



Reserve Bank of New Zealand

Via email: ipsareview@rbnz.govt.nz

18 March 2021

To whom it may concern

Re: Public Insurance (Prudential Supervision) Act 2010: Options Paper 1

Thank you for the opportunity to comment on your November 2020 consultation document relating to the scope of the legislation and overseas insurers.

The New Zealand Society of Actuaries (NZSA) is the professional body for actuaries practicing in New Zealand. Most of the Appointed Actuaries to New Zealand's licenced insurers are members. The Appointed Actuary regime was enacted through the Insurance (Prudential Supervision) Act 2010 and each licensed insurer must have an Appointed Actuary. This submission is on behalf of members of the NZSA.

In our submission we refer to the RBNZ consultation document with specific references to sections of that document made in italics.

Part 2: Scope of the Act

Part 2.1 Definition of a 'contract of insurance'

Paragraph 45: At present, the IPSA definition of insurance is drafted broadly and the Reserve Bank is given the power to extend the list of exclusions from the scope of the act by issuing regulations as it identifies activities that it does not regard as insurance. However, there is no provision for the Reserve Bank to explicitly deem in new activities that it might wish to capture.

From our perspective, the application of the current definition of "Insurance" has not led to any examples of insurance-like activity that are not included in the current IPSA definition. Hence we are comfortable with the *status quo* (**option 1.1**), but recognise that situations may arise in future, particularly with regards to increasing global access to insurance and other financial services, where a "deem in" power may be appropriate.

Part 2.2 Definition of 'carrying on business in New Zealand'

Paragraph 48: The definition of 'carrying on insurance business in New Zealand' sets out the core test for inclusion under IPSA's framework. We do not intend to revisit this test as it is working well. However, a sub-part of the test concerns what it means to be 'carrying on business in New Zealand'. This sub-part is particularly important because it determines



whether foreign businesses issuing insurance in New Zealand are required to be licensed (and therefore subject to the IPSA regulatory regime).

We recognise that this is quite a grey area, and it is not just confined to the Companies Act and the IPSA, it also applies to different criteria that apply under Income Tax legislation, and under Goods and Services Tax legislation, respectively.

New Zealand may well, as a matter of national Policy, wish to be seen as an attractive location to base a financial services organisation. It should not, however, be a form of "insurance haven" which enables companies basing themselves here, to avoid legislation in the countries in which they sell their products. Accordingly the RBNZ should have the power to include in the IPSA, any Company which is, by virtue of basing its operations in New Zealand, exempt from the insurance regulatory regime of the country or countries in which it sells its products. This would mean retaining the *status quo* (**option 2.1**) but adding an additional clause which would cover such organisations.

There are occasions however where it is not clear that the treatment of insurance provided from overseas meets the objectives of the Act, with insurance offered through a third party distributor(s) from unlicensed insurers based overseas. Possible solutions include:

- Consideration that insurance offered to New Zealand individual consumers require a greater level of oversight than insurance offered to commercial purchasers of insurance. That is, an insurer must be licensed in order to offer insurance to New Zealand consumer, with an exception for commercial insurance if the insurer is not carrying on business in New Zealand; or
- an insurer, not otherwise carrying on business in New Zealand, must be licenced under IPSA if they underwrite more than a minimum level of (gross) premium (possibly excluding commercial insurances again).

Requirement for contracts with New Zealand policyholders

Paragraph 59: At present, an insurance company based in New Zealand that only writes insurance contracts with overseas entities is not required to obtain a license under IPSA because the definition of 'carrying on business in New Zealand' includes having at least one New Zealand policyholder.

This is covered in our response to item 2 above, i.e. retaining the *status quo* (**option 3.1**).

There is reputational risk to New Zealand if an insurer is able to reside in New Zealand and write business offshore, either directly to customers or as inwards reinsurance, without being licenced under IPSA. The RBNZ should consider this risk.

Part 3: Overseas Branches, Regulatory Exemptions and Overseas Policy Preference Rules

The current regime: branches and exemptions: Overseas branches

Paragraph 66: In order to facilitate market entry and avoid unnecessary duplication in compliance requirements, IPSA currently allows overseas insurers to operate in New Zealand



through branches. Branch structures enable an overseas insurance entity to write insurance contracts in New Zealand as part of its overseas operations, without needing to create a legal entity (such as a company) or hold any assets based in New Zealand

We note that the *status quo* (**option 4.1**) provides a relatively easy avenue to conducting business in New Zealand for overseas-based insurers, and thereby offers New Zealand consumers additional choice and competition via a branch structure, without having to incur the significant additional costs of setting up and maintaining a local subsidiary. Some of our members however believe that a requirement for local incorporation (**option 4.2**), or the holding of local assets for branches, would be appropriate, to improve policyholder protection (**option 4.3**). This would also present a more level playing field for competing with companies already based in New Zealand that do have to meet the fixed costs of operating here.

Regarding the potential issues that arise with life insurance Statutory Funds and the preference of overseas with-profit policyholders, we note that this market (with-profit policies) has effectively been closed to new business for nearly 30 years. The RBNZ does have some powers to address any concerns when any applications for a Section 44 transfer relating to these insurers are received. As noted above however, we do see the merits of requiring branches to hold sufficient assets to cover their liabilities in New Zealand, which would give additional protection to policyholders.

Paragraph 48: If it is decided that the current regime gets the balance approximately right between encouraging insurance provision through branches on the one hand and protecting policyholders on the other, minor changes might be introduced to deal with some of the problems with the current regime.

Included in the list of possible "minor changes" is a suggestion that branches could provide more information regarding their home offices (accounts, solvency reports, financial condition reports). While there may be some merit in this in concept, we note that this is an extremely complex area, and it would require significant resources for a regulator to fully acquaint themselves and form a view as to the financial position of overseas-based entities.

Part 4. Inwards Reinsurance and Rules for Overseas Insurers:

Treatment of overseas reinsurers

Paragraph 117: New Zealand insurers obtain the vast majority of their reinsurance from overseas-owned entities. Different practices between life insurers and general insurers interact with the IPSA definition of 'carrying on insurance business in New Zealand' in ways that produce quite different results in terms of licensing.:

Overall we are comfortable with the *status quo* (**option 5.1**), with Life reinsurers mostly being licensed by the RBNZ, and with Fire & General reinsurers mostly not. Life reinsurance arrangements tend to be more long-term, cover one or more particular classes of business exclusively, and involve relatively few reinsurers for each life insurer. A Fire & General insurer could easily have twenty different offshore reinsurers making up its reinsurance panel, most of them signatures to a lead writer of a line of cover that they join in in



different proportions, most introduced via a reinsurance broker and with no direct relationship with the insurer.

In our view, the Fire & General industry has some very complex reinsurance requirements, that can often only be satisfied by specialist reinsurers based offshore. New Zealand is of a size where more local regulation of such reinsurance could mean less rather than more protection for New Zealand policyholders, because such reinsurers could consider it not worth the additional resources required to write business here.

We note also that the New Zealand Society of Actuaries' Standards for Financial Condition Reports require the Appointed Actuary to comment on the adequacy of a company's reinsurance arrangements. The Appointed Actuary may, in some instances involving more complex lines of reinsurance cover, be drawing on the expertise of an international reinsurance broker in expressing an opinion. This provides an important cross-check of the suitability of the company's reinsurers.

In our view, the treatment of reinsurance exposures in the Solvency Standards is appropriate, reflecting the same risk weightings as the asset risk charges.

Inwards reinsurance provided by New Zealand insurers

We would also note that the Options paper does not make reference to New Zealand-based insurers writing inwards reinsurance business and future modules do not appear to cover this matter.

This is an area where further discussion of regulatory options may be appropriate. For some insurers, inwards reinsurance is a straightforward activity that fits comfortably within their experience and control, e.g. a life insurer that reinsures the business of a New Zealand-based life insurance associate, or a fire & general insurer that reinsures some of the risks of operations in the Pacific Islands. For other insurers, such as CBL which reinsured an entity which conducted its business via Master Agencies (see Outsourcing Risk below) in Europe, this is a much more of a high-risk activity.

Alternative regulatory option proposed through licensing processes

The RBNZ could consider issuing insurance licenses for specific classes of business only, with inwards reinsurance being a specified class. Currently licenses are generally only issued with a wide "Life" or "Non-life" category.

Part 5: Group Supervision

Group Supervision

Paragraph 135: Group supervision is important because an insurance company's relationship with its broader group of companies (its holding company or subsidiaries) can alter the risks that an individual entity is exposed to, either because of individual entities' subordination to decisions taken higher in the group (for example a group-wide risk management policy), because weakness in one part of the group causes contagion effects, or because gaps between different jurisdictions' supervision enable group risk taking.



We recognise the potential contagion that can arise when one entity in a Group of companies gets into financial difficulties, which then adversely affects the insurance member of the Group. This could be by way of increased costs due to less sharing of costs, a dramatic drop in business due to brand damage, being cut off from distribution channels or from administration services, or other adverse outcomes.

However our view is that there would be significant complexity and expertise required for the assessment of group contagion risks. Similar to the constraints that exist relating to assessing the financial position of home offices of branches (referred to above), this would appear to be a requirement that would require a substantial allocation of additional regulatory resources.

We would note however that there may be some instances where a parent Company has no activities other than owning an insurance company or companies based in New Zealand. In situations such as this, we see significant merit in the RBNZ being able to consider the position of the Parent in placing any conditions on the insurance subsidiary. In the example mentioned in the consultation document, where the parent borrows funds to invest capital in the subsidiary insurer, this may well be a situation requiring greater scrutiny, and the possible imposition of additional licensing requirements on the subsidiary that recognised the loan repayment obligations of its parent.

Noting our comments above regarding non-operating holding companies, overall we are of the view that although imperfect, the *status quo* (**option 6.1**), should continue, with Appointed Actuaries being required to comment on any Group contagion risk in their Financial Condition Reports as they are at present, and for the RBNZ to use its judgement, as required, to respond to any issues that it becomes aware of via this source or other sources.

Part 6: Outsourcing

Outsourcing and operational risk

Paragraph 171: At present New Zealand insurance regulation has no specific rules about outsourcing though, implicitly, the insurance business remains liable for compliance with regulatory requirements regardless of whether it has outsourced business activities.

Paragraph 176: The issue of business continuity is less acute for insurers than for banks in that fewer insurance activities are time critical in the way that payments and settlement systems or basic banking services are.

We recognise the additional risks that a Company incurs into when it enters into any outsourcing arrangement, including the use of all Company data being held in data "clouds". Our members have differing views though as to whether these risks are materially different from the risks that Companies can be exposed to internally (e.g. with a major internal IT administration system replacement, loss of key staff, natural disaster disruptions, etc.).

An additional outsourcing risk not mentioned in the Options paper is that of insurers who write business through an underwriting agency (as with CBL). Such agencies are often given delegated authority for new business underwriting, and claim admission and claim management, which introduces a potentially significant element of risk into their operations.



Alternative regulatory option proposed to manage outsourcing and business continuity risks

The RBNZ could include outsourcing and business continuity risks as an item to be specifically considered in the Appointed Actuary's Financial Condition Report. This translates to being a diluted version of option 7.3, say an **option 7.3b**.

Thank you for the opportunity to comment on these issues. We would be very happy to answer any supplementary questions regarding this submission.

Kind regards

A handwritten signature in black ink, appearing to read 'Ross Simmonds', is written in a cursive style.

Ross Simmonds
President of the New Zealand Society of Actuaries