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New Zealand

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

Submission by Bell Gully

Dated 30 June 2017

This submission has been prepared by Bell Gully in response to the Reserve Bank's March 2017 Issues Paper: Review of the Insurance (Prudential Supervision) Act 2010 (**Issues Paper**).

Our submissions are set out in the table below. We have not answered all of the proposed questions, as we have focussed our comments on those questions which we consider particularly relevant to our areas of expertise and have limited our submissions to matters which we believe require further consideration.

We have no objection to our submission being published by the Reserve Bank.

If you wish to discuss any aspect of our submission please do not hesitate to contact Glenn Joblin, Haydn Wong, Sarah McQueen or Katie Dow. Their contact details are as follows:

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Submission form

Question	Response
<p>1. Do you have any comments to make on the discussion in Part 1 of the Issues Paper?</p>	<p>As a preliminary point, we note that our experience is that IPSA is working well and overall it provides an efficient and effective regime for the regulation of the New Zealand insurance sector. We agree that the principles described in paragraph 28 of the Issues Paper are an appropriate focus of the IPSA regime. While we agree that some improvements can be made to the IPSA regime, we do not consider it necessary to change the fundamental concepts which underpin IPSA.</p>
<p>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.</p>	<p>Yes. In our view the application of the “carries on insurance business in New Zealand” test for overseas companies that do not have an office or other physical presence in New Zealand is too vague due to the requirement for the overseas company to be required to be registered or deemed to be registered under the Companies Act 1993.</p> <p>Section 332 of the Companies Act provides that merely entering into a contract of insurance as an insurer with a New Zealand policyholder does not mean that an overseas company is carrying on business in New Zealand. However, the Companies Act does not prescribe the level of other activity in New Zealand that is sufficient to mean an insurer is carrying on business in New Zealand. The rules are fact-specific and there is very limited judicial or other guidance on these issues.</p> <p>We submit that the test should not be defined by reference to the requirement to be registered or deemed to be registered under the Companies Act. It also needs to take account of the changing technology environment and development of “Insure-tech” products and other innovations which may occur in the near future.</p> <p>However, we are conscious that the test should not be defined too broadly in a manner that would make entities which are not currently subject to IPSA, such as foreign reinsurers, become subject to IPSA. If overseas reinsurers are required to become licensed under IPSA, this may result in them exiting the New Zealand market, which would be likely to be detrimental to the New Zealand insurance market.</p> <p>We would not support the introduction of licensing of foreign reinsurers under IPSA.</p>

		<p>Subject to clarification of the reach of the “carries on insurance business in New Zealand” test, we are not aware of any areas where the scope of IPSA is too broad.</p> <p>On a separate point, we do not support extending the legislative scope of IPSA to include a wider range of entities within a licensed insurers’ corporate group. Probing into the intra-group funding and reinsurance arrangements within a licensed insurers’ wider corporate group would likely deter some overseas insurers from operating in the New Zealand market due to the additional costs associated with doing so and the increased restrictions on overseas insurers’ operations that it may cause. We recognise that it is critical to protect and enhance policyholders’ interests; however, we believe this can be achieved by other means.</p>
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?	<p>We believe it would be helpful for the Reserve Bank to have broader exemption making powers than those currently set out in IPSA. This would enable the Reserve Bank to grant exemptions from compliance with certain provisions of IPSA or the regulations on an individual or class basis where appropriate. We would expect this to be a useful tool for the Reserve Bank as the insurance industry evolves over time.</p>
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?	<p>We believe IPSA should contain a prohibition on a person/entity holding themselves out as an insurer when the policies are, in fact, underwritten by another party. It is important that the general public and policyholders have a clear understanding of the arrangements and that there are sufficient measures in place to deter a person/entity from inaccurately representing their position.</p> <p>Sections 20A-20C of the Financial Advisers Act 2008 provide a useful example of how holding out restrictions can be constructed.</p>
5.	Do you agree that overseas insurers provide valuable support to the New Zealand insurance market? Please provide commentary in support of your view.	<p>We agree that overseas insurers provide valuable support to the New Zealand insurance market through enabling New Zealanders to access appropriate insurance cover and insurers to obtain reinsurance cover that they might otherwise be unable to source in New Zealand. Overseas insurers also increase competition and provide more choice for policyholders.</p> <p>In our view, the New Zealand insurance market needs to retain access to the assets and support of overseas insurers and reinsurers. As such, the IPSA regime should ensure that the participation of overseas insurers is encouraged, while setting appropriate regulatory requirements to protect New</p>

		<p>Zealand policyholders and the integrity of the New Zealand insurance sector.</p> <p>We submit that the Reserve Bank should consider reviewing the prescribed jurisdictions in Regulations 5 of the Insurance (Prudential Supervision) Regulations 2010, with a view to including additional jurisdictions with equivalent regulatory requirements and prudential supervision. The individual application process required to seek recognition of an equivalent home jurisdiction is very onerous for overseas insurers. It may be operating as a barrier to overseas insurers strategically considering entering the New Zealand market.</p> <p>We also submit that the Review should consider reducing the compliance obligations for existing prescribed jurisdictions where there is a duplicity of requirements in the home jurisdiction and New Zealand, or where the additional New Zealand requirements are of limited benefit.</p> <p>In particular, we believe that consideration should be given to collaborating with Australian regulators to implement a comprehensive mutual recognition regime.</p>
6.	<p>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.</p>	<p>We believe that the current regime, which does not require local incorporation by overseas insurers, is the correct approach. Introducing mandatory local incorporation, with the inflexibilities and costs that would arise, would likely result in some overseas insurers exiting the New Zealand market. This would have a detrimental effect on New Zealand policyholders, as this would reduce access to capital and reduce competition in the market and likely result in increased premiums or loss of available coverage.</p> <p>For the same reasons, we would not support the introduction of any “assets in New Zealand” requirements on overseas insurers, particularly given the depth of New Zealand’s capital markets to absorb such capital.</p>
7.	<p>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?</p>	<p>In the context of overseas insurers, we believe the most significant risk to New Zealand policyholders is preferential treatment of the insurer’s offshore creditors and policyholders.</p> <p>However, addressing this without deterring overseas insurers from operating in New Zealand is challenging.</p>

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.	<p>We submit that the current statutory fund regime, which is limited to life insurance business, is the correct approach.</p> <p>We do not support extending the statutory fund framework to non-life insurance as the costs associated with doing so would likely outweigh the benefits to policyholders. Nor do we support the further separation of different types of life insurance from each other for the same reason.</p>
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.	<p>We do not support introducing a statutory fund type concept to overseas non-life insurers as this would likely be a deterrent to overseas insurers entering or remaining in the New Zealand market.</p> <p>We would be supportive of investigating other means of policyholder protection.</p>
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.	<p>We do not support expanding the responsibilities placed on directors and senior managers of insurers as part of the review. In our view, the current approach of supplementing the duties of directors set out in the Companies Act 1993 in limited circumstances is appropriate. However, we would support the provision of further guidance from the Reserve Bank on its expectations of these roles in the context of insurance operations.</p> <p>We support the concept of having a more uniform set of “fit and proper” requirements with the other regulatory frameworks for registered banks and non-bank deposit takers.</p> <p>We submit that it is inappropriate for the New Zealand appointed actuary of an overseas insurer to have responsibility for reporting on group financial statements.</p>
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?	<p>We submit that a “one size fits all” approach to risk management and governance is not appropriate for New Zealand’s diverse insurance market. Accordingly, we do not support a more prescriptive approach to risk management and governance requirements.</p> <p>However, we do believe that insurers would benefit from greater transparency of the Reserve Bank’s expectations in these areas. This could be achieved by the Reserve Bank issuing further guidelines as opposed to binding standards.</p>

12.	Do you consider that there may be opportunities to enhance the enforcement framework? Please provide comment in support of your view.	<p>Yes. We would support the introduction of an enforcement regime that provides the Reserve Bank with a broader toolbox of more proportionate enforcement responses to contraventions of IPSA.</p> <p>In particular, we would support adopting an enforcement regime similar to the Financial Markets Conduct Act 2013, with a system of escalating levels of liability to ensure that the enforcement response is proportionate to the contravention (i.e. ranging from regulatory tools such as stop orders, direction orders and infringement notices to civil and criminal liability depending on the gravity and nature of the contravention). Such a regime would also give the Reserve Bank an increased ability to be pro-active and take appropriate preventative action..</p> <p>We would also support introducing a limit to director liability in respect of statutory fund losses in line with all the other civil liability provisions in IPSA.</p>
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.	<p>Yes, we believe the current approach to prudential capital requirements by reference to a solvency margin and conditions of licence should be within scope of the Review. This is an important part of IPSA and should be considered as part of the Review. However, we do not consider that there is a specific need to impose higher capital requirements on insurers.</p> <p>We agree that the use of conditions of licence to apply and vary the minimum solvency margin requirements lacks transparency and would support greater visibility of this.</p>
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.	<p>To the extent possible, it would be useful to have more clarity and transparency as to the Reserve Bank's likely responses to deteriorations in reported solvency levels; however, this needs to be balanced against retaining flexibility for individual nuances in deterioration scenarios.</p>

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.	<p>We have found the process for approval of proposed transfer transactions has generally worked well in practice. However, the process of formally consulting with policyholders has proved to be of little practical benefit, whilst imposing significant costs and causing potential delay to a transaction.</p> <p>We submit that the scope of the change of control test in IPISA should be clarified. We do not believe that the Takeovers Code threshold is appropriate in the context of the IPISA regime. However, we believe the Reserve Bank should consider adopting a more uniform approach to the change of control test across IPISA and other regimes such as the Non-bank Deposit Takers Act 2013.</p>
18.	Do you consider that approval by the Reserve Bank is more or less effective than alternative mechanisms e.g. court based systems?	<p>Yes. We believe approval by the Reserve Bank is more effective than alternative mechanisms.</p> <p>As the Reserve Bank has specialist knowledge of, and experience in, the insurance sector, the Reserve Bank approval process is a more considered and efficient process than the Court approval alternative, which treats policyholders as creditors.</p> <p>The Reserve Bank approval process also allows the process to be run in a more iterative fashion, with feedback from the Reserve Bank being able to be incorporated into the relevant documents. This can be contrasted with the Court approval where a change to the documents may require a new Court application. The Court approval process also increases both the timeframe and cost of a transaction, without giving rise to any additional policyholder benefits or protections.</p>
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.	<p>Section 64 of IPISA requires a licensed insurer to disclose its financial strength rating in writing before entering into or renewing a contract of insurance with a New Zealand policyholder (subject to a limited exception if this is not reasonably practicable).</p> <p>We believe it would be better for this disclosure to be made on the insurer's website, rather than being disclosed in writing to policyholders as part of the policy or marketing materials, and for policyholders to be referred to the website to obtain this information. The current requirement imposes a significant cost on insurers by requiring collateral to be reprinted if the insurer's rating changes.</p>

		<p>We are aware of some insurers with annually renewable policies that are required to send a letter to policyholders specifically to comply with this disclosure requirement, as there are otherwise no changes to the existing policy. This is costly to prepare and is of no benefit to the policyholder in circumstances where the rating has not changed.</p> <p>Disclosure on the insurer's website would also eliminate the issue that insurers face of being responsible for their brokers' failure to disclose the rating despite the brokers having the interface with the client and the insurer being unable to fully manage that process.</p> <p>Alternatively, policyholders could be directed to a central website which lists the ratings of all licensed insurers on a "live" basis.</p>
20.	<p>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.</p>	<p>We would not support the introduction of wider disclosure requirements such as those applied to the banking sector. This is because we do not believe introducing broader disclosure requirements would necessarily deliver a corresponding tangible benefit to policyholders.</p>
21.	<p>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.</p>	<p>We agree that the collection of industry data by the Reserve Bank and provision of that information to the market is beneficial.</p> <p>However, we would request transparency as to what the data that the Reserve Bank already collects is being used for and consultation as to any proposed increase in insurers' existing data reporting requirements. We would caution against increased reporting requirements for data collection purposes given the cost and time involved for insurers in providing the information.</p>
22.	<p>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.</p>	<p>We would support a rationalisation of the mix of legislative instruments to develop a simpler framework for the regime. In our view, it would improve the administrative efficiency of applying the various requirements.</p>

23.	Are there any aspects of the current requirements that you consider would be better specified using different regulatory tools?	As noted in our response to question 15, the use of conditions of licence to apply and vary the minimum solvency margin requirements lacks transparency. We would support this information being specified in a different form which gives greater visibility of it.
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