New Zealand Society of Actuaries (Inc)

22 June 2009

Mr Richard Dean
Manager, Insurance Policy
Reserve Bank of New Zealand
WELLINGTON

Dear Richard

Draft Insurance (Prudential Supervision) Bill

We refer to your request for comments on the draft Bill.

The attached submission is made by the New Zealand Society of Actuaries, the professional body representing Actuaries practicing in New Zealand.

The New Zealand Society of Actuaries applies stringent controls to its members around competency, impartial advice, and high standards of ethics. As a profession, we meet international benchmarks for qualification, professional standards, disciplinary process, and continuing professional development.

The Society would be pleased to discuss the contents of our submission in more detail if required. For further information regarding our submission please contact the undersigned.

Yours sincerely

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soa906wai.doc (NZSA submission Insurer Regulation – 22 June 09)

New Zealand Society of Actuaries (Inc)

Introduction

1. The New Zealand Society of Actuaries (NZSA) appreciates the approach being taken to consultation, with a draft Bill at this early stage rather than the first opportunity for comment on the proposed legislation being during the Select Committee process. We also commend the high level of both practicality and effectiveness that is being sought in this legislation.

2. As requested, we have concentrated on operational matters rather than policy issues.

3. Our submission is focused on the sections of the Bill that relate to our professional work as actuaries, as well as practical implications for insurers. Our submission is in four parts:

- The first part of our submission addresses the specific issues for which feedback was sought in Richard Dean's email of 20 April 2009.
- The next part covers some comments of a general nature.
- The third part addresses other matters raised in the draft Bill.
- The fourth part of our submission comments on some transitional matters.

Part I - Input Sought on Specific Matters

Ministerial consent for directions by the Bank

4. NZSA agrees that it is preferable that the Bank is able to issue directions in a timely manner without any (appearance of) political interference. However, Ministerial approval of certain actions is an established practice and is preferable to court review as an oversight mechanism for decisions that have to be taken quickly to minimise potential prejudice to members of the public. Some form of ratification is desirable to provide a mechanism of oversight for decisions that could adversely affect the shareholders or creditors of an insurer subject to a direction order.

5. In our view the risk of political interference is limited. While clause 148 would require the consent from the Minister for the Bank to issue a direction, the action is decided by the Bank. The Minister merely ratifies the proposed action (or not).

6. We can see no reason why the regime in this regard should be any different from those that apply to banks.

Controls over owners and changes in owner

7. Clauses 30 – 32 set out a framework for attestation that directors and officers are suitable. The Bill does not require the Bank to assess the suitability of owners. However, we expect that there must be other laws that can be applied to deal with owners who act inappropriately, and the Bill's provisions in regard to the responsibilities of directors of insurers should be sufficient to safeguard policyholders.

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8. Nevertheless, some form of vetting for owners of a licensed insurer might be prudent, applying only if the new owner and related parties exceeded a specified threshold (e.g. 20% as in the Takeover Code). This vetting could take the form of attestation by a private company or attestation by a new owner for public companies, perhaps similar to stock exchange listing requirements. A backstop power may be appropriate whereby the Bank can de-licence an insurer on the basis of seriously unsuitable ownership.

<u>Restriction on constitutions</u>

9. The Bank asked whether any provision which would allow directors to act in the best interests of a holding company rather than the insurer should be prohibited. In our view, it is appropriate to prohibit such a provision, so long as it remains clear that the policyholders' interests take precedence over the insurer's interests.

Part II – General Comments

10. NZSA supports the overall objectives of the draft Bill.

11. Although perhaps straying into the realms of policy, there is a concern that the imposition of a formal regulatory framework may change what is current good practice into box-ticking compliance. Under the new regime, some insurers may potentially do things which the rules allow them to, but which in fact lead to problems in the long term.

12. The rather perverse effect noted in the paragraph above may occur because the regulatory regime is concerned primarily, and rightly, with protecting current policyholders and ensuring that commitments to them are met. The regime is not specifically concerned with the long term survival of a particular insurer, except to the extent that that helps ensure existing policyholder commitments are met. That long-term survival should be the objective of those who govern, manage and advise insurers and it seems reasonable to assume that that is being done well at present. We hope that having to meet new rules does not change this result.

13. A key example in this regard is determining what level of capital to maintain. For example, an insurer's actuary may decide that the level of capital that is adequate for long term financial soundness is significantly higher than that required under the solvency standards. The insurer could decide to hold only the regulatory minimum, and the Bank's requirement would be satisfied, but the insurer's decision is likely to lead to problems in the long term.

14. In this regard, we submit that the financial condition report should be required to contain a discussion of prospective solvency.

15. The insurance industry in most countries is subject to constant change, therefore any legislation needs to be sufficiently flexible to remain relevant. We suggest that as much as possible of the detail in the draft Bill is moved into Regulations, in order to provide more flexibility to adapt to changes.

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16. The Bank has wide discretionary powers in many aspects of the regulations to vary the requirements for any or all insurers, which we support because unique or altered circumstances need to be adequately dealt with. However, it is difficult for an insurer to manage its business to changing requirements or to requirements that are not specified in advance, especially when there is limited provision for appeal. A simple, clear and timely process for insurers to appeal against any additional requirements imposed by the Bank may be needed.

17. We see that there is a possibility that the timing of the Bank approval of changes to (for example) directors and relevant officers, and an insurer's risk management programme, will simply take too long. The process must be flexible enough to cope with the inevitable operational changes that take place within businesses. In practice, the requirement for pre-approval of changes, to the risk management programme in particular, may lead to less active management of the programme in response to changes in the business environment and hence be counterproductive.

18. Certain sections of the Bill and certain regulations (e.g. solvency standards) are specific to some types of insurers or insurance policies and not relevant to other types. The practicality of some of these differences in treatment cannot be seen until all the details are provided.

Actuaries

19. The role of an appointed actuary is expanded under the Bill to include all insurers. There are no currently legislated requirements for general or health insurers to have an actuary except under the Friendly Societies & Credit Unions Act 1982.

20. In the prudential supervision regime outlined in the Bill the Bank is placing a heavy reliance on actuaries. The profession welcomes this opportunity to provide support to insurers in the financial protection of policyholders. However, there are some practical issues that need to be further discussed.

21. We suggest that an appointed actuary should be a Fellow of the NZSA in order to meet the 'fit and proper' standards. This provides the protection of our professional Code of Conduct, in that our members may not undertake work for which they have insufficient experience and training, as well as ensuring that actuaries will be subject to NZSA rules and standards.

22. The Bill places responsibility on the actuary for the assessment of all risk borne by insurers. However, there are some elements of risk for which other people may be more suited by their training and experience. Not all actuaries, for example, have expertise in the assessment of operational risks. The actuary would expect to rely on the advice of others where appropriate in, for example, certain specific elements of the calculation of solvency or preparation of a Financial Condition Report, and state that he or she had done so.

23. We have commented on other specific matters pertaining to actuaries in Part III of our submission.

Part III – Comments on Specific Sections of the Bill

Interpretation (6 to 9)

24. The Bank has invited comment on the fact that there is no definition of insurance. We submit that it is better to have a definition than not, although the best approach may be to have a 'core' definition in the Act and also the ability to further define in Regulations. For example, regulations could be used to exclude benefits provided by superannuation schemes, AA roadside services and ACC Partnership Programmes. Regulations could also be used for 'future proofing' i.e. to include or exclude, as appropriate, other benefits which are at the margins.

25. Policies containing life insurance benefits are treated as life insurance policies, and insurers offering such contracts as life insurers. Clause 118 has a materiality criterion for minor non-life benefits embedded within composite policies. However, no distinction is made for materiality of life insurance benefits embedded within policies which are predominantly general insurance or health insurance. This means that a company writing only policies that are predominantly non-life insurance would have to set up a life statutory fund to contain only those minor benefits. We suggest that this is not a reasonable outcome, and that the de minimis provisions should work both ways.

26. Similarly, the materiality criterion in clause 118 applies only to non-life benefits embedded in a composite policy. We suggest that it would be equally reasonable to allow standalone non-life benefits within a fund or portfolio to fall within that criterion.

27. The materiality criterion in clause 118 expresses non-life policy liabilities as a % of the assets of the fund. The maximum of 5% will have very different meanings in practice depending on the type of life policies that the fund in question contains. It may be preferable to express the minimum as an absolute $ amount or as a % of premiums.

28. There is a particular issue with single premium Consumer Credit policies. These contracts are generally written with terms of between 6 months and 5 years. As the definitions stand, each policy would need to be split between life and non-life. The death benefits are deemed "life", the redundancy and bankruptcy benefits are deemed non-life, and the disability benefits are split between life and non-life according to whether the policy term is greater or less than 24 months. This seems an unreasonable outcome for contracts with identical provisions (other than the term) and the same policyholders.

29. Both "policyholders" and "policy owners" are used within the Bill, whereas only "policyholders" is defined. We are unsure whether there is intended to be any distinction between the two terms.

30. The definition of continuous disability insurance in clause 6(2) is unclear and may exclude insurances intended to be included or vice versa. The use of double negatives together with a combination of additive and alternative characteristics to be defined as continuous disability insurance is confusing. Is the intention to cover (only?) income protection and trauma/critical illness type policies? The reference in subclause 6(2)(a)(i) to benefit periods in excess of 2 years duration may be interpreted as applying only to sickness benefits or to accident and sickness benefits. There is also some doubt as to whether TPD policies are included within the definition. We think the intention is probably to distinguish between cancellable and non-cancellable policies, and we do not think that this has been achieved.

31. The current wording of clause 6(3) implies that if benefits can be removed or reduced by an insurer the insurance policy is not continuous disability insurance. Some trauma policies which provide for adjusted definitions to reflect medical advances may meet this requirement, and therefore would not be classified as continuous disability insurance. We do not think that this exclusion is appropriate.

32. It is unclear as to whether the definition of life insurance includes terminal illness benefits, which are integral to most life covers. We expect it is intended to do so, and the definition may therefore need to be clarified.

33. We note that the definition of life insurance is restricted to “the payment of money”. We question whether this restriction is necessary, for example provision of a funeral service would normally be thought of as life insurance.

34. We also note that it is unclear whether the definition of life insurance includes the savings elements of, for example, unit-linked and investment accounts policies. We suggest that this be clarified.

Process for obtaining licence and conditions of licence (15 to 23)

35. These provisions imply that non-insurance activities conducted by an insurer and insurance activities conducted outside New Zealand are detrimental to policyholders. We note that such activities may equally provide benefits.

Cancellation of licence (26 to 29)

36. The Bank may direct an insurer to assign its liabilities to 1 or more other licensed insurers. We assume, as intimated in clause 29, that the “other” insurer(s) has an option whether or not to accept such liabilities, and we therefore question whether assignment will always be possible. We expect that the “other” insurers would not want to take on any liabilities without undertaking due diligence etc., and the question of who will pay for that process will always arise.

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Fit and proper requirements (30 to 39)

The actuary

37. Clause 74(3) requires an insurer's actuary to be fit and proper at the time of his or her appointment. The detailed requirements for determining whether a person is 'fit and proper' are set out in section 31. Whilst we acknowledge that clause 31(1) is simply stating the issues to be considered rather than setting the standard, we nevertheless consider that some of the wording in clause 31(1)(b) should be adjusted. As it stands, an actuary who has identified an issue that resulted in an insurer being placed in receivership could be interpreted as caught by the provisions, even if the actuary was not part of the deficiencies in management that caused the receivership.

38. Subclause 31(1)(f) appears to be based on an expectation that NZSA will make some formal statement in regard to professional disciplinary matters. We have identified a number of potential practical issues with such a requirement, including privacy and other legal matters. Given the range of public and private degrees of censure available, one of our concerns is whether we would be able to identify "a finding of guilt, however expressed", against the structures of our current and previous disciplinary processes. We would need to consider this matter further before making any definitive statements.

39. We note that other professional bodies to which actuaries belong may also need to be asked for similar statements (e.g. Institute of Actuaries of Australia, UK Institute or Faculty of Actuaries). NZSA cannot speak for other bodies, and they would need to be consulted separately about their ability to identify and report on these issues.

40. We submit that a preferable approach would be for the actuary to self-certify to the Board of the insurer in response to any questions raised regarding fit and proper status and professional misconduct. The Board (not the actuary) should then certify to the Bank that they believe the actuary fulfils the fit and proper requirements. We understand that this is the approach that is taken in Australia.

Other officers

41. Relevant officers for 'fit and proper' certification are generally the CEO, CFO and actuary. There may be a number of other senior executives who have as much if not more influence on direction and strategy of the insurer and who should therefore be included.

42. Some insurers may not have a person, either employee or contractor, in a position titled as CEO or CFO. The application of 'fit and proper' rules in such cases may need to be clarified.

Owners

43. Refer to Part I of our submission – input sought on specific matters.

Transfers and amalgamations (40 to 49)

44. We note that the Bank has an option to require an actuarial report in a transfer or amalgamation of insurance business. We support this provision.

Solvency standard (50 to 61)

45. We welcome the requirement for the Bank to consult before approval of a solvency standard. However, it appears to us that clause 52(2) in effect contradicts this requirement. Perhaps clause 52(2) is simply to avoid any legal challenge around the level of consultation. If so, we would find it useful to have this clarified.

46. Clause 53(1) - we are not sure exactly what "contingent liabilities" is intended to include in this context. There could be a problem if there are some potentially very large but very unlikely contingent liabilities (in the accounting definition) in the disclosures. Are actuaries expected to place a value on contingent liabilities?

47. Clause 54 sets out a list of the matters that may be contained within a solvency standard. This gives rise to a risk that wording within a solvency standard may be challenged on the basis that it does not fall within the categories listed, for example, projections of the future financial strength of the business. To avoid such a challenge, we suggest there should be an overall statement that clause 54 sets out the core content of a solvency standard, but also states that other items within an approved solvency standard are equally valid.

48. Clause 57(1) contains the requirement to ensure solvency 'at all times.' We agree that this is the correct approach. This will mean that some sort of prospective assessment will need to be made by the company or its actuary. The complexity of making the assessment will vary according to, inter alia, existing margins and business plans. Insurers whose actuaries are not in-house will need to ensure that their actuaries receive regular updates to keep up to speed with any intended changes to products, as well as the general activities of the business.

49. Clause 57(4) imposes a fine on insurers which fail to meet the required solvency margin. This approach of reducing the assets of an insurer with a weak financial position seems to us to be to the detriment of policyholders i.e. contrary to the purpose of the regime to protect policyholders. An increased level of supervision or other form of regulatory intervention would seem to be more appropriate.

50. Subclause 58(4)(a) requires the actuary to report on whether the solvency certificate is "true and fair". We agree that it is appropriate for the actuary to make a report of this nature, but the fact that the words "true and fair" are used in the context of an audit implies an audit role for the actuary which is inappropriate. Further, the actuary is likely to be the person who has determined the solvency position, and it is not acceptable for the same person to both "calculate" and "audit".

51. Subclause 59(1)(b) requires every director to sign the solvency certificate. In most other matters 2 directors are able to sign on behalf of the whole Board of directors. It is not clear whether the difference in approach here is deliberate, but if it is there may be practical difficulties e.g. if one or more directors are unavailable.

52. Clause 60 should be amended to include a time horizon and to clarify the meaning of "likelihood of failure."

Credit ratings (62 to 69)

53. The logic of an exemption for small insurers from the requirements for credit rating is unclear. Policyholders and potential policyholders of small insurers need financial protection as much as those who have contracts with larger insurers.

54. Clause 65 does not appear to provide sufficient practical time to notify new or renewing policyholders of any changes in credit rating or watch where these are amended in the interval between initial communications with the insurer and inception or renewal effective date.

55. For long-term policies that are not legally subject to "renewal'' each year, it appears that policyholders are not required to be informed of changes in credit rating or watch other than by displaying the information on the insurer's website. Is this the intention?

Risk management (71 to 73)

56. We note that depending on the nature of the risk management audit (or review) required by the Bank in any particular case, a range of expertise, including actuarial skills, may be required.

Role of actuary and financial condition report (74 to 78)

57. Clause 74 appears to require the appointed actuary be a specified individual rather than, for example, a firm of consulting actuaries. NZSA supports this approach.

58. It is unclear whether the insurer's actuary for the purposes of the Bill must be the same person as the appointed actuary under the Friendly Societies & Credit Unions Act 1982. For practicality, a Friendly Society that is an insurer is likely to use the same actuary in both roles, but there may be other considerations that would support both the Bank and the Registrar of Friendly Societies requiring this to be the case.

59. Clauses 75 & 76 refer to "audit" which is not the appropriate responsibility of actuaries. We understand "review "or "certify" is the intention. The wording should be amended to clarify.

60. It is difficult to comment specifically on the practicality of making a financial condition report until more information is provided on the Bank's requirements. Although clause 78(2) refers to the delivery of a financial condition report to the Bank within (in effect) 5 months and 20 days of the financial year end, audited financial statements are required to be delivered within 3 months (clause 80(1)). In practical terms, we expect that auditors will not be willing to provide an audit report unless they have seen the financial condition report, with the result that the deadline for the financial condition report is also 3 months. Any substantive financial condition report which includes assessments at the end of the financial year may well be difficult to provide within the 3 month period. Further, overly tight timeframes are more likely to result in a 'box ticking' approach to a report, whereas the preferred result is a document that is of the most use to both insurer and regulator.

61. Clause 78 (3) refers to an "objective" assessment of financial condition. We submit that the adjective is not necessary.

Actuaries must have access to information (79)

62. NZSA supports the strong requirement for the insurer to give the actuary whatever information and access to employees he or she may need. We expect that financial condition reports will include a statement on the adequacy of data, and it is possible that actuaries may find themselves in the position of having to qualify their reports in this regard.

63. We also note that the actuary will need to comment on the appropriateness of the data for the purpose, and on certain reconciliations performed e.g. to the figures in audited accounts. However, the actuary cannot certify that the data is correct; we understand that to be one of the roles of the auditor.

Supply of financial statements (80)

64. A 3 month reporting period is much shorter than timeframes under current financial reporting and regulatory requirements. Insurers may find it necessary to calculate liabilities and risks at an earlier date than the end of the financial period and roll these forward in order to meet these deadlines, and the Bank will need to consider the extent to which such an approach is acceptable.

65. One practical matter arises from many companies having the same or similar financial periods. A bottleneck may be created, with some insurers having difficulties in finding an external actuary who is able to act for them within the required timeframes.

Statutory funds (81 to 99)

66. NZSA supports the policyholder protection principles that underlie the requirement for policyholder funds to be ring-fenced within a Statutory Fund.

67. In particular, we support the requirements in clauses 113(2) and 114(1)(a) for directors to obtain actuarial advice before a distribution of retained profits and capital respectively.

68. Clause 118(2) allows life insurance policies with minor non-life benefits to be completely included in the statutory fund. However, the use of a measure based on the value of the non-life liabilities as a % of the assets of the fund may be impractical as life insurance liabilities calculated under NZ IFRS-4 may be negative.

69. We have commented further on clause 118 in paragraphs 25 to 27 of this submission.

70. Clause 84(2) refers to the interests of policy owners having priority over the interests of shareholders or members of an insurer. In the case of a mutual insurer policyholders are both policy owners and members, and furthermore these interests are closely interrelated. A member's interest through surplus generated generally gives rise to subsequent interest as a policyholder (e.g. through reduced future premiums, enhanced benefits or greater security). The potential for conflicts appears to be mainly in actions which benefit some members but not others.

71. The initial move to statutory funds may impose additional costs on life insurers because clause 86(3) requires real separation of assets and disallows notional separation by the actuary. An example of an additional cost and unintended consequence may be effects on tax liabilities and payments, and some transitional arrangements may be needed for assets which exist at the time of the separation.

72. Clause 94 states that investment performance guarantee costs, which are yet to be defined, must not exceed 5% of the policy liabilities of a statutory fund that comprises only investment-linked business. In practice, it seems possible that if asset values decrease, the guarantee costs could increase (depending on the nature of the guarantee) and it is not clear what action the insurer is supposed to take if this causes the investment performance guarantee factor to rise above 5%. We are unable to comment on the suitability of the limit of 5% until details of the calculation are provided.

73. Clause 94(5) limits the applicability of section 94 to policies measured in terms of units. There are non-unitised products which also provide investment guarantees, particularly what is commonly called "investment account" business under which a smoothed return is credited to policies. We are unsure why, if a limit on investment performance guarantees for unitised policies is appropriate, there is no similar provision for investment performance guarantees on any other products.

74. Further, we are unsure why there would be a limit on the costs of investment performance guarantees at all, and no limit on any other forms of liability.

Duties of directors (100 to 103)

75. Clauses 100(1) & (2) require directors to ensure that the interests of policy owners are given priority over the interests of shareholders in the event of a conflict, or where investment, administration, and management of the fund's assets are concerned. Clause 84(2) contains a similar requirement.

76. This could be interpreted quite restrictively. For example, the transfer of any money out of a Statutory Fund will weaken the policyholders' interests and strengthen the shareholders' interests. This could be viewed as a conflict and hence challenged, however reasonable the transfer might be. We note that there is a similar issue, albeit with different wording, in the Friendly Societies & Credit Unions Act 1982. The NZSA standard PS6 deals with this issue in section 5.2.4 by defining an adverse effect on financial position as one where following the change the Friendly Society is no longer financially sound.

Transfer of policies between statutory funds (106)

77. Clause 106 envisages a transfer of assets to match liabilities. However, it is possible that the ‘liabilities’ described in clause 106(4) are negative.

78. Subclause 106(4)(b) mentions the “reserves” of a life insurer, as distinct from policy and current liabilities. It is not clear to us what type of liabilities would comprise “reserves”, and this may need further clarification.

Allocation of profits and losses and capital payments (107 to 112)

79. The definition of non-participating business in subclause 107(1)(a)(ii) appears to mean that investment account business is a participating benefit, unless investment account business is covered by regulations. Some insurers have Investment account business which is not participating business in the sense of a sharing of profits between shareholders and policyholders.

Supply of information (121 to 129)

80. Clause 123(1) requires an associated person to provide information to an insurer. Clause 126(2) requires an associated person to supply information but does not specify to whom. We wonder if there are circumstances in which this process may work better if this information is supplied to the Bank, rather than the insurer.

81. We support the clear statement in clause 127 of the existence of a whistleblowing obligation. However, the thresholds for whistleblowing will need to be discussed further. We appreciate that this is always going to be an especially difficult area. Our initial view is that the words “is insolvent or is likely to become insolvent or is in serious financial difficulty” are not practical unless “likely to become insolvent” can be given a timeframe.

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Confidentiality of information (136)

82. Confidentiality of information will be a particular issue for the financial condition report. The protection of information from requests under the Official Information Act needs to be specified. In particular, we would like to see a clarification of:

    a. which information the Bank receives will be held wholly confidentially (and not able to be discovered under the OIA),

    b. which information is normally held in confidence but could be discoverable, and

    c. which information may or will become public, whether attributable to the insurer or contributing to summaries.

83. Further, we envisage that certain information could be made public at some later time in circumstances such as during or on completion of an investigation into an insurer that failed. This also needs to be made specific.

84. In subclause 136(2)(b) it is not clear to us what is meant by "information in a statistical or summary form" and whether this has potential to reveal information that is able to be identifiable as relating wholly or mainly to one insurer. For example some lines of business may be dominated by a single insurer.

Ministerial consent (148)

85. Refer to Part I of our submission – input sought on specific matters.

Distress management (139 to 200)

86. We note that clause 163 refers to an option for the High Court to require an actuarial report. We would support this provision.

Offences (203 to 206)

87. We are unsure of the reason for the exclusion in clause 205(2) of directors, employees etc. from the acceptable defence.

88. Prohibition from being a shareholder at all, as in subclause 207(2)(c) seems difficult to enforce unless there is some allowance for ownership via collective investment vehicles which are structured to give investors direct ownership but are independently managed.

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Part IV – Transitional Matters

Path to compliance

89. Uncertainty over the transition process makes it difficult for NZSA to comment specifically at this stage on some aspects of the new prudential regime and for insurers to prepare to make changes to meet the new requirements.

90. We very much welcome the concept of the Bank holding discussions with each individual insurer to set out the steps and timeframes for compliance with licensing requirements.

91. We suspect that these timeframes may turn out to be longer than expected, particularly for some general insurers which do not already have an actuary and which may have problems with data quality. Some insurers may experience difficulty finding and appointing actuaries. It will be unsatisfactory to set 'path to compliance' timeframes until an actuary has been appointed.

92. Some insurers, especially smaller general insurers, are likely to take the position that they cannot influence the outcome of the new regime and will passively wait until the rules become clear before assessing the potential impact on their business. There may be some material cost and regulatory impacts, leading to a range of possible business responses.

93. The Bank will need to be prepared to deal with all insurers in a balanced and pragmatic way, particularly insurers that decide to shut down. We would stress the importance of ensuring that policy owners are not disadvantaged by this process.

94. For most insurers the introduction of the new insurance regulations and solvency standards will have a number of implications including (but not limited to) the possible need to:

    a. Build the reporting datasets and processes to determine the insurer's solvency and complete the financial condition report under the new rules. We understand that this took some years in Australia for some companies. The costs of such developments should not be underestimated.

    b. Appoint appropriate staff (external or internal) to do the work.

    c. Determine the insurer's solvency position under the new rules (current and prospective).

    d. Make decisions regarding whether or not to continue certain lines of business and in what volumes – or indeed continue in business at all.

    e. Review investment strategy and asset allocation, including possible sale of subsidiaries or properties – these unlisted asset transactions take time.

f. Review reinsurance strategy and relationships.

g. Raise more capital, if required.

h. Review premium rates and benefits.

95. The possible requirements set out in the previous paragraph potentially involve a great deal of work. This is likely to be most significant for general insurance companies.

96. This environment argues for a phased introduction of the solvency standards and other aspects of prudential supervision. The NZ insurance industry has been without a modern insurance regulatory regime for many years and it seems reasonable to assume that an orderly transition is more important than a speedy one. There is a risk that a hurried introduction could cause inadvertent transition problems for all parties. A possible phased approach (and we have not considered whether this is possible within the provisions of the draft Bill) might be:

a. Step 1: Finalisation of the solvency standards.

b. Step 2: Actuaries are appointed.

c. Step 3: Insurers:

    i. determine their solvency position as at the most recent balance date on a "pre-intervention" basis within a certain timeframe

    ii. advise the Bank

    iii. evaluate their position and take whatever actions are appropriate.

d. Step 4: The Bank can review the advised solvency returns and decide whether the results are consistent with their requirements/expectations.

e. Step 5: The Bank advises any changes to the solvency basis (arising from results in Step 4) and advises a "live" date for the introduction of the solvency standards from when failure to comply will cause intervention. There could be a different approach for insurers that decide to close to new business and are not acquired.

f. Step 6: Financial condition report requirements, including the first financial condition report due date, are finalised. Lessons will have been learned in the steps above.

97. This approach should lead to a more orderly transition that caters to unexpected problems arising from the application of the new standard. We particularly suggest that the first two or three years' financial condition reports are completed on a "best endeavours" basis, with acceptance that some of the requirements are simply noted as missing but with a comment on plans to ensure completion in later reports.

98. One potential issue that could arise in Step 3 is what the Bank should do with any insurers that are clearly insolvent at that time. In order to best protect the interests of the policy owners of such insurers, it will be important for confidentiality to be maintained until suitable actions can be taken by the Bank.

99. The difficulties that some insurers may face in providing actuarial data should not be underestimated. We expect there to be some general insurance companies in which appropriate data is neither understood nor captured nor reconciled. Unless companies already routinely perform reconciliations between administration systems and accounting systems, and in some cases data warehouses as well, there may be major information systems development required. If institutional knowledge is lacking, it may be may be difficult or impossible to find an employee who has a clear understanding of the links between systems and actuaries may find themselves in the position of needing to build from scratch.

100. If obtaining adequate data going forward is difficult, historical data is likely to be simply unobtainable.

101. Data quality issues for some insurers will require a pragmatic approach by the Bank to transition requirements and timeframes. The actuary will have to take a conservative approach in making his or her assessment of an insurer, and both the insurer and the Bank will need to consider their positions and responses especially carefully.

102. While we understand the argument that the additional cost of meeting the new regulatory requirements is one of the costs of doing business, we are concerned to note that this could have results that are not in the best interests of insurers' current policy owners. The effect of increased capital and other regulatory requirements may be that some insurers will close down if they cannot justify the added costs.