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By Email: [ipsareview@rbnz.govt.nz](mailto:ipsareview@rbnz.govt.nz)

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

### **Introduction**

Southern Cross Medical Care Society thanks the Reserve Bank for the opportunity to submit on the Issues Paper.

Southern Cross is a not-for-profit friendly society and licensed insurer. We have over 830,000 insured members and are New Zealand's largest health insurer, with over 60% market share. As the largest health insurer we have a strong interest in ensuring there remains a well regulated, competitive and efficient health insurance industry, operating for the benefit of policyholders.

We have made a brief general submission and then commented on specific issues raised in the Issues Paper that are directly relevant to Southern Cross and its members.

### **Submission**

#### **Comments on the process**

The process proposed by the Reserve Bank is, in our view, appropriate. We are also pleased to note the Reserve Bank view, that issues under further consideration (beyond this stage) will be subject to further detailed consultative input in a phased approach. We consider this approach is appropriate, as while it is important and timely that a stock take of the legislation's effectiveness (as measured against the purposes) is undertaken with options for change being assessed, change itself is not necessarily an outcome. Further, where options for change are recommended they should be evidenced based.

The time frames proposed also appear sound. However, if further issues (outside of the Issues Paper) are identified we would ask the Reserve Bank consider the impact to industry and the need for further time and consultation to be factored in.

Southern Cross is supportive of well-designed and proportionate regulation that aims to address material or emerging risks, whether to protect policyholders, the system or a specific entity. However there is always a balance to be struck. There is some risk when undertaking a multi-stage and wide ranging review of this nature, that the issues under consideration can proliferate or become less focused and lead to unintended

consequences and unnecessary cost etc. However, if change is required providing it is focused, proportionate and well-designed, it should be welcomed.

### **Specific issues**

Our specific submissions below use the same numbering in the Issues Paper.

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

AND

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 agree with the review's current scope as set out.

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.

AND

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.

The original purpose and key risk that the statutory fund model sought to address was that, absent licensing and entity separation, there was in the Reserve Bank's view some necessity to protect long-term liabilities from being undermined by supporting assets being stripped out to cover short-term requirements. For example, general insurance liabilities should not undermine that business's life insurance liabilities or policyholder interests.

The statutory fund model was chosen to provide for similar outcomes as entity separation but, pragmatically, avoid unnecessary restructures and business separation in the existing marketplace. However, in our view, statutory funds have not in practice provided a great deal of additional protection over and above that achieved by the solvency regime. (Which takes a forward looking view and as such makes allowance for the different timing in cash flows (amongst other things)).

While we consider that original purpose retains some relevance, we do have some concern that for many life insurers (especially those that are separately licensed and capitalised entities etc) the relevancy of a statutory fund framework adds little additional protection but carries compliance, cost and complexity. For the same reason we do not consider it necessary or appropriate to extend the framework to other personal insurance like health, where there is an absence of short term liabilities like general insurance.

We do consider that the requirement for statutory funds could be more in keeping with the original risk/purpose if it was more targeted, without adding additional complexity:

1. E.g. where there is a deposit element to the premium and the return to the policyholder is linked to the return on the supporting assets. This is a life product specific issue but it is not, in our view, covered under the current regime as there is no need to segregate life funds where such a linkage exists (compared with Australian legislation that does require this separation).
2. There may be justification in terms of providing NZ policyholders in an overseas insurer some protection (as there is no need for overseas insurers to hold assets in NZ). In our view, however imposing a statutory fund requirement on all insurers to address the overseas insurer issue is unnecessarily disproportionate.

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.

AND

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?

We support further guidance and consistency in the application of requirements in these areas. However, we have not aware of any particular problems warranting change in this area in practice. Therefore any change should, in our view, be proportionate, focused on addressing identified material issues/risks and be evidenced based.

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, we believe these should be within the scope of the Review.

As 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.

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 important when considering potential responses that there is a clear understanding of the potential risk policyholders face. For example there are considerable margins held by an insurer even at a solvency ratio of 1.0, including:

1. explicit margins within Minimum Solvency Capital, and
2. risk margins included in insurance liabilities on an insurer's balance sheet.

As a consequence at a solvency ratio of 1.0 an insurer may hold substantial capital in excess of that required to meet impending cashflow requirements as well as future payments to policyholders. Given these margins, undue regulatory action by the Reserve Bank could be to the detriment shareholders and possibly policyholders as well.

In addition, a statement of intent or guiding principles would assist insurers and their actuaries to interpret the legislation and standards. This is useful at 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 rest.

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

Yes, an equivalent high court process can be long and costly and does not add value or protection over and above the existing regulatory option. Our experience thus far is that dealing with subject matter experts and the Reserve Bank is also more helpful to business, than a semi-adversarial approach and has led to relatively quick and effective decisions for insurers and affected policyholders.

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, but any disclosure and publication should not result in market distortion/arbitrage, misleading impressions or impact generally on competition in specific markets. To this end well signalled consultation on substance and form of disclosures and publications should, in our view, be ongoing with industry. Requirements on insurers to supply/disclose should also be proportionate and have a specific purpose.

Once again thank you for the opportunity to submit on the Issues Paper. Southern Cross looks forward to working with the Reserve Bank on the next stages of the review.

Yours sincerely,



Mark Flaherty  
**General Counsel**