

## **INSURANCE INDUSTRY LICENSING UPDATE**

### **DECEMBER 2012**

#### **GENERAL UPDATE**

The September 2012 major milestone has come and gone. This required insurers to provide material around governance, fit and proper implementation and risk management. The Bank was generally pleased with the compliance and timeliness of insurers in providing this information.

Currently the Bank is processing licence applications from around 100 insurers and dealing with ongoing consolidation and transfer activity. Licensing is guided by the prioritisation framework outlined in previous updates; assessment of insurer compliance and progress; transactional deadlines related to transfers; and also insurer balance dates (as this drives the supply of key information such as financial reporting). This means specific feedback to insurers from their supervisor may not occur immediately.

The next major milestone is 31 December 2012, when most insurers' solvency margin condition takes effect.

As anticipated, during the provisional licence phase some insurers made commercial decisions to restructure or exit. A number of other insurers made changes to their products which meant they were no longer considered to be an insurer under the Act. In addition there were insurer failures resulting from losses incurred in the

Canterbury earthquakes. However, as at May 2012, the Bank estimated that, in aggregate, insurers that had exited primarily due to the Act comprised just 0.02 percent of the market measured by annual premium. It is likely that further rationalisation will occur.

The Bank does not expect to start issuing full licences until the end of the March 2013 quarter. From then on this will occur in batches.

In addition to the licensing effort, the Bank continues to closely monitor the impact of the Canterbury earthquakes on property insurers that had exposures in Canterbury.

#### **DISCLOSURE OF FINANCIAL STRENGTH RATINGS**

The disclosure of financial strength ratings is covered in sections 60-71 of the Act. It is apparent that a number of insurers have yet to update material, internet site etc with disclosure of financial strength ratings in order to meet the requirements.

Some points to note are:

1. Each separate requirement specified within sections 60-71 must be met, including requirements in relation to

point of sale material, renewals, advertising and internet sites.

2. Disclosure must accurately reflect wordings used by the approved rating agency. Rating agencies publish their ratings scales which include descriptions of each rating. If an insurer abbreviates the descriptors (e.g. using 'Strong' or 'Good' instead of reproducing the full sentence published by the rating agency) then (a) it is expected that the abbreviation is an accurate summary using words taken from the rating agency's published definition and (b) a footnote is included to explain that the descriptions used are in summary form with reference to the availability of the full description.
3. Ratings, the name of the agency, and scale, must be disclosed clearly and prominently. Considerations include:
  - It is preferable that internet disclosure is made on the insurer's homepage, but if not, there should be a prominent homepage link to the disclosure.
  - Ratings disclosures which are in a reduced-size or faded font relative to the rest of the material within which the disclosure appears, or which are not displayed with a high profile (i.e. upfront) within the material will not be considered to be prominent.

All insurers required to hold a financial strength rating must review their rating disclosures and make any necessary adjustments. The Bank will require evidence that disclosures are being made in line with the requirements. Where changes to printed material are in progress, the Bank may accept copies of the drafts/proofs ahead of finalised documents being

available. This is subject to also receiving sufficient assurance that the material will be finalised within an acceptable timeframe.

### **SOLVENCY STANDARDS: QUALITY OF CAPITAL AND REGULATORY TREATMENT OF FINANCIAL REINSURANCE**

As advised in the September update, the Bank has been considering its policy position on financial reinsurance.

On 7 December 2012 a [consultation paper](#) was released covering the quality of capital, the treatment of financial reinsurance arrangements for solvency capital purposes and some minor revisions clarifying the interpretation and drafting of the existing solvency standards. The first part of the paper sets out the Bank's criteria for and approach to determining the quality of insurance capital. Part two explains the Bank's preliminary assessment of the potential risks to its solvency standards from financial reinsurance or limited risk transfer agreements. The risks are mainly around the potential difficulty of establishing the amount of risk transfer contained in a financial reinsurance agreement, and the treatment of any financial benefits received by the insurer. Under the current solvency standards, these may have the potential to artificially boost an insurer's solvency position. The paper discusses two possible policy options for mitigating these risks: one is to disallow any solvency capital benefit from financial reinsurance agreements, the other is to cap the amount of solvency benefit that can be obtained. Part three

contains some minor clarifications and revisions to the existing solvency standards.

The Bank invites interested parties to provide feedback on all elements of the consultation paper by 28 February 2013.

### **INSURANCE (PRUDENTIAL SUPERVISION) AMENDMENT BILL**

The Insurance (Prudential Supervision) Amendment Bill is aimed at reducing or eliminating unnecessary compliance costs and increasing efficiency in the operation of the Insurance (Prudential Supervision) Act (IPSA). The amendments include allowing:

- The Bank to publish and maintain an official register of licensed insurers,
- In appropriate cases, an overseas insurer to submit half-yearly insurer and group regulatory financial reports rather than half-yearly financial reports prepared according to NZ GAAP, and
- The term of a provisional licence issued to an insurer in an insolvency proceeding to extend beyond 7 September 2013.

The Bill also contains a number of other technical amendments.

The Bill was introduced on 6 November 2012 and is currently awaiting its first reading. Following this, the Bill will be referred to Select Committee where it will be released for public consultation. It is expected the Bill will take at least six

months from its first reading to be passed.

See the attached [link](#) for details of the Bill.

### **APPLICATION FORMS**

Since the Bank first published the Application Forms, changes have occurred in respect of some dates applicable to transitional licensing requirements. Consequently the forms may be out of date in some respects and insurers should refer to their conditions of provisional licence which override any earlier published dates.

In the last update we indicated an intention to amend the Full Licence Application Form to reflect the revised timing of establishment of Statutory Funds. On reflection, given that many insurers have already submitted a full licence application form and to prevent confusion by different versions being in circulation, the existing form is being retained. The Bank will instead notify any changes in relation to application material through these updates.

Applications should continue to include a Provisional Licence Application Form, a Full Licence Application Form and an Application Summary. These forms are all available on the [website](#).

An updated Application Summary should be provided each time new licensing material is submitted. In cases where an incomplete Full Licence Application Form was provided, an updated form covering all licensing matters should be submitted.

## STATUTORY FUNDS

The Bank is fielding queries and beginning to receive some licensing material in respect of statutory funds. Some insurers have already established statutory funds, but many are due to establish them over the coming months.

The Bank is currently working on guidance relating to certain aspects of the law and regulations on statutory funds. This note is intended to provide interim assistance as insurers progress licence application aspects of statutory funds.

The application form on the Bank's website was written some time ago, and does not reflect the timing of finalisation of the regulations. Below is the Bank's revised expectation of material to be submitted with a licence application in respect of this area.

The applicant for a full licence must provide in its application as much relevant information as possible, in order to demonstrate its ability to comply with the Insurance (Prudential Supervision) Act 2010, Part 2 Subpart 3, "Statutory funds of life insurers" and the regulations.

An insurer who has not, or will not have, established a statutory fund by 7 September 2013 will still be eligible for a licence if it can demonstrate to the Bank:

- that it has made sufficient progress towards establishing a fund to demonstrate that it has the ability to comply with Part 2, Subpart 3 and the regulations; and
- the statutory fund will be established no later than 1 October 2013.

Within five months and twenty days

following the first balance date after any statutory fund is established, the insurer must provide:

1. a statement from its board that outlines how the board ensures the company complies with section 87 of IPSA "Duty of life insurer in relation to statutory funds"; and
2. a report from its compliance or internal audit function, appointed actuary or an independent third party (such as an audit firm) that demonstrates that the insurer is complying or able to comply with IPSA Part 2, Subpart 3 "Statutory funds of life insurers" and the regulations.

Depending on where an insurer is up to in the process of establishing a statutory fund, the information available to demonstrate the ability to comply with statutory fund requirements will vary. Insurers should be aware that the more robust and comprehensive the information supplied to their supervisor, the easier it will be to satisfy the licensing test for statutory funds.

Below is a list of examples of the sort of information the Bank expects to receive. The list is not intended to be either prescriptive or exhaustive, but rather to give an indication of what an insurer could provide as part of its application, to clearly demonstrate an ability to comply with subpart 3 and the regulations. The information need not necessarily be provided as separate reports, and may not all be available at the time of application, depending on how the insurer has been implementing the statutory fund

requirements, and where it is in that process:

Examples include:

- Legal analysis and supplementary information showing the insurer's compliance or planned path to compliance, considering each section of subpart 3 and the regulations.
- Evidence that the insurer has analysed its products to ensure the correct business is/will be referable to the relevant statutory fund.
- Reports on how assets of the insurer are to be allocated to the statutory fund and funds outside the statutory fund.
- Information about how the accounting is/will be set up for the statutory fund, both from a reporting perspective, and from the point of view of day to day transactional processing.
- Actuarial analysis relevant to the set-up or establishment of the statutory fund, including information on the actual or planned solvency position of the funds once established.
- Evidence of changes (planned, or already implemented) to policyholder documentation.
- Any Board reports, minutes or resolutions relevant to the set-up or establishment of a statutory fund.

If a statutory fund has already been established at the time the application is processed, and a notice of establishment provided to the Bank, then this will also be

considered as part of the licensing process. Also, any reporting available on an already established statutory fund would help to clearly demonstrate the ability to comply with subpart 3 and the regulations.

### **CHANGES TO FIT & PROPER POLICY OR RISK MANAGEMENT PROGRAMME**

As advised in the last update, any changes to an insurer's Fit and Proper Policy or Risk Management Programme must be advised to the Bank. The Bank is not being consistently advised of changes.

It is important to note that if material changes are made, formal approval from the Bank is required. This is covered under s34(5) and s73(4) of the Act. The requirement for formal Bank approval of material changes took effect from the date of provisional licensing with regard to Fit & Proper and on 30 September 2012 for Risk Management.

In both cases, the insurer must notify the Bank of the change and whether it is material. Any changes must be accompanied by all of the following:

- a marked-up version of the proposed policy;
- a clean form version of the proposed policy; and
- the relevant sections of the table within the Provisional Application Form populated with comments and section references on how the proposed policy meets the requirements of each section of the Act.

## RELEVANT OFFICER/DIRECTOR - CHANGE NOTIFICATIONS

Section 37 of the Act specifies that an insurer must provide the Bank with a fit and proper certificate for new directors or relevant officers no later than 20 working days after the appointment. The Bank may exempt an overseas insurer from compliance to the extent it relates to directors only.

Fit and Proper certificate obligations aside, the Bank generally expects insurers to notify it of changes in these key roles and in a timely manner. This is in keeping with obligations to maintain good governance and to operate in a prudent manner in order to maintain a licence to carry on insurance business in New Zealand. This notification can take the form of an email to the insurer's designated supervisor.

## ANNUAL RETURNS – COMPANIES OFFICE

The Bank has fielded several queries on whether insurers still need to submit the annual returns that were previously provided to the Companies Office under the Insurance Companies Deposits Act 1953.

The Insurance Companies Deposits Act 1953 was repealed by section 240 of the Insurance (Prudential Supervision) Act 2010 in March 2012.

Section 249 (4) states that

*“Until a deposit is returned under this section or is otherwise withdrawn, the Insurance Companies Deposits Act 1953 or the Life Insurance Act 1908 (as the case*

*may be) continues to apply to the deposit as if this Act had not been enacted”.*

From the Bank's perspective, this means that only the deposits obligation continues, until such time as an insurer is fully licensed and the deposit returned. We are not expecting to be supplied with the annual return that was previously provided to the Companies Office. The Bank will be considering implementing statistical type returns at some stage in the future.

## CHRISTMAS MESSAGE

The Insurance Oversight Team would like to take this opportunity to wish you all a very Merry Christmas and a safe, happy and prosperous New Year.



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](mailto:insurance@rbnz.govt.nz).