



Carrying on business in a prudent manner

Guidelines Insurance Sector

Insurance Policy
Prudential Supervision Department

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Purpose of this guideline

- 1 This document sets out the Reserve Bank of New Zealand's (the Reserve Bank) guidelines in relation to a licensed insurer carrying on business (or an applicant's proposed business) in a prudent manner. This guideline relates to the requirements under [section 20](#) of the [Insurance \(Prudential Supervision\) Act 2010](#) (the Act).
- 2 [Section 20\(2\)](#) of the Act states that 'the Reserve Bank must, when considering the ability of an applicant to carry on business in a prudent manner, confine its consideration to the following matters'. The object of this guideline is to provide background to indicate what the Reserve Bank will be looking for when assessing a licensed insurer in relation to those matters.
- 3 The Reserve Bank will consider prudent management on an individual basis for each licensed insurer in the context of that insurer's own business model. For example, the reinsurance arrangements for a particular insurer may represent prudent arrangements in the context of that business model but the same arrangements may not suit another insurer with a different capital structure and risk exposures.
- 4 The Reserve Bank will consider the requirements relating to carrying on business in a prudent manner at the time of licence application and at reviews thereafter, and a licensed insurer is encouraged to conduct a self-evaluation against the requirements and take appropriate remedial action as part of its own ongoing prudential management. It is noted that the requirement to carrying on business in a prudent manner is permanent in nature and is an ongoing requirement for all licensed insurers.
- 5 This guideline relates solely to the requirements under the Act and does not cover requirements of other legislation that may also be of relevance to licensed insurers.
- 6 Nothing in this guideline overrides the provisions of the Act.

What the Act says about prudent management

- 7 [Section 19\(1\)](#) entitles an applicant to a licence if the Reserve Bank is satisfied that certain criteria in that section can be met.
- 8 [Section 19\(1\)\(b\)](#) lists, as one of these criteria, the ability of the applicant to carry on business in a prudent manner.
- 9 Under [section 20\(1\)](#) the Reserve Bank will consider the following matters; on the basis of the points listed in [section 20\(2\)](#):
 - (a) whether an applicant has the ability to carry on business in a prudent manner; or
 - (b) whether conditions should be imposed on an applicant relating to carrying on business in a prudent manner; or
 - (c) whether a licensed insurer is carrying on its business in a prudent manner.

Reserve Bank considerations

- 10 [Section 20\(2\)](#) lists the considerations to which the Reserve Bank must have regard when assessing the matters in [section 20\(1\)](#):
 - (a) whether financial and human resources are appropriate for the size and nature of the business;
 - (b) internal controls;
 - (c) the size and type of insurance risks carried by the insurer;
 - (d) reinsurance arrangements entered into;
 - (e) the extent of non-insurance business and the nature of those activities (in particular, whether the activities may be prejudicial to the solvency of the applicant or licensed insurer);
 - (f) the nature and extent of related party transactions; and

(g) any other prescribed matters.

11 Further guidance on each of these matters can be found below.

Financial and human resources

12 Having sufficient capital to cover the risks in the business is a crucial element in carrying on business in a prudent manner. Requirements for capital are covered specifically in the applicable solvency standards. In addition, financial resources under section 20(2)(a) cover operational costs.

13 Human resourcing relates to the ability of an insurer to meet its commitments with appropriate numbers of staff who have the requisite background, training and experience.

14 Some of the areas that may be considered under the human resources heading include (without limitation):

- (a) the allocation of human resources (in terms of numbers and quality) relative to levels of business activity, business complexity and location including expertise and experience in the lines of insurance being underwritten and risk reinsurance;
- (b) use of outsourcing, outsourcing policy and management;
- (c) managing human resources in relation to business level peaks and troughs;
- (d) succession planning;
- (e) staff turnover;
- (f) budgeting, financial management and relationship to the business plan; and
- (g) management accounting analysis and reporting.

15 Financial and human resourcing should also be forward-looking and be sufficient to deliver the licensed insurer's business plan.

Internal controls

16 'Internal controls' refers to operationalised risk management that is embedded within day-to-day business practice. Internal controls are concerned with preventing errors, ensuring legal compliance and generally controlling quality.

17 Issues that may be considered include (without limitation):

- (a) appropriate management of information;
- (b) security of information systems, data storage (soft and hard copy), security of premises and the protection of functionality of information technology;
- (c) access to confidential information, storage of client data, transport of data and destruction methods used for confidential data;
- (d) internal audit procedures and assessment of policy against practice;
- (e) financial system controls including appropriate accounts reconciliation and auditing; and
- (f) expense management.

Size and type of insurance risk carried

18 Matters to be considered in the context of [section 20\(2\)\(c\)](#) include the classes of insurance provided by the licensed insurer relative to its resources, experience and history as well as the size of the insurance exposures created by these classes of business.

19 For example, the Reserve Bank would expect an insurer to have, or obtain, or have access to suitable expertise to ensure any new classes of insurance are properly understood and appropriately priced.

Reinsurance arrangements

- 20 The size of the licensed insurer, mix of insurance business and risk profile contribute to differences in reinsurance arrangements between insurers. However, general considerations that can apply to a licensed insurer in relation to prudent management of a reinsurance programme will include:
- (a) the establishment and management of a robust and sustainable reinsurance strategy;
 - (b) the selection process and ongoing management of reinsurers including consideration of issues such as the relevant experience and expertise of reinsurers and counterparty security that will meet the requirements of the reinsurance strategy;
 - (c) the compatibility of reinsurance arrangements with the risk management programme and business plan; and
 - (d) ongoing operational management of reinsurance treaties.

Non-insurance activity

- 21 Non-insurance activity is addressed in the solvency standards through capital charges on the activity. Beyond solvency issues, matters to consider include:
- (a) the business plan rationale for the activity including financial analysis, resourcing and compatibility with the insurer's risk profile and risk management programme;
 - (b) resource capabilities for the activity including human and financial resources; and
 - (c) potential impacts on the insurance business including exposure to new non-insurance liabilities and business risks of that activity.

Related party transactions

- 22 Transactions between and with related parties can increase the level of risk for the licensed insurer when they are not transacted on an arm's length basis.
- 23 Along with the matters outlined below in *Recording of restricted investments*, licensed insurers should ensure they have a strong Conflicts of Interest policy as well as any other matters required to ensure that restricted investments (or proposed restricted investments) are appropriately identified.
- 24 A licensed insurer should:
- (a) identify any related parties;
 - (b) use expert advice in relation to related party transactions (for transparency, integrity, etc);
 - (c) ensure any related party transactions are compatible with the risk management programme; and
 - (d) have an established internal reporting model for related party transactions (and proposed related party transactions).
- 25 [Related party](#) is defined in [section 6](#).
- 26 For a licensed insurer a related party includes:
- (a) an associated person:
 - (b) a director or relevant officer or any other person occupying a position that allows the person to exercise significant influence over the management or administration:
 - (c) a relative of an associated person:
 - (d) a director of an associated person:
 - (e) a person who owns, or in any way has the power to control, or has the right to acquire, 10% or more of the voting rights:
 - (f) a person who has control or significant influence over 25% or more of the composition of the governing body.

Recording of restricted investments

- 27 [Section 100](#) of the Act requires a licensed life insurer to maintain a register of restricted investments which:
- (a) means any investment of assets of a statutory fund of a life insurer in a related party; but
 - (b) does not include an investment of assets of a statutory fund by way of deposit with a registered bank (within the meaning of the [Reserve Bank of New Zealand Act 1989](#)), even though the bank is a related party of the life insurer concerned.

Any other prescribed matters

- 28 Other matters that the Reserve Bank may consider relevant to any consideration of whether or not a licensed insurer is carrying on business in a prudent manner may be prescribed in regulations.

Section 21 – Conditions of licence

- 29 A body corporate may be licensed as a licensed insurer unconditionally, or subject to any conditions that the Reserve Bank may impose under [section 20\(2\)](#).
- 30 A licence may be subject to conditions that relate to any of the matters referred to in [section 20](#) (which relates to carrying on business in a prudent manner), including any matters prescribed by regulations made for the purposes of [section 20\(2\)\(g\)](#).
- 31 The Reserve Bank will notify insurers of any conditions imposed under [section 21](#).



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