Regulation Authority's 2016 review on the role of the appointed actuary and actuarial advice within insurers may also be or may become relevant in the New Zealand context.<sup>55</sup> These issues relate to the role of the appointed actuary within the regulatory framework potentially being seen as a compliance function that may limit the ability of the appointed actuary to provide appropriate advice.

### ***Issues to review***

88. The Reserve Bank considers that the Review provides an opportunity to
- Assess the requirements of licensed insurers' systems of governance and internal control functions and consider whether any further requirements, or clarifications of existing requirements, would be appropriate. Any additional requirements would need to be sufficiently flexible to recognise the diversity of insurers within the New Zealand market.
  - Consider the consistency of requirements with other regulatory frameworks such as the fit and proper requirements within the banking and non-bank deposit takers frameworks and if closer alignment may be warranted.
  - Reconsider the efficacy of some requirements within the legislation relating to risk management plans, fit and proper requirements and governance. These requirements rely largely on 'self assessed review' by the licensed insurer. Although the Reserve Bank considers that this approach remains appropriate and consistent with the importance of self-discipline within the existing framework, there could be improvements relating to the specification of the requirements having regard to:
    - whether it would be appropriate for the Reserve Bank to have additional reserve powers where self-assessment outcomes are deemed inappropriate; and
    - whether there is scope to rationalise how requirements are specified e.g. fit and proper requirements are currently specified within the legislation, regulations and standards.

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<sup>55</sup> APRA's discussion document is available on APRA's website <http://www.apra.gov.au/CrossIndustry/Pages/Review-of-the-Appointed-Actuary-June-2016.aspx>.



89. Consideration of these areas may improve the effectiveness of the roles or functions and promote consistent application of requirements across the sector.

**Question 10: Do you consider that the expectations placed on the directors, chief executive officer, chief financial officer or appointed actuary of insurers, would benefit from being considered further within the Review? This may include clarifications of current expectations or expansion of responsibilities.**

**Question 11: Do you consider that the Review should encompass further consideration of an insurer's key control functions (paragraph 84) to promote effective risk management and consistent application of requirements across the sector?**

## 2.5 Enforcement regimes

### *Current legislative framework*

90. The legislation currently makes provision for certain breaches of requirements to be criminal offences where, on conviction, persons may be subject to fines or, in some cases, periods of imprisonment. No prosecutions under these provisions have been made since IPSA was enacted.

### *Potential issues*

91. The enforcement framework aims to provide incentives for compliance. In order to balance the need to create the right incentives against both the costs to industry of compliance and the enforcement costs, the regime needs to enable enforcement responses to be proportionate. The relatively limited range of enforcement sanctions available within the current framework may limit the ability to respond proportionately to breaches of requirements.
92. Although the current penalty regime provides an incentive for requirements to be complied with, the framework:
- Could apply criminal outcomes to relatively minor breaches.
  - Is reliant on court processes that may be slow and expensive for all parties. This may provide an incentive for breaches not to be pursued when it may otherwise be appropriate to do so.

**Issues to review**

93. The Reserve Bank considers that the Review should include consideration of the enforcement regime within IPSA such that:
- the framework continues to provide a framework that incentivises compliance in respect of requirements;
  - does not necessitate the application of criminal outcomes to minor breaches;
  - provides a low cost mechanism to address minor errors;
  - provides for procedural fairness, and
  - remains consistent with the approach to supervision.
94. The enforcement regime could allow for a wider range of more proportionate enforcement responses that fall short of criminal convictions, such as:
- formal warnings;
  - civil pecuniary penalties;
  - enforceable undertakings;
  - requirements for rectification of errors e.g. for incorrect disclosure; and/or
  - imposition of administrative fines in specified circumstances.
95. Any such frameworks would need to be supported by appropriate process requirements.

**Question 12: Do you consider that there may be opportunities to enhance the enforcement framework? Please provide comment in support of your view.**

**2.6 Distress Management*****Current legislative framework***

96. The distress management provisions set out in Part 4 of IPSA, provide for a number of steps the Reserve Bank can take to help manage a distressed insurer, including:<sup>56</sup>
- the ability for the Reserve Bank to require insurers to prepare a recovery plan;<sup>57</sup>
  - the ability for the Reserve Bank to issue directions in respect of specified matters;<sup>58</sup>

<sup>56</sup> This list is not a complete list of the distress management powers set out in Part 4.

<sup>57</sup> IPSA [Part 4 subpart 1](#).

<sup>58</sup> IPSA [Part 4 subpart 2](#).

- the ability of the Reserve Bank to apply to the High Court to appoint a liquidator, and/or a reduction in the value of contracts, or apply for voluntary administration of a licensed insurer;<sup>59</sup>
- ability for the Reserve Bank to recommend that statutory management be initiated for a licensed insurer and associated persons.

97. These distress management provisions operate within the context of the overall framework of the Act and in conjunction with wider New Zealand and overseas corporate and insolvency laws.
98. The distress management powers in Part 4 of IPSA, have not been required to be used in any substantive sense since IPSA was enacted.

### **Potential issues**

99. Given the large diversity in terms of the size and nature of insurers in the New Zealand market and their significance to the insurance sector in New Zealand, the framework may lack some features or alternative mechanisms to facilitate the quick exit of smaller insurers from the market, or to require the transfer of insurance business to another insurer that are sometimes seen in overseas frameworks.
100. In the context of overseas insurers, there may be potential concerns as to the effectiveness of the New Zealand distress management provisions operating in conjunction with overseas insolvency law or regulatory provisions.

### **Issues to review**

101. The Reserve Bank considers that the Review should consider the distress management powers to ensure the mechanisms achieve the objectives of the legislation, and in particular:
- ensure the Reserve Bank may take appropriate action prior to distress events emerging;
  - whether processes that would allow for the effective management of distressed insurers, such as facilitating a quick exit of a failing insurer, removal of management or transfer of policies, may be warranted, being processes that may avoid potentially costly liquidations or court processes; and
  - whether the current provisions and New Zealand's wider corporate and insolvency law operates effectively in the case of overseas insurers to achieve the purposes and principles of IPSA ( this supports the consideration of overseas insurers noted in 2.2).

**Question 13: Do you consider the distress management framework within IPSA could be considered within the Review to enhance the expected effectiveness of the framework, particularly for smaller licensed insurers?**

**Question 14: Are there any areas of the framework that may pose particular concerns when considering overseas insurers (branch operations)?**

<sup>59</sup> IPSA [Part 4 subpart 3](#).

## 2.7 Solvency requirements

102. The Reserve Bank considers that setting minimum prudential capital requirements is an essential element of the prudential regime. The primary aim of such requirements is to help reduce the probability of the financial failure of a licensed insurer and, if a failure occurs, reduce the cost to wider society and policyholders of that failure. In doing so they promote the soundness of the insurance sector and improve public confidence in the sector.

### ***Current legislative framework***

103. IPSA implements prudential capital requirements by enabling the Reserve Bank to:

- issue solvency standards that set out the methods for determining or calculating a solvency margin and the minimum level of capital required;<sup>60</sup>
- set a condition of licence requiring a licensed insurer and/or a statutory fund to maintain a minimum solvency margin in accordance with an applicable solvency standard,<sup>61</sup> and
- set out requirements for reports on the financial condition or solvency of a licensed insurer, and the disclosure of information on the financial condition or solvency of the insurer.<sup>62</sup>

104. The ability to maintain an adequate level of capital is a key eligibility requirement for licensing<sup>63</sup> and a critical component of a firm's overall financial risk management outcomes.

105. Licensed insurers are required to notify the Reserve Bank if the insurer has reasonable grounds to believe that a failure to maintain a solvency margin is likely to occur at any time within the next 3 years.<sup>64</sup>

106. The solvency margin provides a key measure of a licensed insurer's financial position. The minimum required solvency margin represents a trigger point that can empower the Reserve Bank to take a wide range of supervisory actions.<sup>65</sup> The Reserve Bank has the discretion to determine the most appropriate supervisory response to a deterioration in a licensed insurer's financial position.

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<sup>60</sup> The Solvency Margin is defined in the applicable solvency standards. It represents the value of eligible assets in excess of the value of liabilities determined in accordance with the methodologies set out in the solvency standards.

<sup>61</sup> IPSA [section 21 \(2\)\(b\)](#).

<sup>62</sup> IPSA [section 55](#) and [56](#).

<sup>63</sup> IPSA [section 19](#) (e) and (f).

<sup>64</sup> IPSA [section 24](#).

<sup>65</sup> For example, where a licensed insurer "*has failed, is failing or is likely to fail to maintain a solvency margin*" the Reserve Bank may initiate investigations, require recovery plans, issue directions or potentially recommend the insurer be put in Statutory Management if circumstances warrant. Failing to maintain a solvency margin is a ground for the Reserve Bank to apply to the High Court for the appointment of a liquidator, to appoint an administrator, or a reduction in the value of contracts.

### **Potential issues**

107. The Review is intended to consider areas where legislative change may be required. As such, the technical content of the current solvency standards e.g. the specific methodologies or factors are not within scope.
108. The framework provides significant discretion to the Reserve Bank to respond to deterioration in a licensed insurer's solvency margin. This allows for the circumstances of an insurer in financial difficulty to be taken in to account when considering an appropriate supervisory response and does not force the Reserve Bank to take actions that may be inappropriate in the longer term e.g. forced liquidations. However, this may lead to a degree of uncertainty as to how the Reserve Bank may respond to a deterioration of reported solvency levels or in response to a notification under section 24 of the Act. There is also potential for the Reserve Bank to inappropriately forebear on a deterioration in, or breach of, solvency margin requirements.
109. The use of conditions of licence to apply the minimum solvency margin requirement may also be confusing or lack transparency to market participants (see 2.10 for further discussion on use of conditions of licence).
110. Although the Reserve Bank may require a licensed insurer to hold an increased level of solvency margin by condition of licence, it is not empowered for the Reserve Bank to allow a variation in the factors or methodologies used in a solvency standard for a specific insurer by way of a condition or other notice. Although a standard applicable to an individual insurer may be issued to make such allowances, this process can be relatively slow or inappropriate if the change is required to recognise an insurer's individual circumstances, including situations where factors or methodologies result in inappropriately high or low capital requirements.
111. The legislation may also be viewed as constructing a rather binary approach where licensed insurers are either "business as usual" or "in distress" in respect of solvency measures and possibly more generally. Although a sudden stress event may cause an insurer to enter immediate financial difficulties, it can also be expected that financial condition can deteriorate over time and so a more graduated approach to the response to weakening financial condition may be appropriate.

### **Issues to review**

112. The Reserve Bank considers that it may be appropriate as part of the Review to consider the framework for the application of minimum capital requirements and the ability to vary or alter prudential capital requirements in response to an insurer's individual circumstances.
113. The Review could also consider if a more pre-defined response to differing levels of reported solvency would have merit and for consistency with the enforcement approach.
114. The appropriate application of solvency requirements to overseas insurers has been raised with the Reserve Bank by some stakeholders. These concerns relate to the adequate protection of New Zealand policyholders should overseas insurers enter financial difficulty. These issues would be considered in the context of overseas insurers.

**Question 15: Do you consider that the current approach to prudential capital requirements by reference to a solvency margin and conditions of licence should be within scope of the Review? Please provide commentary in support of your view.**

**Question 16: Do you consider that consideration should be given to clarifying the Reserve Bank's prudential response to deteriorations in reported solvency levels? Please provide commentary in support of your views.**

## 2.8 Supervisory processes – regulatory approvals

### *Current legislative framework*

115. IPSA provides that a range of matters require the approval of the Reserve Bank. The approvals most frequently required are:

- for amending a fit and proper policy or risk management programme in a material way;<sup>66</sup> or
- before a licensed insurer transfers all or part of its insurance business (or New Zealand insurance business in the case of an overseas licensed insurer) to another person or amalgamates with another person.<sup>67</sup>

116. In addition, there are a range of approvals that may be required in relation to:

- statutory funds, including approval of certain investments, or the restructure and termination of a fund;<sup>68</sup> and
- various actions undertaken during the management of a distressed insurer such as approval of recovery plans or amendments to recovery plans.<sup>69</sup>

117. Similarly, the Reserve Bank must be notified of:

- proposed transactions whereby a person may become a holding entity of a licensed insurer or would obtain control of a licensed insurer; or
- a licensed insurer intends or proposes to change its corporate form.<sup>70</sup>

118. In these latter cases, the Reserve Bank must consider whether, if the proposed transaction takes effect or the corporate form is changed, it would still remain satisfied that the applicant is entitled to be issued a licence.<sup>71</sup> Where notification is not given or where the Reserve Bank is not satisfied as to licensing matters following the proposed transaction, a licence may be cancelled.<sup>72</sup>

<sup>66</sup> IPSA [34\(5\)](#) and [73\(4\)](#) respectively.

<sup>67</sup> IPSA [section 44](#).

<sup>68</sup> IPSA sections [99](#), [105](#), [109](#) and [110](#).

<sup>69</sup> IPSA section [139](#), [141](#) and also in relation to liquidation and statutory management sections [154](#), [183](#), [192](#) or to facilitate the cancellation of licence by assignment of liabilities section 32, 207.

<sup>70</sup> IPSA section [26](#) and [27](#) respectively.

<sup>71</sup> IPSA section [28](#).

<sup>72</sup> IPSA section [30\(1\)\(a\)\(iv\) – \(v\)](#).

119. A change of control is defined as a person (or the person and one or more other people acting jointly or in concert), having the power, directly or indirectly, to exercise or control the exercise, of 50% or more of the voting rights in the insurer.<sup>73</sup>

**Potential issues**

120. The Reserve Bank has had most experience in relation to the approvals and assessments required in respect of transfers and amalgamations, changes of control or corporate form and amendments to fit and proper policies or risk management programmes.
121. Reserve Bank approval processes may allow for more flexible and potentially less expensive requirements than mechanisms dependent on court processes. None-the-less, the need for regulatory approval for certain actions imposes additional costs and can introduce potential delays to transactions proceeding or beneficial changes being implemented.
122. It is also clear that significant transactions or changes of control can introduce material new risks to a licensed insurer. Changes to key internal policies may undermine an insurer's governance framework.
123. Hence, it is important that approval processes are applied only where appropriate and in a manner that balances the risks potentially introduced by proposed actions against the potential costs and delay of approval.
124. Potential concerns with the existing approval processes may include:
- Inconsistency in the nature of approvals required. For example, a transfer of insurance business from a licensed insurer requires a direct Reserve Bank approval, whereas a change of control proposal requires a full reconsideration of licensing eligibility.
  - It may be possible, by choice of mechanism, to undertake material transactions in a manner that does not require Reserve Bank approvals, when alternative mechanisms may require such approval.
  - Some, potentially significant transactions, are not subject to approval. For example, significant changes of ownership that fall short of a change of control under the Act or transfers of business from an insurer not required to be licensed.
  - The Act's definitions of "control" may be inconsistent with other relevant frameworks in terms of the level of voting rights or the criteria assessed. For example, the Takeover's Code has a 20% voting right threshold and some frameworks use additional criteria to voting rights, such as rights to appoint directors or other indicators of control and influence.
  - Conversely, some transactions or policy changes that currently require approval, may not introduce material new risks to a licensed insurer, and it may be that the costs of an approval or licensing re-assessment are disproportionate.

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<sup>73</sup> IPSA section [26 \(4\)](#).

### **Issues to review**

125. The Reserve Bank considers the Review provides an opportunity to:

- reconsider the requirements relating to the notification and approval of key material transactions, including changes of ownership, transfers of business and changes of corporate form, to ensure that the scope of the provisions and requirements are appropriate, consistent and flexible enough to recognise the different degrees of risk inherent in different transaction types and circumstances;
- identify any significant differences in the nature of approvals that are required resulting from the choice of transaction mechanism; and
- consider the consistency of the IPSA framework with other frameworks related to material transactions.

**Question 17: Do you consider the Review should reassess the current framework for approval of material transactions and policy changes? Please provide commentary in support of your view.**

**Question 18: Do you consider that approval by the Reserve Bank is more or less effective than alternative mechanisms e.g. court based systems?**

## **2.9 General disclosure and Financial Strength Rating requirements**

126. The disclosure of appropriate financial and other information about licensed insurers forms a key support to the New Zealand regulatory framework's emphasis on market-discipline. Disclosure requirements align with the principles of IPSA to recognise the desirability of providing information to enable members of the public to make their own decisions relating to insurance.<sup>74</sup> Appropriate information is also of importance to other market participants and potential investors.

127. Public disclosure frameworks may also support self-discipline through the associated development of internal processes to ensure disclosed information is of high quality e.g. to support a sign-off by directors. These processes may improve the accuracy of information used internally by management as well as that disclosed to the public.

### **Current legislative framework**

128. The current framework requires most licensed insurers:

- To obtain and/or disclose a financial strength rating from an approved rating agency. The rating must be disclosed as part of the sales process and in relevant advertising and websites.<sup>75</sup>
- To disclose solvency related information within the financial statements and on insurers' websites.

<sup>74</sup> See IPSA section 4, (d) and (e).

<sup>75</sup> Specialist reinsurance firms or certain small insurers or insurer in run-off are not required to obtain a rating but must disclose one if they have obtained a rating from an approved agency.



- Publicly register the appointed actuary's report relating to the actuarial review of the actuarial information in, or used in the preparation of, the financial statements.
129. These disclosures complement the requirements of the broader financial reporting framework and market conduct regulations.
130. In addition, the Reserve Bank may publish industry data, subject to appropriate privacy constraints.<sup>76</sup> The Reserve Bank has developed an insurance sector data collection process over 2014/2015. Consultation on proposed publication of insurance data will be made in due course.
131. Licensed insurers also provide a range of private reporting and signed attestations to the Reserve Bank.

### **Potential issues**

132. The insurance framework's disclosure requirements are focused on financial matters such as financial strength ratings, solvency margin components and ratios. There may be a number of other areas that could be of concern to current and prospective policyholders, other potential creditors and investors, that are not currently required to be disclosed or are not consistently disclosed across the sector. For example, the Reserve Bank's guidelines on governance encourage disclosure of a corporate governance statement in an insurer's annual report that includes coverage of the insurer's corporate governance policies, practices and processes as well as information on the directors and how the governing body operates.<sup>77</sup> Some insurers disclose this information whilst others do not.
133. Although the Reserve Bank can obtain information from licensed insurers and may publish aspects of this information, the framework is not focused on industry wide data collection processes for this purpose. There are advantages to a regulatory agency providing industry statistics, including the ability to obtain data from all licensed insurers. The Reserve Bank's current insurance data collection processes rely on individual notices under section 121 of the Act. This process is administratively costly and may be more appropriately implemented through other mechanisms.
134. There is a degree of inconsistency when the insurance framework is compared to the disclosure requirements applied to other regulated financial sectors, notably the Banking sector. In the Banking sector for example, disclosure requirements may relate to a wider range of matters including:<sup>78</sup>
- the corporate matters of a bank;
  - the prudential matters of a bank;
  - any other matters relating to the business, operation, and management of the bank;
  - information or data on New Zealand domiciled associated persons or publically available information on overseas associated persons; and

<sup>76</sup> IPSA section [135](#).

<sup>77</sup> See Reserve Bank Governance Guideline paragraph 24 available at <http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/insurers/licensing/4295066.pdf?la=en>.

<sup>78</sup> Section [81](#), [81AA](#) [Reserve Bank of New Zealand Act](#).

- individual members of the banking group (being the bank's financial reporting group) or New Zealand incorporated or registered companies in which the holding company has a substantial interest.

135. The current disclosure requirements may fall somewhat short of international standards and guidance in this area either in terms of what is disclosed (e.g. governance) or the level of detail.<sup>79</sup>

### ***Issues to review***

136. Given the importance of the availability of appropriate information for current and prospective policyholders, an insurer's competitors, creditors and investors, the Review is expected to consider aspects of the current disclosure regime such as:

- the consistency with other disclosure frameworks, including elements of the approach developed within the Banking sector;
- mechanisms to facilitate cost effective industry wide data collection processes to support the publication of data by the Reserve Bank for market participants; and
- that requirements are appropriately scoped and set out in an appropriate regulatory form.

137. A review in this area would also provide an opportunity to consider if the existing requirements provide useful information at an appropriate cost and in a manner that is appropriate and useful to the market.

**Question 19: Are there any aspects of the current disclosure requirements that you consider do not provide useful information or are unduly onerous or costly to prepare? Please provide commentary in support of your view.**

**Question 20: Do you consider that there is information that is not currently required to be disclosed that would be beneficial to market participants? Please provide commentary in support of your view.**

**Question 21: Do you consider that the Reserve Bank (or other authority) has a role in providing appropriate industry data to the market? Please provide commentary in support of your view.**

## **2.10 Appropriate regulatory mechanisms**

138. This section considers the options available to set out the requirements and obligations within the legislative framework. These options include setting requirements directly in legislation or using other alternative mechanisms such as regulations or other instruments.

139. The various methods or regulatory instruments available to set requirements differ in a number of respects including:

<sup>79</sup> For example IAIS ICP 20 Disclosure available at <http://www.iaisweb.org/page/supervisory-material/icp-on-line-tool> accessed February 2017.

- who authorises its enactment (authority);
- who scrutinises the instrument (accountability);
- if and where the instrument is published (transparency);
- who drafts the instrument (drafting);
- the status of the instrument in the legislative scheme; and
- the extent to which requirements may be enforced.

140. The use of the best regulatory mechanism to impose requirements can significantly improve the transparency of requirements and the ability of the framework to respond to the evolving industry and circumstances.

### ***Current legislative framework***

141. IPSA provides for regulatory requirements to be set out and applied to insurers in a range of different ways. These include:

- directly in the legislation;
- regulations issued under the Act;<sup>80</sup>
- standards in respect of fit and proper policies and solvency standards;<sup>81</sup>
- application of conditions of licence that may relate to specified matters;<sup>82</sup>
- declarations;<sup>83</sup>
- exemptions available in respect of certain matters;<sup>84</sup> and
- notices issued under the Act.<sup>85</sup>

142. In addition the Reserve Bank has issued guidelines in a number of areas. These guidelines do not have the force of law.<sup>86</sup>

143. Appendix 1 contains a table setting out how the primary methods adopted differ by some of the factors set out in paragraph 139 (authorisation, accountability etc.).

### ***Potential issues***

144. The wide range of regulatory mechanisms used, and the differing specifications of the requirements, can result in the fragmentation of requirements across different

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<sup>80</sup>IPSA [section 237](#).

<sup>81</sup>Under IPSA [section 36](#) and [55](#) respectively.

<sup>82</sup>The full set of areas that conditions of license may relate to are set out in [section 21](#) of IPSA.

<sup>83</sup>For example, under [section 9](#) of IPSA.

<sup>84</sup>Primarily for overseas insurers as discussed in section 2.2.

<sup>85</sup>For example, under [section 121](#) of IPSA.

<sup>86</sup>All guidelines are available on the Reserve Bank website at <http://www.rbnz.govt.nz/regulation-and-supervision/insurers/supervision/guidelines-for-insurers>.

instruments, relatively high administrative costs or a level of enforceability or accountability that may be inappropriate given the priorities of the regulatory and supervisory framework.

145. Examples where some of these concerns may arise include:

- Fit and proper requirements are fragmented, being set out in three instruments: directly in the legislation,<sup>87</sup> the regulations<sup>88</sup> and fit and proper standards.<sup>89</sup>
- Conditions of licence used to apply relatively generic requirements. Currently, some of the conditions of licence applied to licensed insurers are relatively generic, with the same condition applied to all, or a significant class of, insurers. For example, the majority of insurers are subject to a condition of licence to supply a specified certification,<sup>90</sup> signed by the directors, to the Reserve Bank.<sup>91</sup>

Although such conditions are permitted by the legislation, they:

- are not subject to the same degree of scrutiny that a generic requirement set by some other methods may be;
- are not required to be published; and
- can be administratively expensive to change.<sup>92</sup>

However, it is important that conditions of licence are available to be used by the Reserve Bank to take account of any prudential concerns for individual (or relatively small classes) of insurer. It may not be necessary for such conditions to be subject to public scrutiny to the same extent as a requirement that is intended to apply across a wide sector of the industry as they may relate to matters specific to that insurer.

- Use of guidelines in areas of prudential importance. The majority of insurers aim to comply with the requirements set out within the Reserve Bank's guidelines. However guidelines do not have the force of law. In some areas of particular importance to the prudential framework, it may be appropriate for some requirements, currently set out in guidelines, to be applied through other methods that require appropriate consultation to develop, oversight and enforceability options. Such an approach may help ensure that key requirements are implemented consistently across the sector and so result in a more even playing field.

### ***Issues to review***

146. The Reserve Bank considers that the Review provides an opportunity to reassess the application of the range of legislative tools and the balance struck between

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<sup>87</sup> IPSA [section 34 \(1\)](#).

<sup>88</sup> The minimum time between fit and proper reassessments of 3 years is set out in [regulation 6](#).

<sup>89</sup> IPSA [section 34\(3\)](#) requires a fit and proper policy to take account of the matters set out in a fit and proper standard. The standard is available at <http://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/insurers/regulation/4434500.pdf?la=en>.

<sup>90</sup> The certification is required annually and relates to having appropriate systems in place to comply with the legislation and the accuracy of financial information provided to the Reserve Bank.

<sup>91</sup> Imposed under IPSA [section 21\(2\)\(f\)](#).

<sup>92</sup> Conditions require issue of individual notices to licensed insurers and consultation directly with each affected party rather than a broad public consultation for example.

requirements set out in legislation and those requirements set out using other mechanisms such as regulations, standards or guidance.

147. The specification of requirements can be considered so that matters of particular importance to the regulatory framework (and in particular the emphasis on self and market disciplines) are implemented using methods that are subject to appropriate consultation and oversight procedures and are appropriately enforceable if necessary.

148. This may:

- enable requirements that are currently fragmented across a range of instruments to be consolidated and so make the requirements more accessible;
- improve the administrative efficiency of applying the requirements;
- enhance the degree of transparency and oversight in the development of requirements applicable to all or large subsets of insurers, and
- improve the consistency of application of key requirements across the sector and so promote a level playing field.

149. As all requirements need to be implemented using appropriate regulatory mechanisms, this aspect will be considered in all areas that are taken forward to Phase 2 of the review.

**Question 22: Do you consider that the Review should reassess the manner in which requirements are currently specified and the mix between requirements set out in legislation, standards or guidance? Please provide commentary in support of your view.**

**Question 23: Are there any aspects of the current requirements that you consider would be better specified using different regulatory tools?**

## 2.11 Other matters

150. The Review provides an opportunity to consider any areas of the legislation that are now redundant or may require technical improvements to improve drafting clarity.

151. Stakeholders are requested to provide any further comment they wish to make on:

- additional areas that you consider could be taken forward under the Review; and
- any areas that you consider, having regard to the legislative objectives, unduly restrict competition and innovation.

**Question 24: Are there any further issues you would like to raise that you consider should be within scope of the Review? Please provide commentary in support of your view.**

**Question 25: Are there any areas of the legislation that you consider are now redundant or you feel could have clearer drafting or require technical corrections?**

**Question 26: Are there any areas of the legislation that you consider, having regard to the purposes of the legislation, unduly restrict competition or innovation within the New Zealand insurance market? Please provide commentary in support of your view.**

## Part 3. Have your say

152. Your feedback is important. The Reserve Bank welcomes comments and submissions in respect of any aspect of the Review.
153. Each section of this Issues Paper includes some questions you may wish to respond to. A consolidated list of the questions is set out below. Comments do not need to be made in respect of all of the questions. You may focus on those areas that are of most importance to you. Comments are welcome on any other matters you consider relevant to the review of the legislation.
154. Submissions that provide commentary in support of your views are particularly helpful including the linkage to the objectives and principles of the legislation. You are also welcome to offer suggestions about options to address any concerns that you wish to raise that may be considered further in Phase 2 of the Review.
155. The submission due date, contact details and format information are provided on page 1.

### 3.1 Consolidated list of questions

156. The following questions were included in the text. It is not necessary to respond to each question.

- Question 1: Do you have any comments to make on the discussion in Part 1 of the Issues Paper? ..... 12
- Question 2: Do you consider that the Review should assess the current scope of IPSA in terms of the nature of insurance contracts or entities that are subject to the legislation? Please provide commentary in support of your view. .... 15
- Question 3: Do you consider that there are entities where the current provisions of the legislation result in inappropriate compliance costs or inappropriate regulatory obligations relative to the risks being addressed by the legislative framework?..... 15
- Question 4: Are you aware of any currently non-licensed (under IPSA) insurance business activity in New Zealand that you consider should be within the scope of regulation in some form to enhance the effectiveness of the framework? ..... 15
- Question 5: Do you agree that overseas insurers provide valuable support to the New Zealand insurance market? Please provide commentary in support of your view. .... 20

Question 6: Do you consider that the Review should reassess the application of the legislation to insurers operating as branches? Please provide commentary in support of your view. ....	20
Question 7: In the context of overseas insurers, what do you consider are the most significant risks posed to the New Zealand economy or New Zealand policyholders that need to be taken into account? .....	20
Question 8: Do you consider that there is opportunity to clarify or enhance the effectiveness of the statutory fund framework? Please provide commentary in support of your view. ....	21
Question 9: In the context of overseas insurers, do you consider a statutory fund framework may help protect the interests of New Zealand policyholders? Please provide commentary in support of your view. ....	21
Question 10: Do you consider that the expectations placed on the directors, chief executive officer, chief financial officer or appointed actuary of insurers, would benefit from being considered further within the Review? This may include clarifications of current expectations or expansion of responsibilities. ....	25
Question 11: Do you consider that the Review should encompass further consideration of an insurer's key control functions (paragraph 84) to promote effective risk management and consistent application of requirements across the sector? .....	25
Question 12: Do you consider that there may be opportunities to enhance the enforcement framework? Please provide comment in support of your view. ....	26
Question 13: Do you consider the distress management framework within IPSA could be considered within the Review to enhance the expected effectiveness of the framework, particularly for smaller licensed insurers?.....	27
Question 14: Are there any areas of the framework that may pose particular concerns when considering overseas insurers (branch operations)? .....	27
Question 15: Do you consider that the current approach to prudential capital requirements by reference to a solvency margin and conditions of licence should be within scope of the Review? Please provide commentary in support of your view. ....	30



Question 16: Do you consider that consideration should be given to clarifying the Reserve Bank’s prudential response to deteriorations in reported solvency levels? Please provide commentary in support of your views. ....	30
Question 17: Do you consider the Review should reassess the current framework for approval of material transactions and policy changes? Please provide commentary in support of your view. ....	32
Question 18: Do you consider that approval by the Reserve Bank is more or less effective than alternative mechanisms e.g. court based systems? .....	32
Question 19: Are there any aspects of the current disclosure requirements that you consider do not provide useful information or are unduly onerous or costly to prepare? Please provide commentary in support of your view. ....	34
Question 20: Do you consider that there is information that is not currently required to be disclosed that would be beneficial to market participants? Please provide commentary in support of your view. ....	34
Question 21: Do you consider that the Reserve Bank (or other authority) has a role in providing appropriate industry data to the market? Please provide commentary in support of your view. ....	34
Question 22: Do you consider that the Review should reassess the manner in which requirements are currently specified and the mix between requirements set out in legislation, standards or guidance? Please provide commentary in support of your view. ....	37
Question 23: Are there any aspects of the current requirements that you consider would be better specified using different regulatory tools? .....	37
Question 24: Are there any further issues you would like to raise that you consider should be within scope of the Review? Please provide commentary in support of your view. ....	38
Question 25: Are there any areas of the legislation that you consider are now redundant or you feel could have clearer drafting or require technical corrections? .....	38
Question 26: Are there any areas of the legislation that you consider, having regard to the purposes of the legislation, unduly restrict competition or innovation within the New Zealand insurance market? Please provide commentary in support of your view. ....	38

## Appendix 1 Legislative tools factors

157. The following table sets out how the various methods to apply regulatory requirements set out in section 2.10 differ by key factor:

	<b>Regulations</b>	<b>Standards</b>	<b>Conditions, notices and exemptions</b>	<b>Declarations</b>
<b>Accountability</b>	Disallowable by House of Representations  Consultation consistent with Cabinet procedures	Disallowable by House of Representations  Consultation with affected persons specified.	Not disallowable  Reasons must be given for decision  Consultation with affected persons specified in Act	Disallowable by House of Representations  Reasons must be given for decision
<b>Authority</b>	Governor General on advice of Minister	Reserve Bank by notice signed by the Governor	Reserve Bank	Reserve Bank
<b>Drafting</b>	Drafted by Parliamentary Council Office	Drafted by the Reserve Bank	Drafted by Reserve Bank	Drafted by the Reserve Bank
<b>Transparency</b>	Published in legislative series – published on <a href="http://www.legislation.govt.nz">www.legislation.govt.nz</a>	Published by the Reserve Bank <sup>93</sup> and notified in gazette	Exemptions must be available for inspection and published on the Reserve Bank website. <sup>94</sup>	Declarations must be available for inspection and published on the Reserve Bank website. <sup>94</sup>

<sup>93</sup> Although also available on the legislation website <http://www.legislation.govt.nz>.

<sup>94</sup> Available at <http://www.rbnz.govt.nz/regulation-and-supervision/insurers/licensing/declarations-and-exemptions>.

## Appendix 2 Licensed insurer gross premium by domicile

158. The following table shows the gross annual premium by domicile for licensed insurers.

Figure 3: gross annual premium and number of licensed insurer by domicile

Domicile of licensed insurer	Gross Annual Premium		Number of licensed insurers	
	NZD thousands	Proportion of total	Count	Proportion of total
New Zealand (overseas owned)	5,651,376	55.7%	18	19.1%
New Zealand (locally owned)	2,416,634	23.8%	40	42.6%
New Zealand insurer sub total	8,068,010	79.5%	58	61.7%
Australia	1,352,193	13.3%	20	21.3%
United Kingdom	405,331	4.0%	4	4.3%
Bermuda	107,950	1.1%	1	1.1%
France	78,164	0.8%	1	1.1%
Germany	67,894	0.7%	1	1.1%
USA	30,848	0.3%	4	4.3%
Japan	22,315	0.2%	3	3.2%
India	10,025	0.1%	1	1.1%
Netherlands	4,023	0.0%	1	1.1%
Overseas insurer sub-totals	2,078,743	20.5%	36	38.3%
<b>Grand Total</b>	<b>10,146,753</b>	<b>100.0%</b>	<b>94</b>	<b>100.0%</b>

Source: Reserve Bank