American Income Life Insurance Company
National Income Life Insurance Company

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ISSUES PAPER – REVIEW OF THE INSURANCE (PRUDENTIAL SUPERVISION) ACT 2010 (IPSA)

Thank you for the opportunity to make submissions on the Issues Paper: Review of the Insurance (Prudential Supervision) Act 2010 *(IPSA).*

American Income Life Insurance Company *(AILIC)* is a life insurance company incorporated in Texas, United States, and licenced by the Reserve Bank as an insurer in New Zealand. AILIC's principal place of business is in Waco, Texas. AILIC provides life insurance products to individuals.

This submission provides our views on the issues raised by the Reserve Bank in the Issues Paper.

Yours sincerely,

[redacted]

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SPECIFIC QUESTIONS

Question 1: Do you have any comments to make on the discussion in Part 1 of the Issues Paper?
We have no comments on Part 1 of the Issues Paper.

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.
We support greater mutual recognition of home jurisdiction regulation, lessening the New Zealand specific obligations overseas insurers are required to comply with.

We submit that the "carrying on business" test, which currently focusses on physical presence, is outdated and does not reflect the modern environment with Internet based cross-border offerings. The test should look at the degree of New Zealand connection rather than presence.

We suggest that any over-reach in the scope of IPSA from a revised test could be dealt with by including a broad exemption power in IPSA, which would enable the Reserve Bank to grant individual or class exemptions as appropriate (provided they are consistent with the purpose of IPSA, and the exemption is not broader than what is reasonably necessary to address the matters that gave rise to the exemption). Any exemption would be subject to conditions, in the Reserve Bank's discretion. The current lack of a general exemption power has proved problematic in some instances. A "one size fits all" approach to regulation is not suitable, and individual circumstances can be considered and reflected through exemption arrangements.

There could also be fewer requirements for overseas insurers who do not reside in New Zealand and are regulated solely because they offer insurance products from offshore.

If the legislative scope is extended to include the wider corporate group of a licensed entity, this could mean restrictions on subsidiaries or other group companies. In our view, this goes too far and could, in certain instances, bring a group's non-insurance business into the remit of IPSA. Also, in our view, the Reserve Bank already has wide powers under IPSA to request group companies of the licensed insurer to provide information and reports to the Reserve Bank relating to their business.

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?
We refer to our response under Question 2 above.

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?
No. We are not aware of any such entities.

We do submit, however, that the Reserve Bank should have the power to issue designations and declare that certain insurance products and services fall under IPSA and so must be regulated in New Zealand. This would align with the Financial Markets Authority's designation power under the Financial Markets Conduct Act 2013 and would bring flexibility to the legislation and ensure a level playing field.

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.

Yes. The ability for New Zealand policyholders to have the choice to obtain insurance cover, and for insurers to continue to obtain appropriate reinsurance cover, from overseas insurers is important for New Zealand. It increases competition between insurers and provides choice for policyholders.

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.

AILIC is currently operating in New Zealand under a branch structure. A mandatory local incorporation requirement would increase our costs of carrying on insurance business in New Zealand, and trigger a range of additional compliance obligations for us (which would require us to reassess the viability of our business in New Zealand). Also, having large offshore insurers operating in New Zealand via branches diversifies New Zealand's country risk.

We would also like to submit that there should be more exemptions available for overseas licensed insurers from compliance with New Zealand requirements, which are equivalent to the requirements in the insurer's overseas home jurisdiction. This could be covered by the general exemption power referred to above.

We believe there are likely to be jurisdictions with equivalent prudential regulation and supervision to New Zealand which could be recognised under greater mutual recognition arrangement and benefit from certain exemptions (such as certain US states, including Indiana, where AILIC is incorporated).

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?

We suggest that the review should consider and address risks to policyholders if an overseas insurer has an obligation for policyholder preference in their own jurisdiction, for instance, in the event of distress. This currently needs to be disclosed to policyholders; however we query how effective this is in making the New Zealand policyholders aware of these risks.

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.

We submit that there should be no universal minimum deposit requirement in legislation for overseas insurers. Instead, this could be dealt with greater recognition of home jurisdiction regulation (with consideration of the solvency requirements in the home jurisdiction).

Also, the clarification of the application of the duties of the life insurer and the directors of the life insurer in relation to the statutory fund would be welcome.

The potential unlimited liability of directors for losses to the statutory fund (under sections 107 and 117 of IPSA) should be limited and subject to appropriate due diligence defences. We refer to our response to Question 12 below.

We think the Reserve Bank should also consider whether a statutory fund is really necessary for life insurers who offer only pure-risk policies, where there is no savings component.

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.
We refer to our response to Question 8 above.

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.
We do not support placing expanded responsibilities on directors or senior managers as part of the review.

Question 11: Do you consider that the review should encompass further consideration of an insurer's key control functions to promote effective risk management *and* consistent application of requirements across the sector? We do not support that changes to insurer's risk management programmes and internal control functions be set out in legislation, because doing so would make it difficult to amend the requirements in the future. This is better addressed by way of issuing Guidelines. It is important there is flexibility to accommodate changes in technology (such as "InsureTech" products).

Any additional requirements should be sufficiently flexible to recognise the diversity of insurers within the New Zealand market. Most overseas insurers (such as AILIC) are likely to have existing risk management requirements and supervisory oversight in its home jurisdiction in relation to these matters. We submit that any enhancements for an insurer's New Zealand risk management framework should acknowledge and account for any equivalent requirements in the home jurisdiction.

We also suggest that the Reserve Bank should consider exemptions from the fitness and propriety regime where directors or senior managers are subject to similar standards under other legislative regimes.

We also suggest that the pre-approval model for material updates to an insurer's risk management programme and fit and proper policies should be reconsidered and amended to require insurers to notify the Reserve Bank of any material changes. This would align the regime with the licensing regime in the FMCA, where a licensed manager must notify the FMA of material changes to their governance and compliance arrangements as soon as practicable.

The current IPSA requirement for changes to risk management policies and fit and proper standards to be approved by the Reserve Bank:

> may have the unintended effect of discouraging some insurers from continuously improving and updating their risk management programmes and fit and proper policies; and
>
> may result in policies becoming outdated, because insurers are disincentivised from undertaking a potentially costly and time consuming pre-approval process with the Reserve Bank.

In addition, the penalty for a failure to seek the Reserve Bank's approval prior to the update of these policies in sections 34 and 73 - being a fine of up to $500,000 - is disproportionate (particularly where such changes may result in a material improvement to a policy or programme).

For New Zealand licensed overseas insurers, such as AILIC, the current roles of 'NZ CEO' and 'NZ CFO' can be quite artificial. We suggest the CEO and CFO roles should be the actual positions within the insurer, and instead the insurer should appoint a NZ manager or officer as a point of contact for the Reserve Bank and the policyholders.

Question 12: Do you consider that there may be opportunities to enhance the enforcement framework? Please provide comment in support of your view.
We submit that any enforcement regime should be relative to the materiality of the breach.

There are several instances under IPSA where the penalty for the offence is disproportionate to the breach, in particular where the breach is an administrative error (such as a failure to comply with a specific filing time limit). In these circumstances administrative penalties (such as infringement notices, stop orders, warnings and undertakings) would be more appropriate, and easier to enforce by the Reserve Bank as it would not require involvement of the courts. The party in breach should also be given on opportunity to be heard prior to such penalty or notice is issued by the Reserve Bank.

We also suggest introducing a cap on civil liability for statutory fund losses for a director. This would align the statutory fund civil liability provisions with the other civil liability provisions in IPSA.

Under IPSA, directors are jointly and severally liable for any loss to a statutory fund in the event of a liquidation or receipt of a Reserve Bank notice. There is only a limited defence available for directors if they can show that they used due diligence to prevent the occurrence of a contravention or to ensure that the insurer complied with the Reserve Bank's written notice.

IPSA currently offers only one general defence for a person who fails to comply with the Act, if that person can prove that:

> the failure was due to the act or omission of another person, or circumstances beyond their control; and
>
> they took all reasonable precautions and exercised due diligence to avoid the failure.

The defence is limited in that "another person" does not include a director, employee or agent of the person charged with the offence (i.e. the defence excludes reliance on employees).

This limitation may be appropriate for many of the more serious offences in IPSA, where directors should not leave compliance to third parties, but we consider the third party defence exclusion may not be appropriate in all cases, particularly those where directors place heavy reliance on senior management and can exercise only limited additional oversight to ensure compliance.

Support for this approach to a specific due diligence offence can be found in sections 499 and 500 of the Financial Markets Conduct Act 2013, the former of which contains a general due diligence defence, which excludes reliance on directors, employees or agents of the

person, and the latter of which is a specific due diligence defence applicable only to disclosure contraventions, which does not contain a similar third party reliance exclusion.

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?

We think that the current distress management tools available to the Reserve Bank are sufficient. We suggest that the legislation should not be too prescriptive to allow for flexibility in response to insurers in distress, so responses can be tailored to the circumstances to achieve an optional outcome - again, there should not be a "one size fits all" regime. See also our response to Question 16 below.

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

We do not have any particular concerns as to the effectiveness of New Zealand's distress management provisions compared to other jurisdictions.

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.

We suggest that the regime should be more transparent. However, we do not support an increase in the capital requirements themselves.

The introduction of a broad exemption regime to IPSA, as discussed earlier, would also be helpful in this area.

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.

We suggest the Reserve Bank should provide further guidance on the practical supervisory measures that it may take in a deterioration of an insurer's solvency levels. The existing IPSA framework is sufficiently flexible in terms of the Reserve Bank's response to deterioration in a licensed insurer's solvency margin. We suggest that this is maintained. The current wording of IPSA allows the Reserve Bank to take into account the individual insurer's circumstances when responding to deterioration in solvency levels. However, at the same time this creates uncertainty as to how the Reserve Bank would respond in any given case. Uncertainty could be clarified in the guidance.

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.

We understand that the transfer and amalgamation provisions in IPSA have generally worked well. Some improvements could be made to the current Reserve Bank notification/approval regime, but the current regime facilitates transactions in the New Zealand insurance market, and we consider it remains appropriate and consistent with other regulatory approval regimes in New Zealand.

We also note the current Reserve Bank Guidelines on Transfers and Amalgamations are limited and not sufficiently informative. Further guidance on what the Reserve Bank is expecting to see in a transfer or amalgamation application would be helpful.

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

We submit that the decision making power should be kept with the Reserve Bank.

A court process would increase both the cost and time for transaction, and it would have limited added benefit to policyholders.

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.

We submit that the current requirement under IPSA to disclose the insurer's financial strength rating (FSR) in writing to every policyholder before entering into or renewing a contract of insurance is burdensome and costly to the insurer. It is unlikely that a policyholder would consider the FSR an important factor when deciding on an insurance policy (as opposite **to the premium and the policy terms).**

Alternative ways of disclosure would be a disclosure on the insurer's website or through media.

In our view statutory fund disclosures should also be on a website, rather than in a policy document and required only when a life insurer has more than one statutory fund.

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.

We submit that providing too much information may be confusing to policyholders and detract from information that is more important (such as the terms of the policy).

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.

We submit that any information requests should be subject to industry consultation to ensure that the information requested can be collected by the insurers in an efficient manner.

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.

Streamlining the current requirements as discussed above would assist in clarifying compliance obligations and in the consistent application of IPSA regime.

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

We have no submission on this.