THE END OF THE WILD WILD WEST – LEGISLATIVE DEVELOPMENTS AFFECTING INSURANCE

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Recent legislative developments have raised a number of compliance concerns for the insurance industry. The implementation of the Financial Advisers Act 2008, the Financial Services Providers (Registration and Dispute Resolution) Act 2008 and the Insurance (Prudential Supervision) Act 2010 has created a new regulatory regime for the insurance industry which will require insurers to seriously reconsider their operating practices.

Other recent legislation in the process of development, such as the Financial Markets (Regulators and KiwiSaver) Bill, the Anti-Money Laundering and Countering Financing of Terrorism Regulations, the Insurance Contracts Bill and the Auditor Regulation and External Reporting Bill, will impose further obligations on the insurance industry as well as specific obligations on actuaries.

Each piece of legislation when fully in force will impose novel compliance obligations. Actuaries, who play a fundamental role in the analysis of financial risk in the insurance industry, need to be aware of and come to grips with what the changing legislative environment means for them and how it will impact upon the industry as a whole.

PART ONE – THE FINANCIAL SIDE

The Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act) and Financial Advisers Act 2008 (FAA) have received much publicity recently after having both been considerably amended on 30 June 2010 by their respective Amendment Acts. The restructured Acts look to restore consumer confidence in the financial industry after recent fallout from the global financial crisis. The legislation intends to provide further safeguards to domestic financial consumers by requiring compulsory registration and dispute resolution scheme membership by financial service providers, and by implementing a set of minimum standards which financial advisers must adhere to.

The Acts speak directly to the financial industry. However the legislation has a broad scope in terms of its application and also impacts directly on the insurance industry. Once the two Acts are fully in force they will impose serious compliance obligations for the insurance industry. Actuaries need to be aware of these changing compliance obligations and appreciate the wider implications for the insurance industry as a whole.

Implications of the Financial Service Providers (Registration and Dispute Resolution) Act 2008

The purpose of the FSP Act is clearly identified by its title, the Financial Service Providers (Registration and Dispute Resolution) Act 2008. The Act seeks to regulate

financial service providers by requiring them to be registered and be members of an approved dispute resolution scheme.

Who is covered by the FSP Act?

Section 7 of the Act states that, "this Act applies to persons who are in the business of providing a financial service". Providing a financial service is relatively broad in its definition and extends beyond financial advisers as defined by the FAA. There are a number of ways in which a person can provide a financial service.

"Acting as an insurer" for example is defined as providing a financial service. Accordingly, any person acting as an insurer is required to register and join a dispute resolution scheme if they deal with the public. An insurer, according to section 4, is any person who accepts risk in relation to a contract of insurance, or any person who has risk accepted on their behalf in relation to a contract of insurance.

A - Registration requirements of the FSP Act

Part 2 of the Act establishes a compulsory public register of financial service providers. The register allows the public open access to information about registered providers and also imposes a quality control over providers by preventing certain providers from becoming registered. If a person provides a financial service without being registered they will be liable to a fine of up to $100,000 or imprisonment for up to 12 months. If the provider is not an individual it can be liable to a fine of up to $300,000.

Each provider must apply for registration and meet the following criteria:

- the provider must not be disqualified (ie: an undischarged bankrupt, convicted for crimes against other people's property or convicted of a money laundering offence);
- the provider must me a member of a dispute resolution scheme if required by the Act; and
- the provider must be licensed if required by another licensing enactment (ie: the Insurance (Prudential Supervision) Act 2010 if an insurer).

All registered financial service providers are also required to annually supply the Registrar with an annual confirmation of details relating to that provider and must pay an annual levy or fee. By setting limits on who may become registered, the FSP Act intends to enhance the standard of providers and accordingly the standard of financial service.

Individual registration not necessary in some instances

A provider does not need to individually register in circumstances where they are employed by a Qualifying Financial Entity (QFE), provided the QFE is registered. A QFE is an entity such as an insurance company that has been granted QFE status by the Securities Commission, allowing it to be exempt from certain conditions of the FSP Act and FAA.

Providers will also be exempt if the provider is a financial adviser (as defined by the FAA) and the advice being given relates to wholesale, non-retail advice or non-personalised, class advice (wholesale and class advice will be further explained in the following sections). In this case only the entity or business responsible for those individuals must register. However if an individual gives advice to a retail client or provides a personalised service, then the individual will need to become registered (ie: a Registered Financial Adviser (RFA)).

Registration fees and timeframes

Financial service providers will need to comply with the following timeframes:

On and from 16 August 2010:

- The financial service providers register opens. Registration can be completed online at the FSPR website (www.fspr.govt.nz).
- Applications for approval as an authorised financial adviser or for QFE status may be made, and decided on, under the FAA. However authorisation and QFE status can not be granted before 1 December 2010.

On and from 1 December 2010:

- It becomes mandatory for providers of financial services to be registered under the FSP Act. However financial advisers (as defined under the FAA) will not be required to register until April 2011.
- It becomes mandatory for providers of financial services to retail clients to join a dispute resolution scheme under the FSP Act. However financial advisers (as defined under the FAA) will not be required to join until April 2011.
- Most of the conduct obligations under the FAA for financial advisers, brokers, QFEs, and members of QFE groups, and the related enforcement provisions come into force.

On and from 1 April 2011:

- It becomes mandatory for financial advisers to be registered and join a dispute resolution scheme under the FSP Act.
- QFE status must be granted by this date.

On and from 1 July 2011

- The disclosure obligations for financial advisers under the FAA come into force.
- Authorisation must be granted by this date for individual advisers.

Financial service providers will incur the following registration fees:

	Application fees	Ongoing Fees
Registered financial service provider / Registered financial adviser	$357.78	$61.33 (annual fee)
Criminal history check fee (per person named in the application)	$40.25	$40.25 (as incurred by the Registrar)
Dispute resolution regime administration contribution – if required to be a member	$30.67	$30.67 (annual fee)

B - Dispute resolution scheme

The other major requirement of the FSP Act is that every financial service provider must belong to an approved dispute resolution scheme if they provide advice to a retail client. A dispute resolution scheme provides an impartial and independent complaints avenue for financial service clients. Clients must first seek redress through a provider's internal complaints system, but providing no resolution is met the client will then be able to make a complaint to that provider's relevant scheme, free of charge.

A business or entity will be able to join a scheme on behalf of its employees but membership fees will be proportionate to the number of advisers within the business or entity.

Exemption

Advisers of sophisticated, wholesale clients are not required to join a dispute resolution scheme. This type of client is deemed to require less protection because of their extensive financial knowledge.

The following types of clients are categorised as wholesale clients:

- a person who is in the business of providing a financial service;
- a person whose business is to invest money; or
- an entity with net assets or turnover exceeding $1 million (at the end of each of the last 2 completed accounting periods).

Requiring advisers who solely give advice to sophisticated wholesale clients would create unnecessary costs for the adviser, but also the client, who would inevitably have costs passed on to them.

Different schemes available

The Minister of Consumer Affairs has now approved four dispute resolution schemes. The first two accepted schemes were the Financial Services Complaints Limited (FSCL) scheme and the Insurance and Savings Ombudsman (ISO) scheme. The other two schemes, the Financial Dispute Resolution (FDR) scheme (reserve scheme) and Banking Ombudsman scheme, were approved on 1 September 2010. The main point of difference between each scheme is their respective fees and claim limits.

The ISO is open to all financial service providers. Its membership fee is $400 per annum, per member (up to a maximum of $14,000) and there is no joining fee. The cap on claims is $200,000 and a fee of $1,000 plus GST is payable for each complaint investigated.

FSCL is similarly open to all financial service providers. The major point of difference between the ISO and FSCL is that FSCL can recommend payments up to $200,000, but can only enforce payments of $100,000. This reduced cap has proven very attractive to some advisers wishing to limit their liability. FSCL also allows members one free complaint per year. There is a 3 stage process for complaints and the costs increase incrementally. The charge for the first stage is $1,300. The next stages incur costs of $2,000 for a complaint requiring CEO adjudication and $6,000 for a complaint requiring expert panel adjudication.

The Banking Ombudsman Scheme is open to membership from banks and non-bank deposit takers that are regulated by the Reserve Bank and have a minimum credit rating of BB. The amount of financial loss claimed must be less than $200,000.

The most recently approved scheme is the governments reserve scheme, FDR. FDR is promoted and ran by Dispute Resolution Services Limited (DRSL), the primary dispute resolution provider for ACC and the Telecommunication Dispute Resolution service. A complaint can be taken to FDR that involves more than $200,000, but the maximum compensation available will be $200,000. Insurers will pay a membership fee whereby they pay $1,000 for every $5 million total current, in force premium they have for retail clients (up to a maximum of $100,000). The reserve scheme will have incremental complaint costs as well. A low level complaint will cost a member $775, a complex complaint $2,350 and a complaint requiring adjudication $3,270.

Penalties for non-compliance

If an adviser provides a financial service without being registered or holds them self out as being in the business of providing a financial service without being registered, they will be liable for up to:

- $100,000 or imprisonment for 12 months - Individual
- $300,000 - Entity

Summary of the FSP Act

The FSP Act works to promote accountability and responsibility in financial service providers by introducing standardised complaints procedures and industry-wide registration. It gives further protection and assurances to financial clients by enhancing professionalism and transparency.

Implications of the Financial Advisers Act 2008

The FAA has raised a number of compliance concerns for the insurance industry by imposing various disclosure and conduct obligations on financial advisers.

Who is a “Financial Adviser”?

Section 8 of the FAA establishes that a “financial adviser” is any person who provides a “financial adviser service”. The definition is not as broad as that of the financial service provider in the FSP Act. A person provides a “financial adviser service” if they either:

- give financial advice;
- provide an investment planning service; or
- provide a discretionary investment management service.

An investment planning service is where an adviser analyses an individual’s investment needs, identifies their investment goals and recommends how to achieve those goals. Alternatively, a discretionary investment management service is where an adviser decides which financial products to acquire or dispose of, whilst acting under their client’s authority to manage financial products.

The most relevant financial adviser service to insurers is the provision of financial advice. Financial advice is given when an adviser makes a recommendation or gives an opinion in relation to the acquisition or disposal of a financial product. Section 5 of the Act establishes that insurance contracts are financial products. Accordingly, every person giving advice in relation to an insurance contract is potentially affected by the legislation.

There are however a number of exemptions in the Act, limiting the scope of compliance obligations.

What is not financial advice?

Section 10 (3) of the FAA provides a number of circumstances in which a person advising on an insurance product will not be providing financial advice.

If an adviser merely provides information, such as the terms and conditions of an insurance contract, the adviser will not be giving financial advice. This will be a common situation for insurance staff working in call-centres, who receive requests from the public for further product information or quotes. In this situation an adviser would not be subject to the compliance and disclosure obligations imposed by the FAA, provided they only gave information as to the terms and conditions of an insurance contract. Advisers will need to be careful however not to imply a recommendation during their discussions, as this would likely constitute providing financial advice under the Act.

If a person advising on an insurance product only gives advice as to a class of insurance contracts, not a particular type of policy, they will also be exempt. This allows advisers to still give generic, class advice without having to first comply with the requirements of the Act.

Advisers may similarly give advice on the process by which a customer can acquire or dispose of a product, or recommend a person consult a financial adviser, without being caught by the Act. If an adviser transmits the advice of another financial

adviser they will also not be bound by the Act, so long as that person does not hold out that advice as their own.

Is an actuary a financial adviser?

Advisers will be exempt from the FAA if the financial advice they provide is only incidental to their primary business. The service will be incidental if it is a secondary part of the primary business. Typical examples would include a rental car company employee discussing car insurance with prospective clients or a retail assistant discussing hire purchase agreements.

Actuaries usually provide advice to insurers, banks, and superannuation funds. Their core responsibility is the analysis of risk, the processing of financial information and the pricing of policies, not the provision of financial advice.

There may be some limited instances in which actuaries do give financial advice. One example would be the provision of internal advice to an insurer regarding the risks and returns involved in a particular financial investment or transaction. The second example would be that of an actuary in a social setting who participates on a board or committee and is asked for an opinion in relation to a financial matter. Both situations would not typify the primary business of an actuary.

Actuaries who provide financial advice as defined by the Act will generally be doing so in an infrequent manner and certainly not as part of their primary business. The advice would be considered incidental and the actuary would accordingly be exempt from the requirements of the Act.

Further exemptions

An adviser will be exempt from the Act if they work with sophisticated wholesale clients or give non-personalised, class advice. This is because these types of client are not deemed to be in a vulnerable position, requiring regulatory protection.

When giving advice to wholesale clients, an individual adviser will not be subject to the same compliance and disclosure obligations as they would be if giving advice to regular retail clients. They will also not need to register or join a dispute resolution scheme to comply with the FSP Act, as their employer is able to do this on their behalf.

Wholesale clients are defined in a similar fashion as under the FSP Act. The following types of clients are examples of those categorised as wholesale clients:

- financial advisers;
- a person whose principal business is to invest money; or
- an entity with net assets or turnover exceeding $1 million (at the end of each of the last 2 completed accounting periods).

Similarly, advisers giving non-personalised, class advice will not be subject to the same compliance and disclosure obligations as they would be if they were to give advice to regular retail clients. Advisers offering class advice will also not need to

register or join a dispute resolution scheme to comply with the FSP Act, as their employer can register and join.

To be classified as class advice the client must not be readily identifiable and the adviser must not take into account the clients financial goals. The advice will be non-personalised and in this sense could be given to any potential client. This allows insurers to still provide generic product advice through brochures or websites without requiring each person who helps prepare that advice to comply with the FAA's conduct and disclosure requirements.

However, if there are no relevant exemptions then a financial adviser must adhere fully to the conduct and disclosure obligations of the FAA.

Different classes of financial products

The FAA imposes different compliance obligations on advisers dealing in different classes of financial products. The Act distinguishes between complex financial products referred to as Category 1 products and simple financial products referred to as Category 2 products. Advisers dealing in Category 1 products which pose a higher degree of risk to financial customers will have to adhere to more stringent standards than those advisers dealing solely in Category 2 products.

Category 1 products include securities, futures products and importantly for the insurance industry investment-linked contracts of insurance (the only insurance product categorised as a complex Category 1 product). The definition of an investment-linked contract of insurance will be introduced by regulation. It seems likely these contracts will be defined as insurance contracts aimed at producing investment returns on premiums, as opposed to insurance contracts aimed at mitigating the risk of an event occurring. This is in line with the central tenet of the FAA, the protection of client investments. Advisers dealing solely in non-investment linked insurance contracts will be subject to lower compliance obligations.

Who can deal with which products?

If a financial adviser deals in Category 2 products they must be registered (ie: be a Registered Financial Adviser - RFA), or be an Authorised Financial Adviser (AFA) or Qualified Financial Entity Adviser (QFE Adviser).

If however the adviser deals in Category 1 products they must be an AFA, unless the adviser is a QFE Adviser and only sells a Category 1 product provided by that QFE.

	Category 1 product	**Category 2 product**
Financial Advice	AFA/QFEA*	AFA/RFA/QFEA
Investment Planning Service	AFA	AFA
Discretionary Investment Management Service	AFA/QFEA*	AFA/RFA/QFEA

* Only if sell own product

As can be seen by the above table, an AFA has a broad scope to give advice on all types of financial products and services. This is because the AFA is subject to much more stringent compliance obligations than other QFE Advisers and RFAs.

Disclosure obligations for financial advisers

Disclosure obligations have now been implemented by the Financial Advisers (Disclosure) Regulations 2010. The regulations impose different standards for each of the three classes of adviser.

AFAs will have a tiered system of disclosure. In a "primary" disclosure statement the adviser must disclose information relating to:

- the type of financial products being offered;
- how the adviser will be paid for the service they provide (fees, commissions and remunerations);
- complaints procedures available to the customer;
- any bankruptcy or disciplinary action taken against the adviser in the last 5 years; and
- how the adviser is regulated by the government.

In a "secondary" disclosure statement (usually attached to the primary statement) the adviser will need to disclose information relating to:

- the type of financial adviser service provided and the specific products offered;
- the amount of fees, commission and remuneration paid to the adviser; and
- the financial interests, relationships and affiliations of the adviser.

RFAs however will only need to provide a single disclosure statement with less onerous disclosure obligations. The disclosure statement will only need to specify the type of adviser they are and set out the adviser's internal complaints procedure system and external dispute resolution scheme.

QFE Advisers have different disclosure requirements altogether. Unless specifically requested by a client, a QFE Adviser does not have to provide a written disclosure statement, provided they make disclosure by other means. This will allow advisers to give verbal disclosure for example over the telephone. In an insurance context this verbal disclosure is expected to be made by a short automated message at the start of a call, before the adviser even talks to the customer.

In making disclosure, a QFE Adviser must disclose the details of the QFE, its internal and external complaints procedures, and anything else required to be disclosed in the QFE's terms of being granted QFE status. The amount of information required to be disclosed has been purposefully limited. This is a result of submissions that extensive disclosure would have disproportionately increased the time taken on each telephone call and would have consequently reduced call-centre productivity.

Each class of adviser must make disclosure before providing the service, or if not practicable before, as soon as practicable after providing it (section 22(1)(a)). This allows RFAs, as well as QFE Advisers, to still give advice over the telephone and

then make disclosure afterwards. The first section of a AFAs disclosure document however must be disclosed before providing the service. Accordingly most authorised advisers will provide both disclosure statements prior to giving advice.

Sample disclosure statements setting out the specific disclosure requirements can be found in the Financial Advisers (Disclosure) Regulations 2010.

B - Conduct obligations

The FAA states that financial advisers must exercise the care, diligence and skill that a reasonable financial adviser would exercise in the same circumstances. Similarly, advisers must not engage in misleading or deceptive conduct. All advisers must abide by these standards, even where giving wholesale or class advice. Beyond this fundamental obligation are more specific requirements of AFAs and QFE Advisers.

AFAs face the most stringent obligations from the FAA because of the high degree of risk involved in Category 1 products. AFAs must comply with a Code of Professional Conduct. There are 18 different standards in the Code which set minimum requirements for ethical behaviour, client care, knowledge, skills and competence, and continuing professional development.

One of the significant requirements of the Code is that advisers must complete various Unit Standards in order to become authorised. Authorised advisers must also develop a professional development plan and continue to undertake professional training. The Code looks to improve standards of competency and accountability by establishing a minimum set of standards.

QFE Advisers have somewhat different requirements. These advisers have to comply with the terms and conditions of their QFE's granting of QFE status. In order to be granted QFE status, an entity must firstly submit an Adviser Business Statement (ABS) which sets out the particulars of the entity as well as its governance and FAA/FSP Act compliance arrangements.

An entity's ABS must also address the Code of Professional Conduct. Accordingly QFE Advisers will be largely subject to the same obligations as AFAs. However QFE Advisers do not have to follow every standard in the Code, so long as they can satisfy the Securities Commission that a particular standard in the Code is not relevant to them. This has been labelled the "if not, why not" test. It would be unnecessary for example for an insurance company dealing solely with low-risk Category 2 products to have the equivalent training and professional development standards as an AFA, dealing in complex financial products. The Securities Commission has shown a willingness to allow such exemptions.

Compliance timeline

AFAs must apply for authorisation by 1 December 2010 and complete training and be authorised by 1 July 2011.

QFEs need to submit their ABS and apply for QFE Status by 1 December 2010. They must have confirmation of QFE status by 1 April 2011.

The conduct obligations for all advisers will come into force on 1 December 2010 and the disclosure obligations on 1 July 2011.

Penalties for non-compliance

If an adviser holds them self out as an authorised financial adviser, financial planner, investment planner, or QFE without being permitted, they are liable for up to:

- $10,000 - Individual
- $50,000 – Entity

If an adviser provides wholesale or class advice without being permitted, they are liable for up to:

- $5,000 - Individual
- $10,000 – Entity

If an adviser knowingly/recklessly fails to make disclosure or knowingly/recklessly commits misleading or deceptive conduct, they are liable for up to:

- $100,000 - Individual
- $300,000 – Entity

Summary

The FAA encourages competency and accountability by introducing various compliance and disclosure obligations. The legislation essentially aims to increase customer confidence in the financial industry by ensuring minimum standards of professionalism. As can be seen by the penalties above, advisers should be careful to meet those standards or otherwise face serious consequences.

PART TWO –PRUDENTIAL SUPERVISION

The Insurance (Prudential Supervision) Act 2010 (IPSA) passed its third reading on 24 August 2010 and received the Royal Assent on 7 September 2010. The Act provides a legislative framework for the prudential regulation and supervision of insurers. It looks to ensure the protection of consumers by requiring insurers to demonstrate they have sufficient safeguards in place to cover any potential claims.

Unlike the FAA and FSP Act, the IPSA applies solely to the insurance industry. Accordingly, the Act imposes more insurance-specific compliance obligations. The Act imposes specific obligations on actuaries to provide professional guidance to insurers regarding their ongoing financial strength and risk management.

Licence

The most significant implication arising from the IPSA is the obligation for all insurers to obtain a licence from the Reserve Bank (the Reserve Bank functions as the main supervisory body under the Act). Insurers will need to apply for a provisional licence by 8 March 2012. A provisional licence will be given to an insurer provided the insurer has notified the Reserve Bank by 30 December 2010 that it intends to

continue carrying on insurance business in New Zealand after 8 March 2012. The insurer must also be able to prove it was acting as an insurer before 30 September 2010 and that it has taken reasonable steps to develop a fit and proper policy and risk management programme.

The insurer must then be granted a full licence by 8 September 2013, so as to carry on insurance business in New Zealand. In order to be licensed an insurer must meet the following criteria:

- develop a compliant fit and proper policy for directors and senior management;
- maintain satisfactory solvency standards;
- hold a current financial strength rating;
- develop a sound risk management programme;
- appoint an actuary;
- prepare financial statements in accordance with Reserve Bank requests; and
- maintain a statutory fund if life insurer.

Insurers will be continually monitored against these standards. If an insurer does not comply with the conditions of its licence it may be liable to a fine of up to $500,000.

Fit and proper policy

Insurers must develop a fit and proper policy for appointing its directors and relevant officers. The insurer's policy must specify the qualifications and requirements for a particular position, including the requirements of a person's character, competence, and experience as it relates to the position. The insurer will also have to provide a certificate to the Reserve Bank setting out specific details about a director or relevant officer who has been appointed, and confirming that that person conforms to the insurer's fit and proper policy.

The policy will be relevant to the issuing of the insurer's licence and so must be approved by the Reserve Bank. If an insurer wishes to change its policy it must seek approval from the Reserve Bank, and if the Bank believes that a director or senior manager is no longer fit and proper, it has the power to remove that person from their position.

Solvency standards

A licensed insurer must also maintain certain solvency standards and report any likely breaches to the Reserve Bank. An insurer should inform the Reserve Bank 'as soon as reasonably practicable' if it believes it likely that within the next three years it will not comply with the solvency margin imposed by its licence conditions. The use of the term 'likely' may cause some uncertainty in the implementation of this rule as it is a fairly ambiguous concept. Insurers and actuaries should be careful to give the solvency margin careful consideration as failure to comply with the standards will have serious consequences.

The Reserve Bank will implement solvency standards that require an insurer to maintain a minimum margin of assets in proportion to its liabilities (the solvency margin). Insurers will need to maintain minimum capital amounts for their life

insurance policies and non-life insurance policies in order to maintain requisite solvency standards. This minimum capital requirement may place some pressure on financially smaller insurance firms.

The minimum amounts required for both life and non-life policies will depend on a calculation of the liabilities faced by each insurer in respect of the following risk components:

- insurance risk
- catastrophic risk; and
- asset risk

Insurers will rely significantly on actuaries in determining the relevant amounts required. The amount required for life and non life policies will need to be aggregated. If an insurer is required to hold a minimum of $5 million for Life and $3 million for non-life for example, they would be required to hold a total minimum amount of $8 million in capital. These are the minimum amounts required and will likely be much larger for most insurers.

The standards will also place reporting conditions on insurers, requiring them to maintain financial reports which show the insurer is complying with set solvency standards. Actuaries must also prepare a report stating whether in their opinion the insurer is complying with solvency standards. The actuaries report will be dealt with in more detail below.

Financial strength rating

Licensed insurers must have a financial strength rating given by an approved rating agency, unless the insurer is a captive insurer or reinsurer.

An insurer must report any change in its financial strength rating to the Reserve Bank. If an insurer receives a ratings downgrade it will be required to publish that downgrade publicly (on an internet site or in one of the major daily newspapers), or instead give written notice of the downgrade to every New Zealand policyholder. Failing to disclose a downgrade will carry a fine of up to $500,000. Some industry members have complained that the requirement to give notification of every downgrade may be overly burdensome in situations where the downgrade is not material, ie: downgrade from AA to A+ (NZSA submission).

Before entering into or renewing a contract of insurance the insurer must also disclose to the insured its current financial strength rating and provide information about who gave that rating. Disclosure can be made orally in the first instance, so long as written disclosure follows. However, if no disclosure is made then the policyholder may cancel the contract within 20 working days after the contract is entered into or renewed.

Risk management programme

Licensed insurers must also develop and comply with a risk management programme. Insurers must develop a program identifying the key risks associated with its particular insurance business and prepare an adequate programme to address those risks.

The programme must be in writing and allow for the effective identification and management of the following:

- insurance risk;
- credit risk;
- liquidity risk;
- market risk; and
- operational risk.

Insurers must maintain appropriate documentation and record-keeping and ensure that the programme remains current. Most insurers will rely on the professional judgement of their actuaries in preparing such a programme.

The Reserve Bank will be responsible for determining whether an insurer has developed a satisfactory programme. It will also be responsible for ensuring that the insurer takes all practicable steps to comply with that programme. Insurers will require prior consent from the Reserve Bank before making any material change to their risk management programme, unless the change is required urgently. In such circumstances consent may be given retroactively. However the Reserve Bank will require notice within five working days of the change, and can still refuse to give approval to the amended programme.

Appoint an actuary

All insurers are required to appoint an actuary who complies with their fit and proper policy. The appointed actuary must be approved by the Reserve Bank and the Bank must also approve the actuary's fees.

The actuary must review information used for the purpose of preparing the insurer's financial statements. This will include information relating to an insurer's calculations of premiums, claims, reserves, dividends, insurance and annuity rates, and technical provisions. The review should also cover information relating to risk assessments of possible future events and the financial implications if those events occur.

The actuary must prepare a written report in respect of this review. The report must state the scope and limitations of the review and whether the actuary has had full access to information from the insurer. An actuary is entitled to have reasonable access to the accounting records and other documents of the insurer and is able to ask questions of directors and employees of the insurer to the extent they think necessary. A director or employee who unreasonably withholds information may be liable to a term of imprisonment of up to 3 months.

The report must also state whether in the actuary's opinion the information reviewed has been appropriately included in the insurer's financial statements, and whether the insurer is sufficiently maintaining its solvency margin. The report should be prepared prior to the date the insurer's financial statements are due to be registered and must be provided to the Reserve Bank together with the auditor's report.

Prepare financial statements

Insurers will be required to file financial information including financial condition reports and six-monthly financial statements to the Companies Registrar (as required by the Financial Reporting Act 1993) and the Reserve Bank. Interim financial statements will also need to be provided to the Reserve Bank and the Companies Registrar within five months after the insurer's accounting period ends. Interim reports will need to be prepared in accordance with generally accepted accounting practices (GAAP)**.**

Maintain a statutory fund if life insurer

Life insurers must maintain at least one statutory fund in respect of their life insurance policies. All amounts, assets and liabilities which relate to the business of the fund must be credited to that fund.

In some instances insurers providing composite life and non-life policies must also use a statutory fund. If less than 25% of the premiums from a 'line of policies' are being paid in respect of non-life insurance cover, the policy will be treated as if it was a life policy and the insurer will be required to establish a statutory fund. It will be the responsibility of the appointed actuary to determine the proportion of premiums which relate to either life or non-life insurance. A policy which only provides payment if the insured dies by accident or from a stated disease or condition will also not be considered a life policy if the duration of the policy is less than 1 year.

The Act looks to keep all financial activity relating to an insurer's life policies within the scope of the one fund. Premiums payable under the policies must be paid into the account as well as any other money received by the insurer which relates to the business of the fund (ie: investment income earned from the fund). The statutory fund can only be applied to meet liabilities incurred in operating the fund, or in making investments or distributions from the fund. The life insurer must also keep full records of the income and outgoings of each statutory fund.

Compliance timeline

Insurers must notify the Reserve Bank by 30 December 2010 if they intend to continue carrying on insurance business after 8 March 2012. By 8 March 2012 insurers will need to have applied for a provisional licence.

Insurers must then have been granted a full licence by 8 September 2013 (the date that is 3 years after the Act's date of assent).

Penalties for non-compliance

If an insurer fails to comply with the conditions of its licence (ie: fit and proper policy, solvency standards, risk management programme, statutory fund, failure to disclose a downgrade) it may be liable to a fine of up to $500,000.

If an insurer fails to comply with required financial reporting matters or fails to disclose its financial rating before entering into or renewing an insurance contract, it will be liable to a fine of up to $100,000.

Summary of the IPSA

Once fully in force the IPSA, when coupled with the FSP Act and FAA, will create significant changes to the insurance industry. The new regime provides an opportunity for actuaries to act as a check against negative industry behaviour. The imposition of a compulsory actuary for each licensed insurer means that actuaries will continue to play a pivotal role in the oversight of insurance industry standards.

PART THREE – OTHER LEGISLATIVE DEVELOPMENTS

Implications of the Financial Markets (Regulators & KiwiSaver) Bill

The Financial Markets Bill had its first reading on 23 September 2010 and is due to be reported back to Parliament on 28 February 2011. The Bill seeks to "restore investor confidence in New Zealand's financial markets" by creating a Financial Markets Authority to act as a "super regulator" of the financial market industry. The Bill also looks to make amendment to existing financial market legislation. In particular it seeks to reform the KiwiSaver Act 2006, by clarifying the structure and role of trustees in KiwiSaver schemes.

The proposed legislation will have specific implications for actuaries dealing with superannuation and KiwiSaver schemes, as well as broader implications for the insurance industry as a whole.

Financial Markets Authority (FMA)

The FMA will take over the current powers of the Securities Commission and the Government Actuary (the current regulator of superannuation and KiwiSaver schemes). The Authority will have the overarching responsibility of ensuring the effective operation of financial markets. More specifically it will be the primary regulator of financial markets and superannuation and KiwiSaver schemes.

The FMA will have the power to obtain search warrants and enter and seize evidence from companies suspected of breaches. The FMA will also have the power to undertake civil actions against financial market participants. This will allow the FMA to bring an action on behalf of an investor, where for example the investor is unwilling because of the risk and expense involved in litigation.

The Bill also proposes that an additional levy should be charged to financial market participants in order to cover the costs of the FMA in performing its functions, powers, and duties. This proposed levy has been met with some criticism from

market participants already facing large compliance costs under the FSP Act and FAA.

KiwiSaver Act 2006

The Bill looks to reshape the current KiwiSaver regime by adding specific trusteeship and oversight regulations. There will be different requirements for schemes with unrestricted membership and schemes with restricted membership. The provisions relating to KiwiSaver are expected to be enacted by mid-2011 to coincide with the Securities Trustees and Statutory Supervisors Bill.

KiwiSaver schemes with unrestricted membership will be required to have one Trustee and a Manager. The Trustee will be responsible for supervising the Manager's performance and performing the other duties and functions required under the Trust Deed. The Trustee must act in the best interests of scheme members and must also act with the due care, diligence and skill required under the Trustees Act.

A significant change to the current legislation is the requirement for a fund manager to be the public face and promoter of the scheme. The Manager will be responsible for:

- offering and issuing interests in the scheme;
- managing scheme investments and property; and
- administering the scheme.

The Manager must be a "company" under the Companies Act and a "reporting entity" under the Financial Reporting Act. Fund managers will now face greater liability towards investors. The Manager will have similar duties to the Trustee in that it must act in the best interests of scheme members and also act with due care, diligence and skill.

Restricted schemes on the other hand will not require a Manager, but will instead require an independent Trustee. Clauses 211 and 212 of the Bill establish which schemes are currently considered to be restricted. To remain restricted, a scheme must not change its conditions of entry, or the way the conditions are applied, so as to increase the classes of people able to join the scheme.

Summary

The FMA will have a wide ambit of control and will inevitably impose further compliance obligations and costs for those affected by the scheme. The implications of this Bill are likely to be widespread and actuaries should keep abreast of these changes as they develop, paying particular attention to what these changes will mean for them in their everyday work.

Implications of the Anti-Money Laundering and Countering Financing of Terrorism Regulations

On 10 August 2010 the Ministry of Justice released the consultation document on the Anti Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act). The consultation document contains proposals relating to regulations and codes of practice under the AML/CFT Act. The proposals are intended to provide some

certainty to those affected by the Act, especially as regards their compliance and due diligence obligations.

The AML/CFT Act looks to regulate 'financial institutions' with regard to customer due diligence (in particular, identity verification), record-keeping standards and the supervision of anti-money laundering and countering financing of terrorism activity.

Proposals

The consultation document appears to be a positive development for the insurance industry. The Ministry has accepted a number of the industries submissions recommending that pure risk insurance products (including pure risk life insurance policies) should be exempted from the scope of the Act. This will mean that insurers who do not offer life products with an investment component will not need to comply with the obligations of the Act. It will also mean that insurers who do offer investment products will be able to target their consumer due diligence (CDD) efforts on those policies that pose the highest risk.

The key issue for the industry in making submissions on the Consultation Document was defining the boundary between what is a "pure risk-based life insurance product" and what is an investment linked life insurance policy, so that the capture provisions of the Regulations are clear and do not capture pure risk insurers unintentionally. Submissions on this issue included taking into account things like products that allow for part repayment of premium after a certain period of time to reward customer loyalty. A critical part of the submissions from the industry was to seek consistency as between the AML/CFT Act, Financial Advisers Regulations and Securities Act review in the definitions to be used in this area, as the question of definition is currently being considered on all three fronts.

Another industry issue that has gained attention during the submissions phase is the proposed exemption from CDD requirements only for premium funding arrangements. Essentially, it appears that premium funders (including insurance companies) will need to comply, as premium funding arrangements are treated as lending arrangements, and so are captured by the Act. In practice these arrangements should pose very low level risk of money laundering and financing of terrorism. Furthermore, there is inconsistency in requiring insurance policies funded by premium funding arrangements to be subject to the obligations of the Act on the basis that there is the possibility of a refund of premium being given where pure risk products themselves are to be exempted.

Summary

Moving forward, the Ministry will now consider the submissions made on the Consultation Document and produce draft regulations for circulation and a further phase of consultation with stakeholders.

Implications of the Insurance Contracts Bill

The Insurance Contracts Bill was originally intended to be brought before Parliament in 2008, but has still not had its first reading. The Bill appears to have taken a backseat to other legislation currently moving through the legislative stages. The Ministry of Economic Development have confirmed that the Bill is still very much in

its infant drafting stages and due to other legislative priorities they are unable to confirm when exactly the Bill will be introduced. When introduced, it will look to consolidate all existing insurance related legislation.

Its specific focus will be towards insurance contracts, insurance intermediary agents, and the registration of assignments of life insurance policies. One significant area of change will be in relation to the insured's duty of disclosure.

Specific provisions

The Bill will put more of a responsibility on insurers to ask the right questions during underwriting, as opposed to requiring the insured to give the right answers without prompt. This will require insurers to ask specific questions in order to elicit material facts. It is intended to avoid situations where an insured innocently fails to make disclosure and is subsequently not covered under their purchased policy.

Another significant proposal is the requirement for insurers to take further responsibility for the actions of their agents. The Bill will require an insurer to formally declare their relationship with an agent in writing. As a default position it will be presumed that a broker is acting as an agent of the insurer.

Summary

Until the Bill is formally brought before Parliament, the exact compliance obligations for insurers and actuaries alike will not be known. However it does appear that the Bill will refocus much of the contractual responsibility back on insurers.

Implications of the Auditor Regulation and External Reporting Bill

The Auditor Regulation and External Reporting Bill was introduced to Parliament on 14 September 2010. It looks to replace the current self-regulatory regime of auditors with an independent centralised licensing regime, overseen by the FMA. This is intended to increase consumer confidence and promote "quality, expertise, and integrity" in the auditing profession.

The Bill specifically targets the auditing of issuers (as defined by the Financial Reporting Act), as issuers are deemed to pose the greatest risk to consumers. Consumers relying on the accuracy of the financial records of issuers stand to lose the greatest amount of money, should there be audit failure. The term issuer extends to insurance companies and other entities that hold assets in a fiduciary capacity. The Bill will affect any actuary who seeks to conduct an issuer audit.

Role of the Financial Markets Authority (FMA)

The yet to be finalised FMA is intended to oversee the new auditing regime. One of their primary responsibilities will be to monitor and report on the regulatory systems and processes of the New Zealand Institute of Chartered Accountants (NZICA). NZICA receive much attention throughout the Bill as they are the largest providers of auditing services and currently require no independent assessment as to whether they are sufficiently competent and independent to carry out an issuer audit.

The Bill also requires that auditors who conduct an issuer audit must be licensed. NZICA will be responsible for issuing licences to New Zealand auditors, but the FMA will be responsible for setting the minimum standards which auditors must meet to become licensed. They will similarly take over the role of reviewing licensed auditors by implementing ongoing compliance programmes to ensure a licensed auditor remains competent. The FMA will also have the responsibility of licensing foreign auditors, provided the overseas auditor complies with an equivalent foreign standard.

International equivalency

The Bill is intended to bring New Zealand in line with other foreign regulatory regimes, particularly those of Australia and Europe. Self-regulation is no longer accepted as a legitimate international standard of auditor assessment. The new regime will give New Zealand actuaries international recognition and allow them to be registered and work in countries where they were previously unable to.

Summary

The Bill seeks to impart confidence in consumers by ensuring they can rely on the accuracy of audited financial records. The regulation of auditors falls in line with the overarching legislative intent of the new financial regulation regime. Professionalism and transparency are seen as key goals to be achieved through increased professional standards and compulsory licensing.

PART FOUR - CONCLUSIONS

The compliance obligations created by the abovementioned legislation will inevitably impose further restrictions and costs on an industry which has traditionally been relatively under-regulated. Nevertheless, the new regulatory regime offers an opportunity for the insurance industry to further promote standards of professionalism and increase consumer confidence. Actuaries are well placed to help the insurance industry develop into a well regulated, professional and transparent industry.

Actuaries need to be aware of their changing role in the insurance industry. The imposition of a compulsory actuary for each licensed insurer means that actuaries will continue to play a pivotal role in the oversight of insurance industry standards. Coming to grips with their specific role in this new regulatory regime will be the biggest challenge for actuaries in the months and years to come.