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Attention Richard Johnson

Senior Adviser, Prudential Supervision Department
Reserve Bank of New Zealand
PO Box 2498
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Dear Richard

Submission on the Review of the Insurance (Prudential Supervision) Act 2010

1. Introduction

1.1 This submission is made on behalf of MinterEllisonRuddWatts, a national law firm with one of New Zealand's leading financial services law practices. It relates to the Issues Paper released by the Reserve Bank of New Zealand (**Reserve Bank**) on the Review of the Insurance (Prudential Supervision) Act 2010 (the **Review**). This submission reflects our own views, and not necessarily those of any of our firm's clients.

1.2 We have focussed this submission on certain matters relating to:

(a) Question 2 of the Review (specifically, the scope of application of the Insurance (Prudential Supervision) Act 2010 (**IPSA**)); and

(b) Question 8 of the Review (specifically, the extent of statutory fund liability and its alignment with liability under the Financial Markets Conduct Act 2013 (**FMCA**)).

1.3 As a further general point, we support the enhancement of the existing regime in a manner which allows for technological innovation, particularly in the development of new business models and distribution channels. Although the IPSA is a relatively recent piece of legislation, technology is developing quickly and legislation needs to be future-proofed to allow for innovative advances, and to align with other regulatory developments in these areas.

1.4 We do not comment on any other matters raised in the Review, except to the extent relevant to discuss the two matters above.

2. Scope of the IPSA

2.1 Every person who carries on insurance business in New Zealand must hold a licence issued by the Reserve Bank under the IPSA.[1] A person carries on insurance business in New Zealand if that person is, amongst other things, a body corporate, or an overseas company that is required to be registered or deemed to be registered under the Companies Act 1993, or an association of persons formed outside New Zealand that is carrying on business in New Zealand within the meaning of section 332 of the Companies Act 1993 and that person:[2]

(a) acts, or has at any material time acted, as an insurer in New Zealand or elsewhere; and

(b) is liable as an insurer under a contract of insurance to a New Zealand policyholder.

[1] IPSA, section 15.

[2] IPSA, section 8.

2.2 We consider that there are two main issues with this definition that would benefit from clarification or amendment; first, that an overseas person must be “carrying on business” as defined by reference to the Companies Act 1993 and secondly, that a person must be liable as an “insurer under a contract of insurance”. We address each of these in turn.

First limb: Carrying on business

2.3 The analyses for whether a person is (for the purposes of section 8 of the IPSA) “an overseas company that is required to be registered or deemed to be registered under the Companies Act 1993” or “an association of persons formed outside New Zealand that is carrying on business in New Zealand within the meaning of section 332 of the Companies Act 1993 (applied with all necessary modifications as if the references in that section to an overseas company were references to an association of persons)” both require consideration of whether the person is carrying on business within the meaning of section 332 of the Companies Act 1993. That section does not define “carrying on business in New Zealand”, other than to state that it includes administering, managing or dealing with property in New Zealand as an agent, or personal representative, or trustee, and whether through its employees or an agent or in any other manner.

2.4 Section 332(b) of the Companies Act 1993 does, however, list a number of examples of situations in which an overseas company will *not* carry on business in New Zealand, including by reason only that a person enters into a contract of insurance (including a contract of reinsurance) as an insurer with a New Zealand policyholder. This particular example was added to section 332(b) of the Companies Act 1993 by the IPSA. Other examples include where a person maintains a bank account, creates evidence of a debt or creates a charge on property, or invests its funds or holds property.

2.5 The lack of a bright line test in either the IPSA or the Companies Act 1993 with regard to carrying on the business in New Zealand has inevitably led to a lack of certainty with regard to the application of the IPSA as to overseas insurers and reinsurers who may have only a limited business exposure in New Zealand, and potentially only at a wholesale level.

2.6 Judicial consideration of section 332 of the Companies Act 1993 has concluded that whether an overseas company is “carrying on business” is a factual question which must be determined by the particular circumstances.[3] The result being that there is little guidance on the interpretation of “carrying on business” for companies and those operating in the insurance context. Ultimately, even with the benefit of a legal opinion on the application of the provisions to particular circumstances, it remains a judgement call for the overseas person in each case.

2.7 An overseas person can arguably obtain certainty by applying for a notice under section 9 of the IPSA whereby the Reserve Bank can declare a person is not carrying on insurance business in New Zealand. However, this section only empowers the Reserve Bank to declare a person is not carrying on insurance business in New Zealand where:

(a) the person is or will be an insurer only by reason of the fact that the person—

(i) has entered or will enter into an isolated contract of insurance as an insurer; or

(ii) occasionally enters into contracts of insurance as an insurer; and

(b) entering into the contract or contracts referred to in paragraph (a) is incidental or ancillary to the business carried on by the person; and

(c) requiring the person to obtain a licence would, in the circumstances, be unduly onerous or burdensome.

2.8 We submit that this section is of little use to overseas persons whose insurance business is not “incidental or ancillary” to their main business, and the phrase “occasionally enters into contracts of insurance” arguably creates further uncertainty. Furthermore, the application of this section is arguably restricted to persons who already meet the threshold of “carrying on business in New Zealand” who would, but for section 9, be caught by the licensing requirements.

[3] *Probus South Pacific Ltd v Probus New Zealand Inc* [2015] NZHC 2250; *Commerce Commission v Visy Board Pty Ltd* [2012] NZCA 383; *Luckins v Highway Motel Carnavon Pty Ltd* (1975) 133 CLR 164 (HCA)

2.9 However, if the section 9 declaration is available to persons who are not sure whether they are carrying on business in New Zealand, the requirements in section 9 which must be satisfied are stricter than the test for "carrying on business" in the Companies Act 1993. For example, section 332(b) of the Companies Act 1993 states that a person will not be carrying on business in New Zealand merely because it enters into a contract of insurance – this scenario is broader than the scenario in section 9 of the IPSA which requires that the insurance contracts entered into must be occasional or one-off. Therefore, there is no certain test to confirm whether an entity is or is not captured by the licensing requirements under the IPSA.

2.10 The lack of guidance and the inherent ambiguity of the provisions of section 9 of the IPSA and section 332 of the Companies Act 1993 creates uncertainty for overseas insurers, and their directors, who can face significant liability if they are subsequently found to be acting as an insurer in New Zealand without a licence. This lack of certainty also raises the risk that an overseas person may choose not to enter New Zealand's market due to the lack of clarity of whether they would be caught by the IPSA regime.

2.11 We submit that either guidance from the Reserve Bank is desirable on the interpretation of "carrying on business" in the context of the IPSA, or that sections 8 and 9 of the IPSA are re-written to provide a bright line test to establish the requirement for a licence.

2.12 If the policy dictates that sections 8 and 9 should not be amended, Reserve Bank guidance on interpretation could be provided along the lines of that produced for AML/CFT compliance. The guidance could set out the factors that the Reserve Bank considers relevant in determining whether a person is, or will be carrying on business in New Zealand for the purposes of the IPSA. The IPSA could also be amended to broaden the Reserve Bank's powers in section 9 by allowing persons to formally apply for confirmation from the Reserve Bank as to whether they are (or are not) carrying on insurance business in New Zealand.

Second limb: Liable as an insurer under a contract of insurance

2.13 The IPSA imposes the requirement to be licensed on "insurers", i.e. "persons by whom or on whose behalf the risk or part of the risk to which a contract of insurance relates is accepted".[4] A "contract of insurance" is "a contract involving the transference of risk and under which a person (the insurer) agrees, in return for a premium, to pay to or for the account of another person (the policyholder) a sum of money or its equivalent, whether by way of indemnity or otherwise, on the happening of one or more uncertain events".[5]

2.14 Ambiguity comes from the term "money or its equivalent", which is not defined in the IPSA. It is unclear whether "money" includes virtual currencies or tokens and whether "its equivalent" is limited to things which have the same essential attributes of money, such as exhibiting fungibility and having the purpose of operating as an instrument for transferring value, or whether money's "equivalent" extends to things of value.

2.15 There has been no judicial consideration of the phrase "money or its equivalent" and, although the expression "or money's worth" has been the subject of judicial consideration under the Securities Act 1978 (and the term has been carried over into the FMCA),[6] the difference in wording between the Securities Act 1978/FMCA and the IPSA makes this judicial consideration of little value.

2.16 To future-proof the IPSA and for the purposes of consistency of regulation and certainty for insurers who may wish to offer innovative insurance products and services and modes of premium payment, which do not conform to traditional insurance contract models, clarity is required around what constitutes "money or its equivalent". Clarity could be achieved through issuing guidance on how the Reserve Bank interprets "its equivalent", or by amending the IPSA to include the ability to obtain a declaration from the Reserve Bank as to whether a proposed contract of insurance that does not involve the payment of money, will be captured by the regime.

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[4] IPSA, section 6.

[5] IPSA, section 7.

[6] *Hickman v Turner and Waverley Ltd* [2012] NZSC 72

3. **Statutory fund liability**

3.1 Under the IPSA, a life insurer must have a statutory fund and directors must comply with certain statutory duties with regard to the maintenance of that statutory fund. The life insurer and its directors face liability where statutory duties are breached and there are losses to the statutory fund.[7]

Duty of directors

3.2 Under section 105(1) of the IPSA, directors have a duty to the policyholders of life policies referable to a statutory fund of the life insurer 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:[8]

(a) complies with subpart 3 of Part 2 of the IPSA (relating to statutory funds of life insurers); and

(b) gives priority to the interests of policyholders.

3.3 If in respect of any act or omission of a life insurer, a director fails to comply with the duty under section 105(1) of the IPSA and the act or omission results in a loss to a statutory fund of a life insurer, the director is liable to pay to the life insurer an amount equal to the loss.[9] Currently no defence exists for a breach of a director's duty under section 105(1) of the IPSA.

Imputed liability

3.4 Under section 107 of the IPSA, where an act or omission by a life insurer results in a loss to a statutory fund and the life insurer fails to comply with a section 106 notice issued by the Reserve Bank, the persons who were the directors of the life insurer when the act or omission occurred are jointly and severally liable to pay to the life insurer an amount equal to the amount of loss.[10]

3.5 Under section 117 of the IPSA, where a contravention by the life insurer results in a loss to a statutory fund, and the life insurer has been put into liquidation or is otherwise being wound up, the persons who were the directors of the life insurer when the contravention occurred are jointly and severally liable to pay to the insurer an amount equal to the amount of the loss.[11]

3.6 In respect of these two strict liability provisions, directors have recompense to a "due diligence defence". This differs from section 105 which includes due diligence and reasonable steps as part of the duty (which results in the burden of proof under section 105 being with the Reserve Bank or whomever claims there has been a beach). For a section 107 or 117 breach, the burden of proof is on the director to prove they acted with due diligence.

Submission

3.7 We submit that the strict liability imposed on directors by sections 105, 107 and 117 of the IPSA be modified, especially where there is no direct connection to a breach of a director's statutory duty. In addition, although strict liability may arguably be appropriate for particularly egregious breaches of directors' duties, in most cases, breach of directors' duties should be capable of defence, or subject to minor fines where the level of culpability is negligible and/or directors are able to show that reasonable steps were taken to comply.

3.8 We also submit that the existing strict liability approach under the IPSA is inconsistent with the standard of liability imposed on directors under the FMCA. Generally, under the FMCA, where the liability imposed on a director does not relate to a director's duty (but rather a duty imposed on the issuer/offeror/reporting entity), a director will not be liable if he or she can prove that it was not due to any misconduct or negligence on his or her part, or in some instances liability is only where

[7] IPSA, subpart 3 of part 2.

[8] IPSA, section 105(1).

[9] IPSA, section 105(5).

[10] IPSA, section 107.

[11] IPSA, section 117.

the director has knowledge. Where there is liability imposed on a director under the FMCA for certain civil offences, there are "reasonable reliance" and "subjective belief" defences available. We further understand that the historic justification for requiring life insurers to maintain a statutory fund (and therefore introducing the specific directors' duties in relation to statutory funds discussed above) was to provide a form of financial protection from insurer insolvency for people invested in locked in investment-linked life policies, which were a very common means of retirement savings in New Zealand until relatively recently. However, given that KiwiSaver schemes, superannuation schemes and workplace savings schemes have the same underlying purpose as these investment-linked life policies, the Reserve Bank should look to the regulatory regime applying to such schemes under the KiwiSaver Act 2006 and the FMCA for an appropriate range of directors' duties, offences and defences. These Acts do not impose strict liability on the directors of managers of such schemes for fund losses, and there seems no legitimate reason for maintaining a higher standard of strict liability for directors of life insurers as opposed to directors of fund managers.

3.9 To conclude on this issue, we acknowledge that the statutory fund liability imposed on directors under the IPSA is civil rather than criminal (as the director is only required to pay the amount equal to the loss to the statutory fund resulting from the contravention). But this should not justify a strict liability offence where, for example, the reason or the fact that there is a loss to a statutory fund may not be known to the director or even be a result of an act or omission of a director. Directors should be able to focus on business strategy and supervising management, rather than on minimising their personal liability.

3.10 In the Issues Paper, the Reserve Bank notes that the enforcement regime contained in the IPSA could allow for a wider range of more proportionate enforcement responses more generally. We support the introduction of a tiered approach to enforcement consistent with the FMCA approach which can be applied not only to life insurers in the context of statutory funds, but to other insurers, and in a way that is proportionate to the situation.

4. Conclusion

4.1 We have presented our submission at a high level and with the intention of raising issues relevant to any draft form of amendment bill, regulations and/or regulatory guidance. We would be happy to discuss this submission further and any technical and drafting requirements in respect of the amendment bill, regulations and/or regulatory guidance.

4.2 Thank you for taking the time to consider this submission. Please contact us on the details below if you wish to discuss any of the matters raised in this submission.

Yours sincerely

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