INSURANCE INDUSTRY LICENSING UPDATE

JULY 2012

GENERAL UPDATE

The insurance sector faced two significant challenges in 2011 – the Canterbury earthquakes, and the transition to the new prudential regime. The 22 February 2011 earthquake alone was one of the largest global insurance events ever, due to very high insurance coverage in New Zealand. While some individual insurers have struggled with these challenges, overall the sector has coped well. Current estimates of all the earthquake events exceed $30 billion, with a high level of uncertainty remaining. Claims for the 22 February 2011 event exceeded some insurers' reinsurance protection and reinsurance costs have significantly increased as a consequence of the events. The Canterbury earthquakes have diverted both insurer and Reserve Bank resource.

A total of 109 insurers have been licensed by the Bank to date, with 107 licensed as at 20 June 2012. Five insurers were issued with a full licence, five were issued with a S245 run-off licence (these require the insurer to have settled or transferred all of their insurance liabilities by 7 September 2013) and 99 were issued with a provisional licence. Two licences have since been cancelled. Licences may be cancelled for a number of reasons ranging from an insurer ceasing to carry on insurance business due to voluntary exit or transfer through to regulatory action. The Bank's efforts have been focused around provisional licensing to ensure that all insurers required to license did so by the 7 March 2012 deadline. A small number of insurers needed to fully license because the provisional route was not available to them, largely due to being considered new insurers under the Act.

A list of licensed insurers is published on the Bank's website. This will be updated regularly as changes occur.

During the provisional licensing phase there was some exit and restructure activity. A number of insurers that were already in the process of exiting New Zealand completed their exit by the licensing deadline. Others exited by way of transfer to another insurer, including internal restructures. A number of insurers made changes to their products and rules and no longer fell within the jurisdiction of the regime.

More detail can be found in the Bank's Financial Stability Report dated May 2012.

FULL LICENSING

With the provisional licensing phase behind us and around 100 insurers to assess against full licensing criteria the Bank has reflected on the learnings from provisional licensing and the appropriate focus and priorities for full licensing. We will adopt a licence prioritisation framework. This will not necessarily determine the order in which insurers are licensed but rather will drive the focus of supervisors in progressing licensing matters. The priority categories are: -

1. Large insurers, insurers with non-standard licence conditions, those who may be under some stress.
2. Higher than average priority for reasons such as transfer/acquisition deadlines or based on supervisor recommendation.
3. Insurers not otherwise classified.
4. Reinsurers, small insurers, captives and overseas insurers with a solvency exemption.

Insurers should be making plans to fulfill the balance of requirements according to the deadlines detailed in provisional licences. To assist the Bank with planning, insurers that have not already done so recently should update the Application Summary and send it to their supervisor. This needs to include detail on material that will be provided and when. The supervisor can then identify gaps for further discussion.

The provisional and full licence application forms include tables that need to be completed. These documents include detail around requirements which together with various Guidelines and the legislation itself collectively provide direction on what is expected. During provisional licensing the Bank noted examples of inadequate material and also highlighted to insurers certain aspects that need to be enhanced before full licensing. Risk Management, for example, was an area that was frequently identified as one that would need further work before full licensing standards would be met. Due to the full licence threshold (standard and volume of requirements) being greater than for provisional licensing the sector will need to focus on fully utilising the guidance sources available to ensure requirements are met rather than on the Bank reviewing draft level material.

The next major compliance milestones include, but are not limited to: -

- 30/09/2012 - a number of significant compliance requirements around:
  - Governance structure - composition and independence etc
  - Fit and Proper – demonstrating implementation
  - Risk Management – showing operationalisation
- 15/11/2012 – financial strength rating disclosure
- 31/12/2012 - Solvency Margin
- Solvency Standard and other financial reporting items, driven by balance date, such as
  - Financial Condition Report
  - Financial Statements and S78 Report
  - 6 monthly Solvency returns

Requirements and compliance dates vary based on insurer class, size and other characteristics. If you are unclear on the requirements specified in your licence you should contact your assigned supervisor.

The Bank wants to actively engage with insurers now to ensure compliance with the milestones as they fall due and ahead of the full licensing deadline of 7 September 2013. The prioritisation approach is designed to address potential issues early and ensure quality and smooth licensing of the sector as a whole. The Bank expects to start issuing full licences in batches from quarter-one 2013 onwards.

SOLVENCY RETURNS

The first solvency returns for licensed insurers were due on 31 March 2012. The Bank appreciates the efforts that most insurers made to get these in on time. The first stage of the Bank's process has been to collate the results across the industry to get a view of the overall position of the sector and to identify insurers below the required margin and/or that may struggle to achieve the margin within the timeframe required. The next stage of the process will be to analyse individual insurer returns in line with the Bank's priorities and to provide feedback as required. Where the Bank does not provide specific feedback this will be incorporated into the full licence assessment process.

For ongoing solvency returns please ensure that you provide the return in excel format (some insurers provided this in pdf format and we need to be able to access the data and links), the supporting financial statements and an attestation signed by two directors (New Zealand insurers) or the Chief Executive Officer (overseas insurer). The return also requires sign-off by the Appointed Actuary.

FIT AND PROPER CERTIFICATES

Licensed insurers must provide a fit and proper certificate for new directors (except for exempt overseas insurers) or relevant officers within 20 working days after appointment, which complies with section 37(4) of the Act. This needs to contain or be accompanied by a summary of information that is relevant to consideration of whether the person satisfies the licensed insurer's fit and proper policy. Some insurers have been providing insufficient detail and the Bank intends to expand upon the expectations detailed in the Fit and Proper Certificate Guideline. Below is a summary of what this guidance will likely include.

The Act specifies in section 37(4)(c) that the certificate must state that the directors have considered the fitness and propriety of a person after due inquiry by them. In practice this means that a licensed insurer will need to obtain sufficient information to establish that the individual is fit and proper for the designated role and that there are no issues of a sufficiently serious nature to cause the licensed insurer not to appoint the individual. This requires more than accepting information provided at face value and responsibility rests with the insurer to carry out appropriate checks to verify the accuracy and completeness of information provided. The level of inquiry should be sufficient for the directors to be prepared to give the certification and will depend on what is reasonable in the circumstances.

FIT AND PROPER 'QUESTION MARKS'

Provisional licences contain reference that the rationale of an insurer's assessment of any Fit and Proper 'question marks' should be supplied to the Bank together with the Fit and Proper Implementation material, due by 30 September 2012. This was also referenced in the October 2011 Industry Update: -

"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."

STATUTORY FUNDS

Provisional licences require insurers to comply with the Act's Statutory Fund requirements detailed in sections (82-83, 87-107 and 109-118) of the Act, from the start of the financial year following licensing. While the provisions contained in the Act provide the majority of detail required to establish and manage statutory funds, finalisation of the Statutory Fund Regulation is taking longer than expected. The Bank is considering amending licence conditions for insurers with a balance date earlier in the year or where there is inadequate time for implementation. The Bank will formalise its position as soon as possible and contact insurers with confirmation. The expectation is that insurers with a balance date in 2012 prior to 30 September will have their licence condition deferred to the start of the 2013 financial year.

SOLVENCY – CONDITIONS OF PROVISIONAL LICENCE

For insurers without a solvency exemption the provisional licence conditions generally contain several references/rows in the table of conditions relating to solvency. This note is intended to provide clarification.

The row containing the description "Risk assessment – Item 4" relates to the solvency return that the industry submitted on 31 March. It is not part of ongoing solvency reporting which is covered elsewhere.

The various rows have the effect of introducing components of the applicable Bank solvency standard in stages, with dates generally depending on the balance date. Note that the information below is indicative only, a licence may differ for various reasons. Please refer to your conditions of licence for how solvency applies to your insurer.

1. The first solvency reference brings into effect (from date of issue of licence) the solvency standard, **with the exception of**:

- requirement for a positive solvency margin
- certain annual reporting requirements (audited financial statements, Financial Condition Report, section 78 report)
- obligations of the appointed actuary
- solvency calculation disclosure requirements

This means that solvency returns must be completed and filed half yearly in accordance with the applicable standard from the time the condition applies. (Full year returns are due 5 months and 20 days after the balance date, half year returns are due 5 months after the balance date.)

2. There is a row that brings into effect the full annual reporting requirements, from the first **annual** balance date following 7 March 2012:

- audited financial statement, Financial Condition Report, section 78 report
- obligations of the appointed actuary

3. The table includes a reference to when a positive solvency margin must be achieved.

4. Finally, there is a row bringing into effect the solvency disclosure requirements.

INTERIM FINANCIAL STATEMENTS – OVERSEAS INSURERS

The Bank is reviewing the requirement in Section 81(4) of the Act, in particular with respect to its effect on overseas insurers that are exempt from compliance with the Bank's prescribed solvency standards. This includes examining options to relax the requirement for interim reporting on a GAAP basis. The final outcome of this work and detail will be provided in due course.

This newsletter is intended to provide an update on licensing and related matters. It is not policy or legal advice in itself and should not be interpreted in isolation.

If you are an insurer and have any questions, please call your assigned supervisor or send an email to insurance@rbnz.govt.nz.