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## **Submission on the “Issues Paper: Review of the Insurance (Prudential Supervision) Act 2010”**

The New Zealand Society of Actuaries (“NZSA” or the “Society”) welcomes the opportunity to comment on the “Issues Paper: Review of the Insurance (Prudential Supervision) Act 2010”.

The NZSA is the professional body for actuaries practising in New Zealand. Our purpose is to establish, promote and maintain high standards of competence and conduct within the actuarial profession and to provide a source of reference on actuarial matters for government and various official and interested bodies.

The form of this submission is to make some specific comments on matters we wish to highlight in the body of this letter and to attach our responses to the proposed 26 questions as an Appendix to this letter.

In this submission we have used the term “IPSA” to refer to the Insurance (Prudential Supervision) Act 2010.

### **IPSA**

The Society welcomed IPSA and the modernisation of the legislation regulating insurance. The introduction of a licensing regime brought the insurance industry into alignment with most other developed economies. We believe that the introduction of IPSA has reduced the risks of policyholders losing money.

### **Role of the Actuary**

IPSA created a statutory role for actuaries - the “Appointed Actuary”. While life insurers had familiarity with actuaries for some general insurers this was a new development.

In the Society’s assessment the Appointed Actuary regime has been a worthwhile development. While the RBNZ will no doubt have its own criteria for assessing whether the Appointed Actuary regime can be regarded as a success, the Society believes the underpinnings for the success of the Appointed Actuary regime are:

- It is a statutory role with an ability to access information (sec 80 of IPSA)



- The Appointed Actuary is appointed by the Insurer (Board)
- The Appointed Actuary is required to produce a Financial Condition Report (FCR) each year and the RBNZ can determine the content of that report.

The Society believes that the Appointed Actuary should be a Fellow of the New Zealand Society of Actuaries to ensure that the Appointed Actuary is familiar with the New Zealand environment. Such a change would not restrict overseas actuaries from being the Appointed Actuary, as the Society's Membership Rules state:

#### 5. MEMBERSHIP

- a) *Application for membership of the Society may be made by:*
- Any member of the Actuarial Society of South Africa, Canadian Institute of Actuaries, Casualty Actuarial Society, Institute and Faculty of Actuaries, Institute of Actuaries of Australia, Institute of Actuaries of India, Society of Actuaries and Society of Actuaries in Ireland.*
  - Any other person with appropriate expertise as determined by the Council from time to time.*
- b) *There shall be three classes of membership, Fellows, Associates and Ordinary members.*
- Admission to the class of Fellow shall be given to any member who is: a Fellow of any of the actuarial bodies listed in (a) (i) above; and who is ordinarily resident in New Zealand or Australia or is in the view of the Council, familiar with New Zealand conditions ("Fellows").*

This facilitates the Reserve Bank's ability to ensure that the Appointed Actuary is familiar with New Zealand conditions. It also ensures that the Appointed Actuary is bound by the Professional Standards of the New Zealand Society of Actuaries and subject to the local Professional Conduct regime.

The Society believes it is acceptable for Appointed Actuaries to either be employed or to be a consultant.

### **The role of the New Zealand Society of Actuaries**

The Society encourages regular communication between the RBNZ and the Society around the role of the Appointed Actuary and connected issues such as solvency. One idea worth consideration is the establishment of a more formal agenda for communication or even a formal body. We note that in the early days of the Australian insurance regulatory framework an actuarial body (Life Insurance Actuarial Standards Board) was established to provide advice on the relevant standards. We understand this included actuaries from both industry and the regulator. This helped ensure there was appropriate industry input as the regulations were evolving. As APRA employed more actuaries this body has since been disbanded. However it may be worth considering given that the RBNZ is at an earlier stage of development as a regulator. We would welcome discussion on this topic.

### **Solvency Frameworks**

IPSA brought in a solvency requirement that was in addition to that contained in section 4 of the Companies Act 1993. This was an essential aspect of IPSA, mandating a similar but



otherwise voluntary regime that the Society had developed following the advent of “margin on services” financial reporting for life insurers in 1998. Conforming with this solvency standard may have reduced the harm caused to policyholders by Orange Insurance, a company which was not conforming to the Society’s professional standard which was, in effect, voluntary at that time.

The Society supports the operation of a mandatory solvency/capital adequacy standard to protect policyholders.

The Society is aware there has been some discussion on the difference between solvency requirements for locally incorporated insurers compared with overseas branches. This is best illustrated in the case of general insurance catastrophe risk and the APRA requirement of 1 in 200 year sufficiency versus the RBNZ standard of 1 in 1,000 years sufficiency. This is a complex issue that requires further thought than the statement above may at first imply. The fundamental issue at stake may not be local incorporation per se. Consideration of the relative security of a branch of a larger parent company holding capital at 1 in 200 versus a smaller locally incorporated company holding capital for a 1 in 1,000 New Zealand event, for example, is not straight forward. The Society believes this matter requires careful consideration including examination of the exemption criteria applied by the RBNZ, before any decisions are made.

## **Statutory Funds**

A further policyholder protection in IPSA is the requirement for a statutory fund for life insurers. The operation of a statutory fund has extra obligations for the company and the Directors. The Society supports extra obligations in respect of life policies because of their long term nature. We do believe it would be useful to clarify the purpose of statutory funds to ensure that their operation is aligned to that purpose.

However, one area we believe needs further clarification and guidance from the RBNZ is the requirement to give priority to the interests of policyholders over the interests of shareholders. In the extreme it could be taken to mean a company should never pay a dividend but clearly that was never intended as IPSA was instituted in an environment where the existence of for profit companies which paid dividends was known and it was never foreshadowed that the paying of dividends would have to stop.

The prohibition of investment of statutory fund assets in an associated person has been problematic for those entities with associated funds management entities. Whilst the Society agrees with intent of section 99 of IPSA the current wording has had unintended consequences that should be fixed so that RBNZ approval is not required in all circumstances. An example of an issue is an insurer is prohibited from investing in a registered bank’s PIE deposits (a structure that uses a trust that only invests in the registered bank’s deposits so in substance is a deposit with a registered bank) if the bank is an associated person.

## **Transfers and Amalgamations**

The Society supports the requirement for RBNZ approval of transfers and amalgamations under sections 44-53. In fact, the Society believes consideration should be given to those sections being expanded to encompass and permit substantive changes to a group of policies. This would provide a mechanism for product rationalisation such as trauma definition updates or even deeper changes to products such as with-profit policies. An RBNZ approval process



could lead to better outcomes for policyholders than a Court process such as a “scheme of arrangement” and be more cost effective.

### **Risk Management Programme**

The Society supports the requirement for a risk management programme.

### **Fit and Proper**

The Society supports the requirement for the Fit and Proper regime.

### **Regulations under the Act**

The Society believes it would be beneficial to have a clear hierarchy and a rationalisation and limitation of the types of regulatory instruments currently in place under IPSA. Currently there are regulations, standards and amendments to licences which attach conditions to the licence. It seems sensible to limit the places where people need to look for the rules with which you have to comply. The Society believes it is sensible to explore a more graduated response to non-compliance.

Please contact us if any aspect of our submission requires further clarification.

Yours sincerely  
for **New Zealand Society of Actuaries (Inc)**



Andrea Gluyas  
President



## Appendix – Responses to the 26 questions

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

The RBNZ is tasked with maintaining an efficient insurance sector. It would be good to understand how far that remit extends. Does it extend beyond maintaining an appropriate solvency regime?

**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.**

Yes. Extended warranties and repayment waivers should be considered for inclusion.

Although extended warranties are provided by the manufacturer or supplier, if the period of them becomes too long, they can cross the boundary into insurance.

A repayment waiver is insurance by any other name (**repayment waiver** means an agreement between a creditor or lessor and a debtor or lessee under which the creditor or lessor, for an additional consideration, agrees to waive the creditor's or lessor's right to any amount payable under the credit contract or consumer lease in the event of the unemployment of, sickness of, injury to, or the disability or death of the debtor or lessee) and should be included.

However consistency between IPSA and IFRS 17 should be considered.

It is our view that the phrase “carrying on business in New Zealand” should be clearly defined in the Act. With the passage of time, different business models have evolved which need to be catered for, for example, the sale of insurance policies directly to the public online.

**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?**

No response

**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?**

Repayment waivers.

Further consideration of reinsurance involvement in the New Zealand market could be considered. Some companies are heavily dependent on reinsurance and the solvency standard applies capital requirements depending on their rating. Additional scrutiny of reinsurers could be considered.

**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. An example is AMP in the life space and there are many examples in the general insurance world. Overseas insurers add to competition and capital depth. In addition, overseas reinsurers provide a lot of support to both the life and general insurance markets. Providing property insurance on any scale in NZ is only possible with support from overseas reinsurers.



**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.**

Yes, the Review should consider the application of the legislation to insurers operating as branches. As noted in the body of this letter this is a complex area that warrants careful consideration. The Review should include consideration of the application of RBNZ exemptions for insurers operating as branches and overseas policyholder preference.

**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?**

Simply “where the money is when the music stops is what counts”. Consideration should be given to requiring assets to be held in NZ to support NZ liabilities and those assets should not be able to be repatriated without RBNZ approval.

Overseas events could result in the diminution of assets available for New Zealand policyholders as a result of the event itself or overseas policyholder preference. It is not clear to us the extent to which New Zealand consumers are aware of the risks associated with overseas policyholder preference, or that they even understand the nature of this preference.

For example if an Australian insurer operating here suffered an Australian event and can’t afford to reinstate catastrophe cover and operates here under a solvency exemption it is not clear what might then happen to New Zealand policyholders in a subsequent event.

Overseas reinsurers provide support to the New Zealand market and need careful consideration as a limit on reinsurance capacity to NZ (for example, due to events outside of NZ) could cause some significant solvency issues for insurers.

**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.**

As noted in the body of this letter, it is our view that it would be helpful to clarify and provide guidance around the placing of policyholder interests ahead of shareholder interests.

IPSA should accommodate associated party assets where appropriate.

**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.**

This is a complex area. It could be used to ensure New Zealand liabilities are matched by assets controlled by the New Zealand entity. Consideration could be given to the application of the New Zealand solvency standard. On the other hand, there may be significant diversification benefits that might be lost by this approach, which may not be beneficial.



**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.**

Yes. It would be useful to clarify the Board/management relationship. The New Zealand (NZ) Board must be able to control NZ management otherwise there is little point to having a NZ Board. The NZ Board should clearly appoint the CEO and control their employment.

We note that the APRA discussion paper “The role of the Appointed Actuary and actuarial advice within insurers” notes the following:

*“The Appointed Actuary plays an important role within insurers by providing independent advice to boards and senior management on the key financial risks facing an insurer.”*

And further

*“[T]he key objective of the review is to: streamline and sharpen the role of the Appointed Actuary and ensure the role has the capacity to provide independent and unbiased advice and challenge in an efficient and effective manner. This should allow the Appointed Actuary greater capacity to play a strategic role within insurers.”*

In this regard we believe it is appropriate that there are a number of requirements that require the Appointed Actuary to explicitly provide input. The areas included within the Act currently address these. In addition there may be benefit in considering a Purpose Statement for the Appointed Actuary, such as that included within the APRA discussion paper referred to above:

*“The purpose of the Appointed Actuary role is to ensure that the board has unfettered access to expert and impartial actuarial advice and review, to assist with the sound and prudent management of an insurer and that the insurer gives adequate consideration to the protection of policyholder interests. The Appointed Actuary must have the necessary authority, seniority and adequate support to ensure their views are considered seriously by the board and they are able to make a significant contribution to the debate of strategic issues at the executive level. The Appointed Actuary plays a key role in, and provides effective challenge to, the activities and decisions that may materially affect the insurer’s financial condition as well as its treatment of policyholders.”*

**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?**

Yes, but for the RBNZ to effectively supervise additional control functions would require the RBNZ to dedicate the resources to more actively supervise those control functions. For example how would the RBNZ monitor that policyholder interests are appropriately managed in relation to shareholder interests?



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

Yes, the enforcement framework should allow more proportionate responses but it could be questioned whether infringement notices with instant fines may be a step too far.

**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?**

Yes, the distress management framework should be reviewed.

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

Yes, for example in a distress situation the RBNZ may have difficulty in forcing the sale of a NZ branch.

**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.**

Yes, they should be in scope. The RBNZ should be able to vary requirements as necessary.

As is noted in the issues paper, the current approach can be unwieldy and relatively slow to respond. Consideration should be given to other approaches that allow the Reserve Bank to respond more quickly to changes in an insurer's circumstances or market conditions.

The following example demonstrates the issue and is a current concern for some: How should insurers, Appointed Actuaries and the Reserve Bank act and respond if a large earthquake were to occur in, say, Wellington similar in impact to the February 2011 Canterbury earthquakes? There is a reasonable chance that a number of insurers' solvency ratios would reduce to less than 100%, given the requirement to:

- establish net outstanding claims at a 75% probability of sufficiency (at a minimum)
- pay a reinstatement premium, or utilise reinstatement included within existing treaties, and hold additional capital for a further reinstatement premium
- hold additional risk capital charges against (what are likely to be) substantial reinsurance recoveries
- hold additional risk capital charges against the net outstanding claims.

We expect that a number of insurers will be unable to satisfy the capital requirements of the solvency standard for a period of time while additional capital is raised. If the Reserve Bank, as regulator, does not have the ability to respond quickly in such circumstances, policyholders, insurers and their shareholders are all likely to lose value.

**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.**

Yes. Greater clarity can only assist insurers and their boards to understand the Reserve Bank's intentions and objectives. It is however important that, in considering potential responses, there is a clear understanding of the risk to policyholders. For example, there are considerable



margins held by an insurer, even at a solvency ratio of 100%. In addition to the explicit margins within the minimum capital, insurance liabilities held on the balance sheet include risk margins in the case of general insurers and future profit margins in respect of life insurers. As a consequence, at a solvency ratio of 100% an insurer may hold substantial capital in excess of that required to meet short term cashflow requirements as well as policyholder liabilities. In these circumstances undue regulatory action by the Reserve Bank will be to the detriment of shareholders and possibly policyholders as well.

Furthermore, a statement of intent or principles would assist actuaries and insurers to interpret the legislation and standards at any points where there is potential for ambiguity, or in circumstances where external change occurs, such as a change to accounting standards that underpin the balance sheet on which the solvency standard rests.

**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.**

Yes. The RBNZ should be able to approve policy changes such as definition changes (“modernisation”) or product rationalisation such as removal of guarantees and conversion to other than a life policy. These are changes where the fundamental nature of the policy contractual arrangements are to be altered and this may be best done with RBNZ approval required as opposed to through a Court process. This would provide a mechanism to rationalise legacy products.

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

The current approval process by the Reserve Bank is more effective and less costly than the previous court based system. Both mechanisms have their place but the RBNZ would appear best placed to express a view on fairness or supervise the assessment of that. Court processes can be about process and where policyholders are not sufficiently motivated or financially able or literate enough to help themselves, they might receive poor outcomes.

**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.**

Current disclosure should go further and include matters such as capital raisings included in the three year projection of solvency. This fact feels very important for policyholders to know in comparison to other matters.

Some consider having a solvency requirement and a rating is two attempts at the same thing. The usefulness of compulsory financial strength ratings in the context of Prudential Supervision is not obvious. We consider that such ratings have some value as a tool for consumers, but wonder about the extent to which these ratings are useful indicators of long term financial strength. Many insurance policies (life, disability and health for example) are long term contracts with potentially significant underwriting barriers that effectively prevent policyholders changing insurers if they have developed adverse health conditions. As a result these policyholders’ ability to change insurers as a result of a change in financial strength rating is diminished, unless it is on adverse terms.

The effectiveness of market discipline in the NZ insurance sector is limited because so few insurers are listed and analysed here in NZ.



**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 have confined our consideration to only those matters the RBNZ determines. This points to enhanced disclosure of the solvency requirement to better allow comparisons between insurers and to consider whether conditions of licence should be disclosed.

**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.**

Yes, as the regulator the Reserve Bank is in a unique position to collect, collate and publish industry data. The challenge is in collecting and publishing data that is both comprehensive and timely, as well as being detailed enough to be useful and relevant to industry participants and commentators.

**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.**

Yes. This opportunity should be taken to review and streamline these in order to provide greater clarity and certainty for insurers and to simplify the regulatory processes for the RBNZ. It is also an opportunity to provide greater clarity at source and reduce the need for further guidance statements.

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

There should be a limitation of section 121 notices and licence conditions for “standard activities”. Licence conditions are not transparent.

**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.**

No response

**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?**

Yes. We would like to see the wording of Section 78 clarified – it refers to the actuary’s report when in practice what is being produced is actually an actuary’s sign-off and not a report.

**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.**

No response