

INSURANCE INDUSTRY LICENSING UPDATE, OCTOBER 2011

LICENSING PROCESS, FIT AND PROPER, BOARD INDEPENDENCE

This newsletter is intended to provide a brief update on the licensing process to date and feedback from the Reserve Bank on aspects of applications received so far.

The time and effort devoted by insurers to the licensing process is appreciated and the Bank looks forward to ongoing cooperation to resolve outstanding matters prior to 7 March 2012.

INSURANCE LICENSING PROCESS UPDATE

Less than five months now remain until the 7 March 2012 deadline for provisional licensing. To date 100 applications have been received and up to another 20 entities are expected to submit applications, but have not yet done so. The responsibility remains with these entities, if they are carrying on insurance business, to be suitably licensed by 7 March 2012.

Another 50 entities have been identified as potential insurers – 20 of these have either exited the industry in the past year or, upon further inquiry, are clearly not conducting insurance business. The remainder are still being assessed.

The Bank is still awaiting additional information from some insurers to complete their provisional licence packages, while revisions or clarifications are being sought from some others. It is expected that all provisional licence applicants will provide complete information by the end of November.

The issuing of provisional licences will commence soon and insurers will be formally advised as approvals are given, along with details of licence conditions. A register will be made available on the Reserve Bank website in the coming weeks, listing insurers that have had licence applications approved. This will be updated on a rolling basis with the order of listing bearing no relation to size or relative strength of applicants.

FIT AND PROPER POLICIES AND CERTIFICATES

The Bank is scrutinising these certificates closely for compliance with the Act and the Fit and Proper Standard. To avoid a situation where an individual, concerned they might not meet fit and proper requirements, could attempt to avail themselves of gaps in an insurer's fit and proper policy, we are insisting that:

- Fit and Proper Certificates comply with the wording in the Insurance (Prudential Supervision) Act 2010 (IPSA). The Fit and Proper Certificate material on our [Licensing for Insurers](#) webpage is helpful for this; and
- the fit and proper criteria in an insurer's Fit and Proper Policy are no less stringent than the wording of the Standard.

Some insurers have been asked to re-sign such certificates due to issues with one of the two points above and the Bank has also sought minor amendments to Fit and Proper Policies where they don't comply with the Act.

The most common examples are:

- section 34(2) – many policies don't "clearly specify the qualifications, requirements, and other criteria for" each particular position.
- section 34(4)(b)(i) – which is in essence about whistle-blowing. The Act says the Policy must contain adequate provisions to "encourage" whistle-blowing. In many applications this important element in a robust risk management culture was missing.

For overseas insurers with branches in New Zealand, fit and proper certificates signed by directors (as well as relevant officers) are required for licensing. Any exemptions granted for directors only apply once the licence is issued.

DIRECTORS AND RELEVANT OFFICERS WITH A FIT AND PROPER 'QUESTION MARK'

A number of insurers have asked their directors and relevant officers to disclose any 'question marks' in their Fit and Proper Certificates. The Bank believes this is an excellent risk management practice. All insurers should state whether there were any 'question marks' found for any of their directors or relevant officers in their Fit and Proper Assessment. If a 'question mark' has been raised and the director or relevant officer was assessed as fit and proper, the insurer should provide a rationale for that conclusion.

Any director or relevant officer found by the insurer not to be fit and proper would need to be removed from their position before a provisional licence could be issued.

BOARD INDEPENDENCE

For an insurer to gain a full licence by September 2013, the Bank must be satisfied under section 19(1)(i) of IPSA that the insurer's "incorporation and ownership structure, ownership, governance structure, and financial strength are appropriate, having regard to the size and nature of the applicant's business". The Governance Guidelines provide a standard that will meet the satisfaction of the Bank.

Prudential supervisors around the world have observed that financial institutions which fail often have an unquestioning approach to risk management and/or particularly dominant personalities in the executive ranks. The Guidelines are designed to reduce the prevalence of these factors.

The Bank expects insurers incorporated in New Zealand to have board composition and independence in line with the Governance Guidelines. Where this has not been achieved at the time the provisional licence is issued, conditions will be placed on provisional licences requiring compliance by 30 September 2012.

In essence, the Guidelines for insurers have several main elements:

- the board should have at least two directors – larger insurers should have larger boards;
- at least half of the directors should be independent;
- the Chairman should be independent;
- at least two directors should be residents of New Zealand; and
- there should be an audit committee and it should be chaired by an independent director (who is not the chairman of the Board).

The Guidelines and the norm that the chairman has a casting vote will mean a parent company will not necessarily have a voting majority of the insurer's Board. This is consistent with:

- section 221 of the Act which voids any provision in a company constitution allowing directors of a subsidiary company to act in the best interests of the parent company, even though it may not be in the best interests of the insurer; and
- for life insurers with statutory funds, section 105(2) which says: "In the event of conflict between the interests of policyholders of life policies referable to a statutory fund and the interests of shareholders or members of a life insurer, a director's duty is to take reasonable care, and use due diligence, to see that the life insurer gives priority to the interests of policyholders of those policies over the interests of shareholders or members".

The majority of insurers that are not in run-off should have a board of at least four persons, of which at least two would be independent directors (one of whom would act as the chairman of the board, with another acting as chair of the audit committee).

In some circumstances, the Bank may accept as independent an independent director of a parent or sister company. The Bank's criteria for concurrence are:

- the director clearly has the qualifications and experience to maintain independence;
- the parent or sister company board should have overall responsibility for the group or oversee significant business activities; and
- the proposed cross-directorships have a sound business rationale.

Where an insurer operates as part of an integrated corporate group (e.g. shared corporate services functions), we will not object to the composition of a parent/sister board (which meets composition requirements) doubling up as board of the insurer.

Where the Bank, in its assessment of the insurer's risk management, has accepted that the insurer's group has appropriate financial strength and risk management processes, the Bank will not object to non-independent directors being non-executives.

**DEFINITION OF CAPITAL, DEDUCTIONS FROM CAPITAL AND 100% ASSET RISK
CAPITAL FACTORS ITEMS**

The solvency standards are conservative in the treatment of subordinated debt capital, intangible assets, loans to related parties (except for captive insurers) and assets used as security for loans.

Insurers that consider they could be significantly affected by these solvency standard provisions will need to take action or have a convincing licensing action plan before the Bank will issue a provisional licence.

If you have any questions, please call your allocated adviser or send an email to insurance@rbnz.govt.nz.