Supervision of the insurance industry

A quick reference guide

November 2012

This fact sheet outlines some of the key details of New Zealand's insurance industry supervision system.

New Zealand has a diverse insurance industry. A government review in the mid-2000s identified a need to bring the regulatory and supervisory side of this industry up to international standards. Following this review, a new prudential supervision system was introduced in 2010 for progressive implementation by 2013. The new system requires that all insurers in New Zealand are licensed and subject to ongoing prudential supervision by the Reserve Bank of New Zealand.

The insurance industry in New Zealand

There are five basic types of insurance in New Zealand:

- **Life insurance.**
- **Health insurance.**
- **Non-life insurance** – this comprises a wide range of products including retail products such as car, property, contents, and commercial products such as property, business interruption, personal liability.
- **Reinsurance** – reinsurers are insurers that insure other insurers; i.e., it is a means of spreading claims risks over a wide number of insurers – most insurers obtain reinsurance to spread risk.
- **Captive insurance** – captive insurers are insurers that generally have only a single corporate client, which is their own shareholder. Some large companies find it more cost and tax effective to self-insure and so set up their own subsidiary to carry the risk.

These types of insurance are provided by around 100 companies, which vary considerably in the types of products they provide, and in their size and ownership. Some are large companies offering a wide range of products, both retail and commercial. Some are small companies or mutuals that specialise in a narrow product range.

Many insurers operating in New Zealand are owned in New Zealand. However, a significant number of insurers that are in New Zealand are branches of overseas-based insurance companies. The parent companies are based in a number of countries including Australia, USA, and some Asian and European countries.

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Canterbury earthquakes

The Canterbury earthquakes in 2010 and 2011 had a major effect on the insurance industry in New Zealand. The biggest impact has been on property insurers who have felt it in two main ways:

- They have incurred substantial claims costs, most of which are covered by reinsurance; and increased reinsurance premiums.
- The volume and complexity of claims has meant claims are not being settled as quickly as they normally would be. In addition, the Reserve Bank was required to facilitate the restructuring or exit of a small number of insurers that had a particularly high exposure to the Canterbury region.

The need to develop a system of licensing and supervision

An efficient and sound economy needs an effectively functioning insurance market. Many business investments would not be made unless insurance was available, and households could be exposed to ruin if people could not insure their major assets.

For these reasons, governments worldwide have considered it necessary to regulate the insurance industry to help ensure this sector remains sound and operates in a fair manner (like the banking industry, which is also widely regulated). Best-practice insurance industry regulation is about ensuring that:

(i) insurers manage their risks prudently (prudential supervision); and

(ii) insurers' customers are treated fairly (consumer protection).

In most countries, these two regulatory tasks are undertaken by different government agencies. In New Zealand, the consumer protection role is undertaken by the Financial Markets Authority and the Commerce Commission. The prudential supervision role is undertaken by the Reserve Bank of New Zealand.

This is a new function for the Reserve Bank of New Zealand

Until the Reserve Bank gained this task, limited and fragmented oversight of New Zealand insurers was undertaken by a number of government agencies. The insurance industry had been stable, and there had not been any major problems before the Canterbury earthquakes. However, the industry's regulation lagged behind what was considered best practice internationally. New Zealand regulation was extremely light-handed and based on outdated legislation.

The need for an update of the prudential supervision of the New Zealand insurance industry had been recognised for some time. The shortcomings in the New Zealand situation were made more apparent by external events, for example the consequences of major insurance company failures in Australia, and the increasing complexity of the insurance industry. The outdated system that existed in New Zealand did not sufficiently safeguard the soundness and efficiency of the insurance market in New Zealand.

A formal review was undertaken by government from 2003, which culminated in the Insurance (Prudential Supervision) Act in 2010. This made the Reserve Bank the prudential supervisor of the New Zealand insurance industry. The Act provided that all insurers had to be licensed by the Reserve Bank, and that the Reserve Bank would prudentially supervise all insurers on an ongoing basis. The manner in which prudential supervision would occur was set out in the Act and in associated Regulations.

The licensing process

The Act required all insurers in New Zealand to be licensed by March 2012. Insurers that wished to continue in business in New Zealand submitted licence applications to the Reserve Bank, which were assessed and licences issued. Some insurers, all small in size and who would have found it difficult to meet the required standards, chose to exit the industry at this point.

Licensing was stepped in as a two-phase process. During the first phase, up to March 2012, the Reserve Bank issued existing insurers with a provisional licence. This allowed an insurer to continue in business until September 2013, giving time for the Reserve Bank to complete a more in-depth assessment.

In order to qualify for a provisional licence, an insurer had to demonstrate that:

- It had adequate fit and proper policies that applied to all directors and senior management, and such persons had all been assessed and found fit and proper for their positions.
- It had adequate risk management policies.

The second phase involved issuing a full licence by September 2013. The tests for a full licence are more comprehensive than for a provisional licence. However, some insurers are exempt from some requirements – these limited exemptions generally apply to small insurers, overseas branches, reinsurers and captive insurers. As well as the provisional licence requirements, the full licence requirements also include:

- Having a financial strength rating.
- Carrying on business in a prudent manner.
- Ability to comply with any condition of licence.
- Holding at least the minimum amount of capital specified.
- Having and implementing a satisfactory risk management programme.
- Ensuring the applicant'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.
- If the applicant is an overseas person, being subject to satisfactory prudential supervision in its home jurisdiction.
- Being registered on the Financial Service Providers register.
- Having the ability to comply with anti-money-laundering legislation.

The Reserve Bank publishes a list of all licensed insurers:
http://www.rbnz.govt.nz/finstab/insurance/listQR.html

On-going supervision

After the licensing phase the Reserve Bank will undertake on-going prudential supervision of the New Zealand insurance industry.

On-going prudential supervision consists of:

- Proactive monitoring of financial and prudential information provided by insurers.
- Enforcing compliance with prudential requirements.
- Anticipating and managing financial stress in licensed insurers.

The overall aim of prudential supervision is to ensure that insurers manage risks prudently. The aim is not to prevent all insurance company failures at any cost. The Act contains powers that the Reserve Bank may use to manage a situation when an insurer is suffering financial stress. These powers include seeking information, or issuing instructions to a company.

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