New Zealand Society of Actuaries (Inc)

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Review of the Insurance (Prudential Supervision) Act 2010 Options Paper 4: Governance, Supervisory Processes and Disclosure

We welcome the opportunity to make submissions on the consultation paper (Paper 4, Governance, Supervisory Processes and Disclosure), which has been published by the Reserve Bank of New Zealand (Reserve Bank).

The New Zealand Society of Actuaries (NZSA) is the professional body for actuaries practicing in New Zealand with members working in a wide range of roles. NZSA currently has over 400 members and approximately 230 of those are qualified actuaries. There are around 50 appointed actuaries to New Zealand's licensed insurers and most are members.

The appointed actuary regime was enacted through the Insurance (Prudential Supervision) Act 2010 (IPSA) and each licensed insurer must have an appointed actuary. The Act sets the framework for insurers carrying on business in New Zealand and is of particular interest to many of our members. As such, NZSA is well placed to provide expert comment on the role of appointed actuaries and actuaries more widely in governance.

The views of the membership were sought in preparing this submission and there is a high level of agreement within the membership as to its content.

The key points of our submission are:

- **NZSA is generally supportive of clarifying some aspects of IPSA and improving and modernising the regulatory framework for insurers**. However, we are concerned at potential additional complexity or overreach where that is disproportionate for the NZ market. We note that Australia and the UK were used as comparators for the NZ market in the consultation. While we agree there are similarities between the markets, Australia and the UK are significantly larger markets with substantially more resources available both within insurers and the regulators.

- **We are supportive of IPSA empowering standards as outlined in the consultation, including the potential introduction of an Actuarial Advice Framework, Governance and Risk Management standards, and an ICAAP/ORSA standard**. Such initiatives would be in many cases not new to actuaries in New Zealand (for example, those with overseas owners). The introduction of such standards should help improve the understanding and practice of good governance within companies, and aid informed regulatory oversight.

- **However, the development of a large suite of standards will require further detailed consultation with industry**. They will need to be a good fit for insurers of different sizes and risk profiles. In addition, NZSA will need to develop certain professional standards to sit alongside the new standards. Given the number and breadth of new standards proposed, this process will require the commitment of significant resources from NZSA and its membership, insurers and regulators. As such, we believe a realistic timetable needs to be set which appropriately prioritises and paces the development and implementation of the standards.

- **We are strongly opposed to the introduction of a statutory duty of due diligence with civil pecuniary penalties on appointed actuaries**. NZ has a small pool of actuaries and the imposition of such a statutory duty with civil pecuniary penalties risks shrinking this pool further. If the purpose of this proposal is to further empower the appointed actuary as an independent voice within insurers, then we believe this would be achieved by the introduction of further standards as detailed above and the recent modernisation of NZSA's Code of Conduct and Disciplinary Procedure (in force July 2023) . We believe it would be invidious to single out appointed actuaries when good governance is better as a shared responsibility.

- **The consultation referred to "policyholder interests" in several contexts. Defining this term can be complex and will differ from insurer to insurer, or in different situations**. We believe the Reserve Bank should be solely concerned with the economic interests of policyholders to ensure financial soundness. In determining the economic interests of policyholders, it is necessary to balance interests of policyholders with shareholders and other stakeholders – prioritisation is rarely straightforward. We counsel against too rigid or prescriptive a definition that may not prove robust to future trends or unanticipated situations.

We would be glad to discuss our submission in more detail and would encourage the Reserve Bank to continue its close consultation with industry and key stakeholders on this important topic.

Yours sincerely

Scott Lewis
President of the New Zealand Society of Actuaries

Section 2: Governance, key officers and control powers

2.2 Fit and proper

Q 2.2.1 Should IPSA be amended so that a licensed insurer must obtain the Reserve Bank's approval prior to appointing a director or relevant officer? Would this create any difficulties for insurers?

We do not agree that IPSA should be amended to obtain approval *before* an appointment. We are concerned about the risk of delays in approval with the insurer left to drift without a key person in post. In practice, the combination of the scarcity of experienced talent, the time such high-level appointments take and the requirement to obtain Reserve Bank approval *after* appointment, means that insurers are highly motivated to make appointments which will obtain Reserve Bank approval.

We note IAIS ICP provision 5.3.2 allows the supervisor to assess the suitability of key persons "as soon as possible after appointment".

Instead of a requirement to obtain prior approval in IPSA, we suggest the principle of keeping the Reserve Bank meaningfully engaged throughout the appointment process for key people should be included in the proposed governance standard.

Q 2.2.2 Should insurers have a duty to inform the Reserve Bank if they become aware of information that might reasonably cast doubt on a director or relevant officer's ongoing fit and proper status?

We agree with this proposal in principle. We note the provision in the Deposit-Takers Bill (DTB) for the disclosure of information to the Reserve Bank "as soon as practicable" and would appreciate further comment from the Bank as to the interpretation of this clause. For example, an insurer should conduct an internal investigation to confirm whether the doubt is reasonable before informing the Reserve Bank.

Q 2.2.3 Are there any reasons for, or against, extending fit and proper requirements to senior managers? Is 'managers that report directly to the chief executive officer' a useful way of delineating who should be captured as a 'senior manager'?

We do not think the definition of "managers that report directly to the chief executive officer" is useful or practical. It could lead to distorting the organisational structure of an insurer and downplaying the seniority of important roles.

We do not believe there is a case for extending the fit and proper requirements further into executive management. We believe the roles covered under current fit and proper requirements – directors and specific clearly-defined executives – hold the relevant responsibilities to ensure an insurer is suitably managed and directed. Further roles are not as consistently defined across companies.

2.3 Directors' accountabilities and duties

Q 2.3.1 Are current directors' duties under IPSA appropriate? Or is there a case for imposing wider duties, to reflect the potential impact of insurer distress on policyholders and the wider economy?

We believe current directors' duties under IPSA are appropriate. Without commenting on the penalties proposed in the DTB, if directors' duties under IPSA were to be widened, then in principle we support being consistent with the DTB - that is, that directors (not executive officers) should exercise due diligence to ensure *compliance* with prudential obligations, as defined in paragraph 2.3.12 of the consultation.

Q 2.3.2 If there is a case for broader duties, which approach is more appropriate: the narrower approach proposed in the DTA , the extensive approach adopted in the UK/Australia, or some other approach?

We support the DTB approach for directors as defined above and would not be in favour of the extensive approach adopted in the UK/Australia as described in 2.3.13, for the reasons given in 2.3.14.

We believe resourcing for both insurers and regulators of the extensive approach would be highly challenging in New Zealand. We also do not see a rationale for a more extensive approach for insurers compared to banks.

Q 2.3.3 Are there any other considerations you would like to draw to our attention when thinking about director's duties?

None

Q 2.3.4 Other than the duty to life policyholders established under the statutory fund regime, are there any other areas under the IPSA regime where directors or insurers should be obliged to consider policyholder interests or give priority to policyholder interests ahead of those of shareholders or members?

We have not identified any areas where additional duties to consider policyholder interests should be placed on directors of insurers.

Managing an insurer involves ongoing balanced consideration of shareholder, member and policyholder/owner interests. This includes consideration of issues such as policyholder security, benefit entitlements, contractual rights, as well as the solvency, capital adequacy and financial strength of the corporate entity. These issues are closely interlinked. For example, shareholders need to earn a reasonable return on capital in order to provide the business with the capital it needs. This was seen particularly after the Christchurch earthquakes when shareholder capital injected into New Zealand following the Christchurch earthquakes firmed up the market and benefited policyholders by supporting claim payments.

We do not think there is a situation where it would be always appropriate to require one of these interests to be a priority at the potential expense of the others. Prioritisation between the interests of policyholders with shareholders and other stakeholders is rarely straightforward. We counsel against too rigid or prescriptive a definition that may not prove robust to future trends or unanticipated situations or may constrain necessarily fine judgements. To this extent, we find the wording of section 105(2) of IPSA ("priority to the interests of policyholders of those policies over the interests of shareholders or members" in a statutory fund) difficult and encourage the Reserve Bank to review this existing wording as part of the IPSA review.

We also note that IPSA (section 22) does allow the Reserve Bank to impose conditions of licence which could address specific issues on the treatment of policyholder interests (or other issues) if deemed to be required.

2.4 The Appointed Actuary

Q2.4.1 Would it be helpful for standards to:

(a) set out clearer expectations for the appointed actuary's role;

We support that standards should clearly set out the Reserve Bank's expectations for the appointed actuary role. Care is required to ensure that the requirements are not too prescriptive as companies, and hence the role, can all be quite different.

(b) set out the appointed actuary's place in the insurer's governance structures; and/or

Differences between insurers make this suggestion difficult to come up with a 'one size fits all'. The key issue is that the appointed actuary should have demonstrable, and unfettered, access to the Board, as per the Reserve Bank's Expectations of Insurers and Appointed Actuaries, published after the Thematic Review. Currently IPSA 80(3) – access to information arguably already allows for this.

Because we believe the appointed actuary should not have statutory liability there is no need for the Reserve Bank to set out the insurer's governance structure – as expanded upon in response to 2.4.4.

(c) require insurers to explicitly consider resourcing needs for the appointed actuary role?

We interpret this suggestion as the capacity for an individual to hold multiple roles – either within a company (multiple hats) or across multiple insurers. We suggest the onus be on the insurer's board to take responsibility to ensure that the appointed actuary has the capacity and resources to fulfil their role(s). We also note that individual appointed actuaries need to take responsibility to consider their own ability to provide actuarial services as part of the NZSA Code of Conduct.

Q 2.4.2 Would it be valuable to require insurers to have an actuarial advice framework in place under IPSA?

We are supportive of an actuarial advice framework under IPSA. It would be helpful for the role of the actuary and the purpose of and place for actuarial advice to be clear to all within an insurer.

We suggest that the Reserve Bank standards set out minimum requirements, with requirements above the minimum to be agreed between the insurer and the appointed actuary.

The development of a Reserve Bank standard would require consultation in which we would be happy to participate. We would be keen to ensure that the standards allow a framework which is not one-size-fits-all but reflects the size and risk profile of the insurer.

Q2.4.3 To what extent do you think that the Reserve Bank's power to remove an appointed actuary based on fit and proper requirements provides adequate incentives and sanctioning power, in light of the role that appointed actuaries play in the regulatory framework?

We believe that the fit and proper requirements provide adequate incentives and sanctioning power. IPSA 39 currently allows the Reserve Bank to remove the appointed actuary if it deems appropriate.

We also point to NZSA's revised Code of Conduct and Disciplinary Scheme (DP) which come into force in July 2023. The Code sets out the principles which actuaries are required to observe: Integrity, Compliance, Competence and Care, Objectivity, Speaking Up, and Communication.

Under the DP, Misconduct is defined as "any acts or omissions by a Member that do not meet the standards as reasonably determined and expected by the Society." The standards and expectations of the Society are set out in the NZSA Code of Conduct.

The sanctions available under the Disciplinary Process for Misconduct are wide and include a public reprimand, suspension or expulsion and a pecuniary penalty.

We believe that the threat of loss of professional standing through the working of the NZSA Disciplinary Process, combined with the current fit and proper process, is strong incentive for appointed actuaries to perform their role in line with fit and proper requirements. We note that any one of the sanctions mentioned in the paragraph above would cause the appointed actuary to fail the fit and proper requirements.

Q2.4.4 Should the Reserve Bank impose a statutory duty on the appointed actuary to use due diligence to carry out their assigned role, enforceable with a civil pecuniary penalty?

We do not believe a statutory duty of due diligence should be imposed upon the appointed actuary, whether an employee or consultant. We do not accept that a civil pecuniary penalty would be appropriate for an executive advisory role. We believe this proposal would have serious adverse consequences for the insurance industry and its customers.

We describe in our answer to Q 2.4.3 the revised NZSA Code of Conduct and Disciplinary Process. These act as a very strong incentive for all actuaries (including appointed actuaries) to perform their duties in line with Code principles. The principles of Compliance and Competence and Care are particularly relevant here. Actuaries must also follow NZSA Professional Standards for specific types of work.

Practising actuaries must meet the continuous professional development requirements and conduct standards of NZSA and of their qualifying body (most commonly the UK's Institute and Faculty of Actuaries or Australia's Actuaries Institute). This keeps actuaries at the forefront of professional expertise, and adds another layer of professional discipline to performing the actuarial role with due diligence.

Taking all the professional requirements together, there are already weighty impositions placed on appointed actuaries to perform their duties diligently, and heavy sanctions for not doing so. We believe an additional statutory duty on appointed actuaries to follow due diligence in their assigned role would be cumbersome and unnecessary.

Appointed actuaries advise boards on matters involving uncertainty and complexity. Appointed actuaries are not the only contributors to the total advice boards receive when making their decisions. It would be invidious to single out actuaries for a civil penalty.

We also note that actuarial information contained in Financial Statements and Insurer Solvency Returns are subject to external audit review, imposing a layer of external review over the appointed actuary's work in these areas.

The introduction of the possibility of a civil pecuniary penalty for doing complex work which few people would have the expertise to adequately assess, would be likely to reduce an already insufficient pool of suitable candidates for the role of appointed actuary. Insurer costs would increase as a result. These outcomes would be detrimental to policyholder interests.

We also reiterate that NZSA is supportive of IPSA empowering standards as outlined in the consultation, including the potential introduction of an Actuarial Advice Framework, Governance and Risk Management standards, and an ICAAP/ORSA statement. Such initiatives would be in many cases not new to actuaries in New Zealand (for example, those with overseas owners). The introduction of such standards in New Zealand should help improve the understanding and practice of good governance within companies, and aid informed regulatory oversight. An Actuarial Advice Framework would be particularly helpful in making visible within an insurer the role of the appointed actuary as an independent voice. In our view, sharing the responsibility for good governance in this way is a better approach than targeting appointed actuaries with personal liability.

Q2.4.5 Should appointed actuaries have a duty to identify and present the interests of policyholders? If so, should that be a general duty or only one that applies in specific contexts (such as preparing the financial condition report?)

We support the introduction of a standard that defines a role for appointed actuaries to identify and present the economic interests of policyholders (please see Q3.2.6 for further comments on what constitutes economic interests). The financial condition report would be the appropriate place to comment on that.

In defining such a role, it will be important to avoid giving the impression that the appointed actuary has a wider role as a customer advocate.

2.5 The Auditor

Q2.5.1 Should IPSA include a provision requiring auditors to notify the Reserve Bank if they become aware that an insurer is failing to comply with its accounting and financial reporting obligations?

This is a potentially complex issue and we recommend that the Reserve Bank consult with the audit profession to work through the possible implications of such a requirement.

2.6 Banning orders

Q 2.6.1 Should a serious and persistent breach of statutory due diligence duties (if they were introduced) be grounds on which a court might issue an industry-wide banning order?

In principle, if a statutory duty were to be introduced we would support a banning order; however we reiterate our responses to 2.4.4 above.

2.7 A governance standard

Q 2.7.1 Do you agree that it would be appropriate for IPSA to empower a governance standard?

We support, in principle, an amendment to IPSA to empower a governance standard. We believe that a well-constructed standard would provide a powerful framework for insurer boards.

Company boards are complex entities, staffed by individuals from a range of backgrounds, skills and experiences. That diversity is the most valuable attribute of boards, allowing them to function effectively when faced with a variety of issues. To effectively opine on the construction and operation of those boards, we believe the Reserve Bank will require regulators with board level experience themselves.

As noted in the consultation, it will be important that the standard recognises the varying sizes and risk profiles of insurers and as such the requirements should be proportional.

Q 2.7.2 Can you suggest any principles that should guide the drafting of empowering provisions or the design of governance standards?

The designing and implementation of a governance standard will be a complex process with numerous stakeholders and we welcome the opportunity to provide feedback on a fuller consultation at the appropriate time.

2.8 Risk management

Q 2.8.1 Do you think it is appropriate for IPSA to empower a risk management standard? Are there any high-level issues relating to standard scope or drafting of the empowering provisions that the Reserve Bank should consider?

We support, in principle, an amendment to IPSA to empower a risk management standard. A well-designed standard would help to set insurer expectations about the design and management of their risk management plan.

Key aspects of the standard would be to formalise the process by which the Reserve Bank interacts with insurers to ensure their risk management plans remain current and provide clarity to insurers as to the circumstances under which they would be required to notify the Reserve Bank of changes or issues relating to their existing plan. The standard should also clearly lay out the Reserve Bank's powers of enforcement and possible sanctions for breaches of the standard.

As with the governance standard, we believe that the risk management standard will need to recognise the varying size and risk profile of insurers with NZ and establish proportional requirements where appropriate.

We welcome further consultation on this topic in due course.

Q 2.8.2 Do you think it is appropriate for IPSA to empower a standard requiring an ICAAP/ORSA process? Are there any high-level issues relating to standard scope or drafting of the empowering provisions that the Reserve Bank should consider?

We support the introduction of an amendment to IPSA to empower ICAAP/ ORSA in order to achieve more integrated risk and capital management practices in NZ. This would be in line with the IAIS guidance and global trends.

We would however propose that the timing of any new requirement is aligned with the other planned changes to the solvency standards. In the interim, we support the leveraging of local practices and other concurrent requirements and guidance including those of the appointed actuary. As such we would be supportive of a proportionate and a phased approach as has been done in many international jurisdictions. This gradual approach can initially involve a more qualitative phase by leveraging from the current risk management practices but by requiring the company management to demonstrate tangible progress towards a risk informed and integrated business decision making where possible.

3.0 Supervisory processes

3.1 Licensing

Q 3.1.1 Do you agree that it is appropriate for IPSA to contain a requirement for RBNZ to consult with the FMA, before the RBNZ issues or cancels an insurer licence issued under IPSA?

We agree that there is some logic in requiring the Reserve Bank to consult with the FMA, especially given the reciprocal requirement for the FMA and the upcoming COFI legislation. Policyholders would probably assume that such consultation does take place, and it is better to formalise the intent, scope and processes for such information-sharing than leave it to be done informally.

However, if any information from the FMA were used to make a decision against the insurer, that would add to the need for transparency from the Reserve Bank.

3.2 Approvals for restructuring

Q3.2.1 Do you agree with the proposal to consolidate the approval process for change of control, change of corporate form, transfers and amalgamations into a single test? Why?

Yes. It makes sense in any form of "restructuring" that the "permissible considerations" are the same. A form of "restructuring" not covered in the discussion document is where a policy reconstruction is undertaken via a "Scheme of Arrangement" under Part 15 of the Companies Act 1993. That form of "restructuring" should also be caught, similar to statutory fund changes are.

Q3.2.2 Do the proposed permissible considerations cover an appropriate range of considerations or are there other matters the Reserve Bank should be considering?

Yes. The "permissible considerations" are lifted from section 48 of IPSA and include "any other matter the Bank considers relevant" so are comprehensive. The "permissible considerations" also include "the interests of the policyholders". The interests of the policyholders requires more specificity and we comment on that later in our submission.

Q3.2.3 Please identify any issues that you believe should be governed by a 'red line' prohibition – i.e. transactions that the Reserve Bank must not approve.

There is no need for "red line" prohibitions if the "permissible considerations" are comprehensive.

Q3.2.4 Please identify any constraints that you think should be placed on the Reserve Bank's ability to attach conditions to its approval of a restructuring.

A constraint should be that there can be no more conditions than IPSA permits for a licenced insurer. The Reserve Bank should be required to explain how IPSA permits any conditions applied.

Q3.2.5 What do you consider to be the appropriate mechanism for setting out details of the approval process: primary legislation, secondary legislation (i.e. regulations), guidelines, or other?

We believe the appropriate mechanism for setting out an approval process is through secondary legislation via a standard. The documented process needs to be able to be changed within a reasonable timeframe and subject to public feedback. The approval process is likely to be complex and thus require too much documentation for it to be within primary legislation.

We believe that the Reserve Bank should set standards or guidelines which are fairly generalised. Too rigid and definitive a framework for restructuring could cause unintended adverse consequences. Making restructuring too difficult would not be in the interests of the industry or policyholders. A restructuring (perhaps of a type not yet anticipated) could improve prospects for policyholders compared to the status quo.

Q 3.2.6 How should the Reserve Bank balance market freedom with policyholder security in assessing restructuring transactions? Do you have any comments on wording that you think would capture this balance appropriately?

The need to balance market freedom with policy holder security should apply equally in all circumstances based around sound principles for assessing policy holder security. We believe “policy holder security” should be limited to meaning policy owner economic interests which we broadly define as the need to consider contractual benefits, reasonable expectations of benefits, and the security of those interests. NZSA proposes that an assessment basis (set of tests) be set out in a standard so it is clear how those economic interests should be assessed. We note that too rigid a test to assess economic interests could unnecessarily restrict industry restructurings.

The policy owners should include both those in-scope policy owners i.e. those whose policies will be directly affected, and those whose policies will be indirectly affected i.e. those out of scope in the restructuring (e.g. existing policy owners in the purchasing insurer for example).

We note the Reserve Bank in its guidelines for insurers regarding transfers and amalgamations requires consideration of policyholder security, benefit entitlements and contractual rights. The Reserve Bank guidelines further require consideration of the solvency, capital adequacy and financial strength of the transferee. All these aspects should be assessed via the agreed tests set out in a standard.

Q 3.2.7 Should the requirements to consider policyholder interests be different for statutory funds than for other restructuring transactions for which Reserve Bank approval is required?

The principles for assessing policyholder interests should be the same for all “restructurings”. However, the outcome of the tests will be different. For example, a car policy is short term and able to be cancelled by the policyholder (often with a refund) and by the insurer. The policyholder interests in that case are quite different to a life insurance policy with long term features.

Q3.2.8 Would it be helpful for Reserve Bank guidance on approval processes to say more about how we interpret the requirement to consider policyholder interests?

Yes. Setting out the tests for policy owner interests and level of materiality (at the individual policy level?) is highly desirable. See 3.2.6 above.

Q 3.2.9 Should approval processes include a requirement for us to consult with the FMA as part of our approval decision-making?

Yes, it seems a sensible requirement to consult with the FMA but the test the Reserve Bank should apply must be about economic interests.

Q3.2.10 Do you agree that section 44 should be extended to apply to the acquisition of insurance business by a licensed insurer from a non-licensed overseas insurer?

Yes. The same tests should apply in all circumstances.

Q3.2.11 What do you think the appropriate threshold should be for a change of control to be notified to the Reserve Bank? Why?

We note this is outside of the scope of NZSA subject matter expertise but our comment is that an entity being able to appoint more than X% of the governing body or having more than X% of the voting rights should be notifiable to the Reserve Bank. The reason for this being to allow awareness of strong influences on the insurer from such aspects as "drag along" provisions in a shareholder agreement or different classes of "ordinary" shares.

Q3.2.12 Please comment on the appropriateness of: (a) replacing the fixed 20 working day timeframe for approvals with a 'within a reasonable time' timeframe, or (b) extending that timeframe to 45 working days. Please provide any other comments or options you consider appropriate.

We would support a "reasonable time frame" provided the Reserve Bank undertakes to be transparent and realistic about the information it requires in each case, and sets an expected timeframe for making its decision.

4 Data and disclosure

4.2 A data and disclosure standard

Q4.2.1 Should IPSA empower a data and disclosure standard that could set out disclosure requirements, including data that should be made available to the public?

We agree with the proposal of a data disclosure standard in principle as we support the improved transparency and clarity of appropriate data provisions.

While we strongly support improved transparency with the public, the new standard would need to ensure that any additional information provided aids understanding and allows consumers to appropriately differentiate between insurers. For example, while we support the continued publication of high-level solvency information, we would argue that even this information, given its technical nature, is not well understood by consumers. Therefore, it would be important to decide whether the provision of more information is aimed at consumers, or more informed stakeholders such as agents and brokers. If the new information is aimed directly at consumers, we believe that it would be incumbent on the Reserve Bank to explain to them why that information is important when making their financial decisions.

Maintaining appropriate levels of confidentiality will also be a key consideration in the design of the standard.

We welcome further consultation on this topic in due course.

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