

SOVEREIGN

ISSUES PAPER: REVIEW OF THE INSURANCE (PRUDENTIAL SUPERVISION) ACT 2010

30 June 2017

SUBMISSION BY SOVEREIGN¹

SECTION 1 About Sovereign

SECTION 2 Responses to specific questions

Sovereign welcomes the opportunity to provide feedback on the Reserve Bank of New Zealand's (the **Reserve Bank's**) Issues Paper *Review of the Insurance (Prudential Supervision) Act 2010* (the **Issues Paper**).

Sovereign has also contributed to the submission on this matter being made by the Financial Services Council (**FSC**) and except where our submission presents a different view, we support the points made in that submission.

Sovereign operates in the life and health insurance sector only, and accordingly our submission only relates to life and health insurance (and reinsurance). Our submission does not address the regulatory environment for general insurance.

Sovereign does not seek confidentiality for any aspect of this submission (though, for commercial or privacy reasons, it may request confidentiality of any further supporting information that the Reserve Bank might seek).

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¹ "Sovereign" is defined as Sovereign Assurance Company Limited, Sovereign Services Limited, and associated entities.

SECTION 1 – About Sovereign

- 1.1. Sovereign is New Zealand’s largest life insurance company protecting over 741,000² New Zealanders and their families through the provision of life and health insurance using a range of distribution channels. Sovereign insures total sums insured of over \$120 billion³ and last financial year paid out more than \$374 million³ in claims.
- 1.2. Sovereign has an A+ (superior) financial strength rating from AM Best. Our life insurance market share is 27.9%⁴ and our health insurance market share is 6.9%⁴.
- 1.3. Sovereign is a subsidiary of Commonwealth Bank of Australia and a related company of ASB Bank Limited (**ASB**).

² This includes policy owners, lives assured, borrowers and workplace business

³ Sovereign internal reporting as at 30 June 2016

⁴ FSC Market Share Report March 2017

SECTION 2 – Responses to questions from the Issues Paper

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

We support the current regulatory and supervisory philosophy for insurance.

While New Zealand's regulatory and supervisory philosophy for insurance is "lighter touch" than some overseas jurisdictions, we consider that it strikes an appropriate balance between:

- black letter regulation and direct supervision; and
- insurer self-discipline/self-responsibility,

in pursuit of and in support of a cost effective supervisory regime that promotes the soundness and efficiency of the insurance sector and supports public confidence in the insurance sector.

While we support the aims of the Review and readily acknowledge the potential for improvement in some parts of the application of the philosophy in practice, we do not consider that there is a need for any significant change to New Zealand's overall regulatory and supervisory philosophy for insurance.

Part 2.1 – Entities required to be licensed

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 support the Review considering whether there are activities which should be brought within the scope of IPSA, including to ensure:

- New Zealand policy holder interests are appropriately protected;
- public confidence in the insurance sector is supported; and
- there is a level playing field across entities providing insurance to New Zealand policy holders.

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?

We consider that for the most part the IPSA regime appropriately balances the level of compliance with the risk being addressed. However, we recommend that the Review take the opportunity to critically consider whether each element of the compliance requirements is appropriate and necessary and the implementation is cost effective for insurers.

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?

Not currently in the context of life and health insurance.

However, with the emergence of non-traditional insurance models, e.g. peer to peer, different insurance products and new entrants to the insurance value chain will emerge that may fall outside of the scope of the regulation. We would support the Review considering how best to include such models in the prudential regulation.

Part 2.2 – Overseas Insurers

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.

In the case of direct life insurers, we agree that they provide valuable support to the New Zealand insurance market, by increasing choice and competition in the market.

We also consider that overseas reinsurers provide valuable support to the New Zealand life insurance market through provision of capita and access to specialist services and global expertise.

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.

For direct life insurers, we support the principle of ensuring that there is a level playing field with respect to capital and other requirements on insurers operating as branches, to support policyholder security.

For overseas reinsurers, our view is that the key consideration is balancing:

- enabling access to global pooling via the reinsurance market vs.
- ensuring appropriate policyholder security by requirements for capital and assets held in New Zealand and related requirements.

We consider that the balancing of these aspects should be examined separately for life insurance vs general insurance, given the fundamental difference between the two markets with respect to the nature of the products sold and the timeframe for commitments made by both insurers and reinsurers. Our concern is that the current requirements appear to have been driven by the significant role that overseas non-life/general insurance reinsurers play in New Zealand's general insurance market, and thus more broadly in New Zealand's economy.

We therefore recommend that the Reserve Bank:

- benchmarks current requirements for overseas reinsurers operating in New Zealand's life insurance market against similar requirements adopted by other countries (e.g. Australia);
- investigates whether the current requirements create unfair competitive advantage for New Zealand life insurers heavily relying on support from overseas reinsurers;
- investigates whether the current requirements inadvertently reduce protection of customers insured by these insurers; and
- considers whether the current requirements should be strengthened in light of the above points.

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?

See response provided above.

Part 2.3 – Statutory funds and enhanced protection of life insurance policyholders

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.

We consider the statutory fund framework to be sufficiently effective.

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.

We support the statutory fund framework applying to overseas life insurers and overseas life reinsurers as a means of ensuring that there are separately identifiable capital and assets to support the security of New Zealand policyholders.

Part 2.4 – Role of key officers and key control functions

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.

We consider that the expectations placed on key officers are appropriate and sufficiently clear.

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 consider the relatively low levels of prescription in the current framework provide flexibility in the application of the requirements, given the diversity of insurers in the New Zealand market.

Part 2.5 – Enforcement regimes

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

Currently, some relatively minor infringements under IPISA attract disproportionate penalties that may result in either:

- outcomes for insurers that are too severe in the circumstances (e.g. where a criminal penalty is pursued); or
- the Reserve Bank electing not to take enforcement action given the resources required to prosecute the offence.

We would therefore support the principle of the Reserve Bank having a "graduated toolbox" of enforcement actions available to it, including aspects such as civil penalties and enforceable undertakings, to enable proportionate enforcement responses in a timely and cost effective manner.

Part 2.6 – Distress management

Question 13: Do you consider the distress management framework within IPISA could be considered within the Review to enhance the expected effectiveness of the framework, particularly for smaller licensed insurers?

We agree that the distress management framework should be considered within the Review including examining the potential for the Reserve Bank to have a more graduated ability to respond as an insurer's financial position deteriorates and to ensure that the Reserve Bank has the ability and resources to work with insurers towards recovery in these circumstances.

Any such modification to the distress management framework must carefully balance the objective of assisting an insurer encountering financial difficulties with the risk of worsening the situation through the Reserve Bank's involvement. The extent to which the assistance by the Reserve Bank

is publicly known or not is an important aspect to consider in this area – weighing up the need for transparency against the potential for public knowledge of the Reserve Bank’s assistance being self-defeating.

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

Apart from supporting the application of the statutory fund framework to overseas life insurers and overseas life reinsurers, as noted in our response to question 9, we have no other particular concerns.

Part 2.7 – Solvency requirements

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.

We agree that these aspects should be within the scope of the review, including to consider:

- Future changes to be made to the solvency requirements in response to the transition of general purpose financial reporting from Margin on Services (MoS) to IFRS17;
- Whether or not the current regulatory requirements relating to financial reinsurance are producing appropriate results for policyholder security; and
- Whether there are components of the regulatory capital requirements that are not producing appropriate results in a low interest environment e.g. the life resilience risk charge component that includes a fixed 1.75% additive shock with an interest rate floor of 0%.

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.

Guidance on the Reserve Bank’s response while an insurer seeks to recapitalise would assist insurers in their determination of the target surplus to hold.

Part 2.8 – Supervisory processes - regulatory approach

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.

We have no specific comments.

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

We consider that RBNZ approval is more effective, and thus preferable to, court-based processes in terms of flexibility, timeliness, cost and for bringing appropriate expertise to bear on the issue at hand while giving appropriate weight to policyholder interests and other considerations.

Part 2.9 – General disclosure and Financial Strength Rating requirements

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.

We recommend that the Review take the opportunity to critically consider whether the current disclosure requirements continue to appropriately balance the purpose of the disclosure with the related compliance costs, including whether there are alternative means of achieving the desired purpose. For example, disclosure of information through websites, rather than contained within policy documents or other printed material.

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 consider that the information that is currently required to be disclosed achieves an appropriate balance between relevance/usefulness and volume/cost to prepare. In this regard, we note that increasing the volume of disclosure requirements may not in fact assist consumers and may instead be counterproductive.

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.

Publication of industry statistics based on the information collected by the Reserve Bank would be useful for market participants, consumers and policy makers. However, care is needed to ensure that confidentiality of entity specific data is preserved and that results are not presented that pertain to, or substantially relate to, only one or a small number of entities.

Part 2.10 – Appropriate regulatory mechanism

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.

We agree that the Review should assess whether improvements can be made in the manner in which regulatory requirements are specified, balancing:

- Flexibility for dealing with changing circumstances;
- Certainty of application/durability of the overall principles; and
- Clarity of the overall suite of regulatory obligations, which assists with efficiency and cost effectiveness of compliance.

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

We have no specific comments.

Part 2.11 – Other matters

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.

We have no specific comments.

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?

We have no specific comments.

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

We have no specific comments.