



Submission to the Reserve Bank of New Zealand on the Issues Paper: Review of the Insurance (Prudential Supervision) Act 2010

June 2017

Background

The Health Funds Association of NZ (HFANZ) appreciates the opportunity to make a submission on the issues paper: Review of the Insurance (Prudential Supervision) Act 2010.

HFANZ is the industry body representing health insurers. Members include friendly societies, mutual, and subsidiaries of public companies. HFANZ's eight members together account for over 80% of lives covered by PHI in New Zealand. It is noted that individual HFANZ members may be making their own submissions on the issues paper, and these may differ in some aspects from the general position in this submission.

A list of HFANZ full members is attached as an appendix to this submission.

HFANZ Submission

1. General comment – review and philosophy

Review process and timeframe

It is noted that in this review the RBNZ has dual roles as both reviewer and implementer. While this is not ideal in legislative reviews, the overall timeframe and process looks appropriate.

Overall regulatory impact and compliance costs

HFANZ would like to reiterate concerns made in previous submissions around the cumulative impact of regulatory and compliance cost and the possible negative effects these can have on consumers and choice.

HFANZ fully supports the two stated purposes of the legislation:

- (a) promote the maintenance of a sound and efficient insurance sector; and
- (b) promote public confidence in the insurance sector.

There is a concern that the cumulative impact of regulation and compliance costs can get to the point where it negatively impacts on these objectives. Over the past decade since the GFC, organisations in the financial services space have incurred significant additional regulatory and compliance costs (from a prudential as well as operational side). These requirements have added cost at all levels of the process and these costs are ultimately paid for by consumers – in the form of higher fees or premiums.

For example, in terms of the cost of data compliance with IPSA, there are a host of additional permanent costs, including the costs of ratings, actuarial costs, additional director and governance costs, computer and software costs – both one-off and ongoing.

In the health insurance space, around three-quarters of lives covered are by not-for-profit insurers, and these additional costs must be passed on to consumers. This means premium increases are higher than they otherwise would be.

This also has a disproportionate effect on smaller insurers, who are less able to spread the additional costs over a large pool of policyholders. As a result, there is a risk that excessive compliance and regulatory costs can precipitate market consolidation and reduction of consumer choice.

HFANZ is therefore supportive of moves to reduce compliance costs where possible as set out in this submission. While it is accepted that a level of compliance cost is inevitable in order to achieve the prudential requirements, it is important that an opportunity is taken as part of this review to critically consider whether each element of the compliance requirements is appropriate and necessary, and the implementation is cost-effective for insurers.

2. Comment on issues identified

The following comment is made in the same order and format of the issues paper.

2.1 Licensing and scope

HFANZ agrees the review should consider the current scope of IPSA as set out.

The recent growth in peer to peer lending has also sparked some consideration of how this model might be applied in insurance markets. Currently any peer to peer or crowd-funded insurance arrangements would sit outside the scope of IPSA licensing. Some early consideration should be given to how this might be regulated to avoid the potential risks down the track in the event that such platforms grow rapidly.

2.2 Overseas insurers

The issues paper notes that some difference in treatment may be warranted as overseas insurers can be subject to home country prudential and solvency requirements. However, the flip side of this is that changes to an insurer's home country regulations – for example capital requirements – could impact adversely on the solvency and risks for its NZ entity or operations.

2.3 Statutory funds

HFANZ notes the discussion in the paper around possible options to extend the statutory fund framework, although do not support extension of the framework beyond the life insurance business. Our comments here relate specifically to why it would not be appropriate to extend the statutory fund framework beyond life to for example health insurance.

Firstly, the driver for the existing stat fund regime was, as noted in the issues paper, to provide appropriate separation between the (long term) liabilities that exist in life and general insurance. These aspects do not exist in health insurance primarily for two reasons:

1. Health insurance does not carry the same long term liabilities and while it is acknowledged they are not identical, are closer in this respect to general.
2. Around 90 percent of health insurance is in effect held by mono-line insurers, with two health insurers having already separated life insurance business. No health insurer underwrites general insurance.

As such, the original need to ring fence life does not exist in the health insurance industry. (We also note that there is not the concentration issue in health that is apparent in general insurers who underwrite life insurance).

This issue was extensively considered in 2010 by the RBNZ and industry. We would submit that those submissions and considerations also remain (given the same market participants, structures and dynamics still exist) as relevant today as they did in 2010.

In relation to health insurance in particular, there are significant differences in the nature of the product which would make a statutory fund requirement inappropriate. Health insurance already sees a reasonable level of consumer choice and switching between different providers and products despite pre-existing condition.

This is because with health insurance there are a number of providers who will cover pre-existing conditions after a certain period, or with the application of a premium loading or business placed in employer group schemes that provide pre-existing coverage, so there remains a significant degree of consumer choice and competition.

Further, there may from time to time be opportunities for policyholders to transfer from other insurers and have their pre-existing conditions covered. A recent example of this was in 2015, where the two largest insurers Southern Cross and nib accepted policyholders transferring with pre-existing conditions.

Finally, the risks covered by private health insurance exist in New Zealand against the backdrop of a public system of universal health coverage and ACC, (so comparisons with systems such as the US or even Australia are misleading). Health insurance does not cover acute (A&E), public health epidemics, accidents or chronic illnesses and conditions. Private health insurance is not a necessary requirement for medical treatment in NZ. For the 30% of New Zealanders who have PHI, their insurance entitles them to access faster treatment and surgery (where there are waiting lists) and have a choice of provider. Pre-existing conditions that are not covered because they have recently switched providers or recently taken out cover for the first time –means even if a particular treatment is not ultimately insurance funded, it will generally be available in the public system, albeit in a public setting .

2.4 Role of key officers and control functions

HFANZ supports consistency in the application of requirements, and to this end the alignment of terminology with other standards in NZ regulation is supported.

The issues paper also raises the possibility of clarifying and expanding responsibilities. HFANZ considers the current arrangements relating to standards, together with the expectations placed on directors and key officers, to be already sufficiently specified and appropriate to the purpose of the legislation. There is a concern that revisiting this area with a view to enhancing and expanding

responsibilities risks the imposition of further compliance costs without any material benefit in terms of the purpose of the legislation. For this reason, HFANZ does not support the expansion of responsibilities.

2.5 Enforcement regime

HFANZ has limited support for broadening the range of penalties and enforcements. Noting that there have been no criminal prosecutions under the Act since enactment is not in itself a justification for broadening the range of enforcement remedies.

Arguably, there are already processes to encourage compliance, and the current provisions seem to work well.

HFANZ accepts that one possible outcome of the review is to provide for the application of more proportionate enforcement responses, such as in situations where a criminal prosecution may be seen as disproportionate.

While such an outcome is supported, there needs to be an element of caution to avoid a proliferation of enforcement penalties which do not really add much in terms of the overall functioning of the sector, the level of compliance, or the stated purposes of the Act.

Finally, it is noted that while certain breaches are criminal offences, the RBNZ has a wide range of powers to intervene in an insurers business quite separate from – and arguably with a good deal more impact – than the instigation of criminal proceedings.

2.6 Distress management

HFANZ believes the current provisions relating to distress management are appropriate and does not support proposals for allowing premature intervention in the market by RBNZ. The discussion in the issues paper raises the prospect of RBNZ becoming more of a *participant* in the market – taking action ‘prior to distress events emerging’ and ‘...to facilitate the quick exit of smaller insurers from the market.’

If any change is considered, then a degree of caution is required. For instance, the size of the insurer should not be the sole focus, rather the relative risk vs the size of the insurer needs to be taken into account.

2.7 Solvency requirements

HFANZ considers the current solvency requirements to be adequately provided for in the legislation. A fundamental legal principle is that any rules should apply fairly and evenly to all, and confidence in the solvency regime rests in the knowledge that the rules are being applied consistently across all insurers.

If the proposals in this section are taken forward, then some care needs to be taken to ensure confidence in the overall regime is maintained.

HFANZ considers the solvency provisions were well-debated at the time the original bill was introduced and as the solvency standards were developed. Other than potential amendments to

reflect changes to accounting standards, there should not be any need for wholesale review of the solvency provisions.

2.8 Supervisory process – regulatory approvals

HFANZ supports the proposals here to the extent that they are more appropriate and can reduce compliance and administrative costs by streamlining approvals.

2.9 General disclosure and financial strength rating requirements

HFANZ supports proposals for consistency with other frameworks and desire for cost-effectiveness.

HFANZ notes that the provision of industry data is a key role of many industry associations, including those in the insurance sector. While HFANZ does not believe it is the RBNZ's role to duplicate the functions of industry associations, there is some support for the provision of aggregate industry data to the market, for example – total premium by broad classification (eg general, life, health).

2.10 Appropriate regulatory mechanisms

In line with best practice, HFANZ supports the specific setting out of provisions and mechanisms in legislation to the extent possible. It is noted that the current legislation already devolves a great deal to RBNZ in terms of regulatory flexibility.

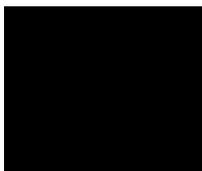
Some of the issues noted as concerns are with the RBNZ's own guidelines and the status of these being below regulation (ie unenforceable). These are not issues which can be resolved or addressed in a review of the legislation. The review of the Act should only consider the balance between what is specified in primary legislation and what is left up to regulation made under the Act.

If there is a desire for greater regulatory flexibility by RBNZ, including the elevation of guidelines or standards to have the force of regulation or statute, then care will be needed to clearly set out the limits or constraints on this in legislation, including review or appeal rights.

2.11 Other matters

It is suggested that consideration be given to the next proposed review, and that the current review should clearly set out what the envisaged outcomes will be and some sort of criteria for future evaluation – ideally by an independent party engaged some way down the track. That way, there will be a framework for evaluation in place well in advance of the next review.

Thank you again for the opportunity to make this submission. I am happy to provide such further comment or clarification as may be required on any of these points. A detailed response to each question is attached.



Roger Styles
Chief Executive

Responses to specific questions in the issues paper

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

- Support moves to reduce compliance costs where possible.

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?

- Consider application to emerging models such as peer to peer or crowd-funded insurance.

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?

- Changes to an insurer's home country regulations – for example capital requirements – could impact adversely on the solvency and risks for its NZ entity or operations.

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.

- Extension of statutory funds beyond life insurance is not supported. Inappropriate to extend the statutory fund framework to health insurance (refer detailed comment).

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.

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.

- Support consistency and alignment of terminology with other standards in NZ regulation;
- Do not support the 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?

- Do not support the expansion of responsibilities.

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

- Limited support for broadening the range of penalties and enforcements.

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?

- Do not support proposals for allowing premature intervention in the market by RBNZ.

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

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.

- Limited support for legislative amendment to allow differential solvency calculations for individual insurers (refer detailed comment).

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.

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.

- Support proposals to the extent that they are more appropriate and can reduce compliance and administrative costs by streamlining approvals.

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

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.

- Limited role for providing some aggregated data. (refer detailed comment).

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.

- Support setting out of provisions and mechanisms in legislation to the extent possible.
- Do not support the elevation of guidelines or standards to have the force of regulation or statute (refer detailed comment).

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

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.

Appendix: HFANZ full members

The following insurers are full members of HFANZ:

- Health Service Welfare Society Limited
- AIA International Limited
- Education Benevolent Society Incorporated
- Manchester Unity Friendly Society
- Police Health Plan Limited
- Southern Cross Medical Care Society
- Sovereign Assurance Company Limited
- Union Medical Benefits Society Limited