

INSURANCE INDUSTRY LICENSING UPDATE

SEPTEMBER 2012

GENERAL UPDATE

The 7th of September 2012 marks one year until the full licensing deadline is reached. The Bank has a big task ahead of it with around 100 insurers to fully license before this deadline hits.

Meanwhile, the end of September 2012 is also a major milestone, this time in terms of provisional licence conditions. A number of requirements fall due at this time, including:

- Governance structure - composition and independence etc;
- Fit and Proper – demonstrating implementation; and
- Risk Management – showing operationalisation.

The licence application forms together with the Regulations, Standards, Guidelines and the legislation itself, collectively provide information regarding what is required to satisfy these requirements.

FULL LICENSING

In the [July Licensing Update](#) the approach and prioritisation framework was outlined. As explained, 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 prioritisation approach is designed to address potential issues early and ensure quality and smooth licensing of the sector as a whole. The Bank does

not expect to start issuing full licences until the March quarter 2013 onwards and from then on this will occur in batches.

The process for getting ready to submit full licence applications and communicating timeframes to the Bank for planning purposes was also outlined. Insurers were asked to update the [Application Summary](#) and send this to their supervisor with detail on what material will be provided and when. The supervisor can then use this as a starting point to identify any gaps and for further discussion.

STATUTORY FUNDS

The Regulations relating to Statutory Funds came into effect on 1 September 2012. Because the regulations have been issued later than was originally intended, the Bank is offering a deferral of conditions of provisional licence relating to statutory funds to insurers with balance dates up to and including 30 September. Supervisors have already been in touch with affected insurers informally regarding this, and notices of proposed variation of licence will be issued shortly.

The Bank intends to amend the Full Licence Application Form in relation to Statutory Funds, to reflect the revised timing of establishment of funds in some cases. The Bank will commence active monitoring of insurers' compliance with IPSA s91(5) from September 2014 onwards.

RELATED PRODUCT GROUPS (SOLVENCY STANDARD FOR LIFE INSURANCE BUSINESS)

The Bank is considering how the industry is classifying life insurance business into Related Product Groups (RPGs) for the purpose of solvency calculations. The Bank notes that:

- The definition of a RPG is essentially the same as the definition used in the New Zealand Society of Actuaries' professional standard relating to the determination of life insurance policy liabilities;
- The existing New Zealand Society of Actuaries' professional standard relating to life insurance solvency used the same RPG groups for solvency as for profit reporting;
- Therefore, the introduction of the Solvency Standard for Life Insurance Business (the Standard) need not, in itself, have led to a change in RPG classifications for solvency purposes; and
- There appears to be a wide range of interpretations throughout the industry of the wording of the definition of a RPG.

The classification of business into RPGs can have a very material effect on the resulting capital requirements under the Standard. The Bank will be considering its policy position on this issue. Possible outcomes are:

- No change;
- The Bank issuing Guidance on how the existing wording should be interpreted; and
- A change to the wording of the Standard.

In the meantime, insurers and their Appointed Actuaries should be aware that the Bank may be requesting information on how products have been grouped in the past, how they are grouped now, and questions on any differences between groupings for profit and solvency reporting purposes. The Bank will consult stakeholders on any potential changes.

RETURN OF DEPOSITS

The Public Trust and Reserve Bank have received a number of enquiries from provisionally licensed insurers regarding the return of deposits under IPSA s249. IPSA provides for deposits to be returned as follows:

- On issuing a Full Licence, the Bank notifies Public Trust, and the deposit is to be returned within 30 days of the Public Trust receiving the notice;
- For non-licensed depositors, deposits were due to be returned within 30 days of 7 March 2012; and
- Any deposits not returned under either of the above options must be returned within 30 days of 7 September 2013.

The issue of a Provisional Licence is not a trigger for the return of deposits, as provisional licences are issued under IPSA s244, not under Part 2 as required for return of deposits to licensed insurers.

MATERIAL CHANGES TO FIT & PROPER POLICY OR RISK MANAGEMENT PROGRAMME

The Act requires an insurer to obtain the Bank's approval before amending its Fit & Proper Policy or Risk Management Programme in a material way. This is covered under s34(5) and s73(4) of the Act. The Bank's approval is required from the date of provisional licensing for Fit & Proper and 30 September 2012 for Risk Management.

Once an insurer has determined that a change is material in the context of the policy as a whole, it must make an application for approval to the Bank. This application must be accompanied by a marked-up and clean form version of the document.

If changes are made that are not material then the insurer should simply provide an updated document, in marked-up and clean form, for the Bank's records.

AUDITING OF SOLVENCY RETURNS

The Bank has been working with the auditing profession, through discussion with the New Zealand Institute of Chartered Accountants and the larger audit firms, to clarify audit requirements for the annual solvency return. We are still developing our position. To the extent that changes to existing standards are needed to better meet regulatory and supervisory requirements, we will consult the industry once we settle on proposed changes.

It is, however, recognised that some insurers are required to have returns audited now or in the near future. In the interim, to enable required audit work to proceed, the Bank has decided that the Directors may choose the level of assurance that is appropriate in order for them to provide the necessary attestations in respect of the solvency return.

The interim requirements are that, at a minimum, Directors may choose:

- Either a reasonable or limited assurance engagement on whether the Solvency Return has been prepared in accordance with the relevant Solvency Standards;
- Either no assurance engagement on the Catastrophe Risk Capital Charge component of the solvency calculations or a limited assurance engagement that the catastrophe charge has been prepared in accordance with the insurer's documented methodology; and
- Either that no assurance engagement or an agreed upon procedures engagement is required in respect of the projected solvency position within the return.

Although the solvency standards include definitions of materiality, auditors will conduct their work on the solvency returns using their professional judgment. However, materiality for the purposes of the assurance engagement is to be no higher than that applicable to the audit of the financial

statements prepared as at the balance date applicable to the solvency calculations.

The Bank reserves the right to require information provided to it to be subject to additional audit procedures or independently reviewed if circumstances require.

S78 REPORTS

The Bank wishes to draw insurers' attention to s79 of the Act. This section requires the appointed actuary's report under s78 to accompany the auditor's report on the financial statements when the auditor's report is registered with the Companies Office or included within a company's annual report. The appointed actuary's report is therefore a publicly available document similar in concept to the auditor's report.

FINANCIAL REINSURANCE

The Bank is in the process of considering its policy position on reinsurance agreements that have, or could be considered to have, a financing element. The policy issue is that financial reinsurance can have the effect of undermining the objectives of solvency capital requirements, and therefore what the appropriate treatment is for solvency purposes. Industry should be aware that accounting treatment for such contracts will not necessarily meet the Bank's requirements in this respect, and that a public consultation on possible changes to the Bank's solvency standards on these matters is expected to be undertaken.

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.