INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ INC

SUBMISSION

TO THE

RESERVE BANK

ON THE

DRAFT

INSURANCE (PRUDENTIAL SUPERVISION) BILL

22 June 2009

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INVESTMENT SAVINGS AND INSURANCE ASSOCIATION OF N.Z. INC.

1.0 Introduction

1.1 The Investment Savings and Insurance Association ("ISI") is the industry association representing the companies which issue or manage life insurance, superannuation and managed funds.

1.2 ISI members are also the leading providers of KiwiSaver funds and all six default providers are members of ISI.

1.3 As there are 15 ISI members that offer life insurance products, as well as 5 reinsurance companies, ISI is well-placed to provide views on the consultation draft of the Insurance (Prudential Supervision) Bill (“the Bill”).

1.4 A list of ISI members is given at the end of this submission.

1.5 ISI generally supports the draft Bill and commends the Reserve Bank of New Zealand (“RBNZ”) for the work that has been done. We note that the drafting is consistent with the Cabinet papers in December 2007 and August 2008 and the consultation paper on which we commented in June 2008.

2.0 Key Recommendations

2.1 The key recommendations of this submission are:

- RBNZ should endeavour to maintain trans-Tasman consistency in the regulation of life insurers
- RBNZ should be given a wider exemption power in respect of branches of foreign insurers, to apply where it is satisfied that home regulation is at least as robust as in NZ
- Insurers that are part of a group structure should be able to meet certain obligations on a group basis, such as the fit and proper person policy and the risk management programme
- The 5% threshold for composite policies should be increased to 10% and applied to all non-life business of a life insurer
- The 5% limit in relation to investment performance guarantees attached to investment linked policies within a statutory fund should be reconsidered
- The requirement for RBNZ approval before changes are made to fit and proper person policies and risk management programmes should be reconsidered
- A comprehensive regime for the RBNZ to consider transfers and amalgamations should replace the current process under the Companies Act
- Any solvency standard should be consistent with the solvency provisions in NZ IFRS 4 Appendices C and D

- There should be no requirement to disclose the date of a rating
- The date for filing financial statements should be the same as required under the Financial Reporting Act 1993
- Actuarial reporting requirements should be reconsidered, including use of the word ‘audit’ and the onus on the actuary to notify RBNZ of an insurer’s potential financial difficulties
- Further definitions should be added including a definition of life insurance.

2.2 The ISI membership comprises both foreign and New Zealand insurers. Individual submissions will be made with respect to specific policy issues as they relate to:

- exemptions for foreign insurers (section 4.2)
- conditions of licence (section 4.4 re clause 21 (2)(b))
- specific questions (section 5)

3.0 General Comments

3.1 ISI supports the introduction of a robust prudential supervision regime, with the proviso that it should be appropriate for the size and shape of the industry in New Zealand.

3.2 Our main concerns arise where the draft legislation will lead to an increase in compliance costs for insurance companies (which must be passed on at least partly to policyholders) without a corresponding increase in policyholder protection.

3.3 The Bill establishes a framework addressing a number of matters in principle, the details of which will be covered by regulations under draft sections 64, 99 and 217 and also by the RBNZ exercising its judgement, particularly in respect of allowing overseas insurers to operate in New Zealand. The successful implementation of the new regime will depend to a great extent on the content of the regulations and we strongly recommend that the industry be given the opportunity to comment on an early draft.

3.4 As well as matters specified to be included in the regulations, clause 217(1)(u) of the draft Bill allows for regulations to be made on any other matters necessary for the implementation and/or administration of the Act. That may include matters such as:

- Content of the Financial Condition Report
- RBNZ requirements for certifying compliance with the solvency margin
- RBNZ requirements for auditing of a risk management programme

We request the opportunity for input into all draft regulations.

3.5 In addition, we recommend that the RBNZ should be required to publish its policies, principles and procedures with respect to the way it will exercise its licensing and supervisory powers.

3.6 The responsibilities and resulting workload imposed on the RBNZ by this new prudential supervision regime should not be underestimated. In order to properly fulfil these responsibilities it is likely that a significant amount of additional human resource will be needed both for the implementation stage of the regime and for the ongoing oversight of the industry.

It will be important that RBNZ is able to appoint the appropriate staff, both in number and skill set, to provide meaningful oversight of the industry. For some positions, eg, insurance actuaries, the RBNZ may well be competing for the same limited pool of experienced senior actuaries that the insurance companies will require to fulfil their needs for actuarial skills in order to meet the demands imposed by the new regime.

Once the Act and regulations become law, the RBNZ must be able to process the licensing applications and any merging / amalgamation of insurance portfolios that may result, without any undue delays.

This may well be a good reason for phasing in components of the prudential supervision regime.

4.0 Detailed Comments

4.1 Branches of Foreign Insurers

We recognise that the RBNZ has considerable discretion in the granting of licences, their conditions, and exemptions. For branches of foreign (mainly Australian) insurers it is essential to understand the intention of the RBNZ in terms of the extent of their expected ability (as overseas insurers) to meet the New Zealand obligations through compliance with their home legislation and regulatory requirements.

In the spirit of trans-Tasman mutual recognition principles and in order to ensure the objectives of the new regime are efficiently met, we expect there will be a close working relationship between the RBNZ and the Australian Prudential Regulation Authority (“APRA”) on matters such as setting guidelines, information sharing and reporting in relation to overseas insurers. This would avoid unnecessary cost and duplication of requirements and reporting, and would help mitigate the risk of any inconsistencies between regulatory regimes.

We would appreciate clarification of how any conflict between New Zealand requirements and requirements in a home jurisdiction will be dealt with and the role of the regulators in this. One particular area of potential conflict is the requirement for foreign insurers who cannot fall within the clause 119 exemption to establish statutory funds under the New Zealand legislation.

4.2 Exemptions for Overseas Insurers

The Bill requires the RBNZ to be satisfied with the law and regulatory requirements, and the nature and extent of prudential supervision, in an overseas insurer's home jurisdiction in relation to:

- granting a licence to an overseas insurer (clause 18(1)(i));
- providing an exemption from compliance with a solvency standard (clause 61); and
- providing an exemption from compliance with statutory fund requirements (clause 119).

It is not clear what process the RBNZ will undertake to be satisfied of the home jurisdiction requirements in granting licenses and providing exemptions. For example, will the RBNZ 'automatically' provide exemptions from solvency standard and statutory fund requirements for certain home jurisdictions? Alternatively, will the overseas insurer be required to provide evidence of both the requirements of the home jurisdiction and compliance with such requirements?

The exemption power provided by the Bill is more limited than the one in the Securities Act, and allows for exemptions for foreign insurance providers only in certain limited circumstances. The Bill also removes the potential for exemptions from the Financial Reporting Act that recognise different international financial reporting approaches. The practicality of a broad exemption power (with the ability to exempt any person from any aspect of the Bill) and the flexibility to allow financial statements prepared in other jurisdictions is already demonstrated (and recognised) in the Securities Act context. We believe the considerations are not significantly different here and recommend that a similar approach should be taken.

We recommend consideration being given to the Bill being amended to give the RBNZ a broad exemption power, so (amongst other things) the RBNZ can develop exemptions that recognise the prudential supervision provided in other jurisdictions. We would also encourage the RBNZ to seek memoranda of understandings with foreign prudential regulators with a view to co-operating with them in regulating in a coordinated way insurance companies which operate on a global basis.

We also suggest that the Bill allow for "mutual recognition" of insurance prudential supervision in other jurisdictions, including Australia, and that the RBNZ actively pursue mutual recognition of Australasian insurance companies.

4.3 Wider Exemption Power Necessary

The November 2007 Cabinet Paper proposed a general exemption power which has not been included in the Bill. Paragraph 43 of the Paper states:

> "*To cater for the unintended consequence that some institutions or products are captured by the legal definition of insurance, but which are clearly not intended to be within the scope of the prudential regime, I am proposing that the RBNZ will have a general power to exempt institutions, products and other activities, from licensing and prudential requirements, who are captured by these definitions, but are not in substance providers of insurance to New Zealand policyholders*"

We strongly believe that an exemption power is necessary and appropriate for the reasons recognised in the Cabinet Paper. Even if a definition of "insurance" is included in the legislation, we believe that some areas of uncertainty are inevitable. For example, it is currently unclear whether certain superannuation schemes that provide death benefits are providing life insurance.

This uncertainty is capable of creating considerable difficulty and disruption for affected entities. We believe that the best way of dealing with this uncertainty is to provide the RBNZ with a general exemption power for exempting entities and contracts that are not insurers or insurance. Such a power will enable specific issues to be considered on their merits and will "future proof" the legislation so that it is able to accommodate changes and innovation in the business environment.

4.4 Conditions of Licence

ISI acknowledges the considerable work that has gone into the licensing requirements and, in particular, into addressing the issue of appropriate licensing of overseas insurers in New Zealand. We would, however, appreciate more clarity around the expected process of insurers obtaining a licence and the granting of exemptions. For example, the extent of any application process for the granting of transitional licences to insurers and the expected time frame for insurers to be required to meet all components of clause 18 of the Bill.

Clause 18(1)(h) requires the RBNZ to be satisfied that an applicant's governance structure is appropriate. We are interested in what the requirements of this will be in relation to overseas insurers.

Clause 21(2)(b)

Clause 21(2)(b) permits the RBNZ to impose conditions on licensed insurers that require a specified amount or proportion of the licensed insurer's insurance business to relate to New Zealand policyholders. We understand that the intention behind this provision is to stop insurers coming to New Zealand solely for "regulatory forum shopping" reasons. We question whether the Bill should be regarded as being a "soft" option giving rise to such concerns. The clause does not contain any guidelines on appropriate thresholds to be imposed and accordingly we submit that the clause confers too great a discretionary power on the RBNZ.

4.5 Application of licensing requirements to group structures

Clause 13 of the Bill requires every person who carries on insurance business in New Zealand to hold a licence and clause 15 provides for such a person to apply to the RBNZ for a licence. Clauses 16 and 17 require each applicant to prepare a fit and proper policy and risk management programme. Clause 18 specifies the matters relating to an applicant that must be met to the satisfaction of the RBNZ for a licence to be issued, including compliance with clauses 16 and 17.

Where an applicant is a member of a group, the requirement for an individual applicant to prepare a fit and proper policy and risk management programme may create duplication and increase compliance costs. This is particularly the case where the group includes other persons who also carry on insurance business in New Zealand. In practice, an entity that is a member of a group is typically subject to group policies established and maintained by its parent entity, which include both obligations applying to all members of the group and obligations applying only to a particular member of the group due to the nature and location of the business carried on by that member.

ISI submits that clauses 16, 17 and 18 should be amended to reflect that the fit and proper policy and risk management programme submitted by an applicant may be the policy and programme established by its parent entity, and applying to it as a member of the group carrying on insurance business in New Zealand. This will enable ISI members to update existing group policies that apply to all entities in a group to specify the particular matters that apply to any members of the group carrying on insurance business in New Zealand, rather than creating a separate fit and proper policy and risk management programme for each such member.

4.6 Non-alteration of fit and proper policy without RBNZ approval

Fit and proper policies for foreign insurance groups typically span regions. These policies are often approved at board level and are reviewed on an annual basis (or more regularly in response to specific issues that arise) and therefore many branches of foreign insurers will find it difficult in practice to obtain RBNZ approval to any changes to the policy before amendment. There is no requirement for prior approval in Australia where the prudential standard only requires insurers to provide a copy of the policy on request. In practice, insurers in Australia keep APRA informed of any substantial amendments to their policies and will encourage feedback on an informal basis.

We recommend that as a more appropriate approach for New Zealand and that RBNZ approval should not be required to amend the fit and proper policy.

Should approval by the RBNZ be required, we would strongly advocate for insurers to be able to notify changes of policy to the RBNZ after the changes have been made, with the RBNZ being able to issue directives where a policy is seen to fall short of requirements, together with a reasonable time frame in which insurers must rectify the policy. We note further that the draft Bill does not include any test of materiality in respect of these amendments, and therefore insurers would be faced with obtaining RBNZ approval for any minor amendments to their policies.

4.7 Statutory Funds

Composite Policies

Clauses 81 and 118 of the Bill require the statutory fund to include only those funds that relate solely to the life insurance business of the licensed insurer unless the life insurance policy is part of a composite policy. However, there is a restriction that the value of the liabilities for the non-life portion cannot exceed 5% of the value of the assets of the fund. This restriction may be an impractical one under MoS accounting where negative liabilities are common for risk policies. In any case, we do not see the need to disallow these covers in a statutory fund except in the case where there may be a need to protect the rights of unit linked policy holders.

The threshold in Clause 118 relates only to composite policies. We recommend that it should apply to any non-life business, composite or not, particularly considering the business profile of companies in business when the Act first comes into force. We also recommend an increase in the threshold to 10% of the value of the assets of the fund.

The initial move to statutory funds is likely to impose additional costs on life insurers with the required separation of assets and the additional accounting and management burdens this will involve. Restrictions on non-life elements and investment linked guarantees may create a need for extra statutory funds and further increase this burden and associated cost.

We note that the RBNZ is the Regulator for both life insurance and general (non-life) insurance with wide ranging powers. Therefore, there is no reason why the inclusion of any level of non-life insurance into a statutory fund should cause any issues. Any perceived weakening of the policyholders’ security that might arise would be best addressed by the requirements of the solvency standard rather than by arbitrary exclusion.

Clause 84(2)

If there is a conflict of interests between policy owners and shareholders or members of a life insurer, priority must be given to the policy owners (clause 84(2)). We agree that policy owners’ interests must be protected; however, we recommend that it would be more appropriate for the directors' duty to be to ensure that shareholders' interests are not advanced to the detriment of the interests of policyholders.

Investment Guarantee

Clause 94(2) proposes a limit of 5% in relation to the investment performance guarantee attached to investment linked policies within a statutory fund. It is not clear how this test is to be applied.

This appears to duplicate a similar test in the Australian regime. The Australian regime requires a separate statutory fund for investment-linked business in order to ensure that the assets supporting investment linked contracts cannot be called upon to meet any liabilities in respect of non-investment linked policies. A 5% limitation is placed on the cost of guarantees in relation to the total liabilities of the investment linked statutory fund.

The purpose of this restriction is not to limit such guarantees, but to ensure substantial guarantees are not provided ***from an investment linked statutory fund***.[1]

It is not clear from Clause 94(1)(a) that investment linked policies may not be provided from within the main statutory fund, in which case applying this rule could restrict the provision of guarantees from the mandatory life insurance statutory fund and stop such guarantees being supported by standard life insurance policies. This seems to have misunderstood the purpose of this clause as used within Australian regulations. A clearer outcome would be to specifically require a separate statutory fund for investment linked policies and then apply this clause to that fund alone. In this respect we note that there are no criteria under clause 81 to guide the insurer in establishing more than one statutory fund.

However, we can see no reason why guaranteed savings type products cannot be provided from the main statutory fund.

Also, clause 94(2) requires this 5% threshold to be complied with at all times. With the possibility of extreme market movements and the requirements imposed on moving business between statutory funds, this could make absolute compliance difficult unless no guaranteed business is provided at all. There needs to be a specific provision in the Bill for life insurers to be able to notify the RBNZ of any breach of the threshold and to come to an agreement with the RBNZ on how that breach will be addressed or rectified.

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1. [1] see *Life Insurance Act 1995, Circular to Life Insurance Companies, Administration No.B4 – Administration of Section 42 of the Life Insurance Act 1995, June 2007*
"It is not the purpose of section 42 to limit the ability of the company to offer products which provide more substantial guarantees. Rather it is to ensure that those guarantees, if offered, are not provided from an investment-linked fund. The guarantee benefit may be provided by another (generally a non investment-linked) statutory fund; this reinforces other requirements which impose on the industry the discipline of separately identifying and costing the guarantee component and disclosing this information to the policy owner and prospective policy owner."

4.8 Related Party Exemptions

Clause 95 restricts related party transactions other than investing in registered RBNZ deposits. We recommend that clause 95(5) and 96 should also allow for investing in bank-like investment products, such as cash and term PIEs, which are offered by related parties.

4.9 Risk management programme

Clause 71(2)(d)(ii) and clause 71(4) prohibit alteration of an insurer's risk management policy without RBNZ approval.

Comments in paragraph 4.6 in relation to the practical difficulties in obtaining RBNZ approval for amendments to our fit and proper policy apply equally in respect of risk management policy. We note also there is no test of materiality in respect of amendments to the risk management policy.

The requirement to obtain RBNZ approval seems out of step with the equivalent Australian Prudential standard LPS 220 which sets out the requirements for the Risk Management Programme but leaves the operation and on-going management and monitoring of the programme to the insurer.

There are no guidelines on the grounds for the RBNZ to decline approval of a policy or amendment to a policy and therefore the onus will be on the RBNZ to have suitably qualified risk management professionals to monitor and evaluate risk management programmes. We would support the onus being on the insurer rather than the regulator to have appropriate risk management expertise to meet these requirements.

We note that the Australian standard includes requirements to notify APRA in the event of any material breach of, or deviation from, the risk management framework, or where it is discovered that the framework did not adequately address a material risk. We would support similar provisions in the New Zealand legislation.

4.10 Transfers and amalgamations

Clause 29 of the Bill refers to insurance policies being treated as if they had been novated when such policies are transferred. Novations can occur on different terms and it is unclear which are imposed under this clause.

Often novations have the acquirer assuming liability from the date of novation. Section 11 of the Contractual Remedies Act however prescribes that the acquirer assumes all the transferor's obligations, including those predating the date of assignment. It would be helpful if clause 29 could clarify whether acquiring insurers can assume the insurance obligation from the date of the transaction (and expressly override section 11 of the Contracts Remedies Act) if that is the intention.

Subpart 1 of Part 2 includes provisions relating to the RBNZ's approval of transfers and amalgamations and clause 48 currently provides that the preceding clauses do not limit the application of other enactments that must be complied with. Consequently, the RBNZ approval of transfers and amalgamations is in addition to, rather than instead of, other legal requirements such as the Companies Act.

The current complex process for the approval of arrangements, amalgamations and compromises contained in sections 235 to 237 of the Companies Act 1993 requires an application to be made by the company, or any shareholder or creditor of the company, to the High Court. The Court can then make an order that an arrangement, amalgamation or compromise will be binding on the company and on such other persons as the Court may specify. Before making such an order, the Court has discretion to make various orders under section 236(2) such as directing that a meeting of the company's shareholders and/or creditors be held to consider the proposed arrangement, amalgamation or compromise.

When considering whether or not to sanction an arrangement, amalgamation or compromise, the Court's role is to ensure a number of requirements have been met: that there has been compliance with statutory provisions; that the scheme has been fairly put before the class or classes concerned; that the class is fairly represented by those who attended, and that the majority are acting bona fide; and that the scheme is such that an intelligent and honest business person, a member of the class concerned in acting in respect of that interest, might reasonably approve.[2]

ISI supports the requirement for the RBNZ to approve transfers and amalgamations, and supports the retention of access to procedures (such as the amalgamation regime of Part 13 of the Companies Act in respect of New Zealand companies). However, we also strongly support the introduction into the Bill, for both transitional and ongoing use, of a standalone regime enabling a licensed insurer to rearrange its business in New Zealand with the approval of the RBNZ alone.

Clause 44 of the Bill gives the RBNZ the ability to take into account a potentially broad range of matters in approving transfers and amalgamations and, accordingly, we recommend that the provisions for the RBNZ to consider transfers and amalgamations replace the current process under the Companies Act.

We also recommend that clauses 40 to 49 of the Bill should only apply to an overseas insurer in respect of the life insurance business it carries on in New Zealand.

[2] Re Tower Limited (2007) 10 NZCLC 264, 240

We support the need for an efficient process for the transfer of policies and note that the Bill will likely include transitional provisions that address statutory schemes to enable transfer of insurance policies without requirements for novation or Court approval. We are interested in what these provisions will be and question whether they should have ongoing application rather than being transitional only in nature.

It would also be helpful for the Bill to include transitional provisions enabling transfer of business between members of the same group. Where a group includes more than one entity carrying on insurance business in New Zealand, the group may wish to undertake a restructure during the transition period to consolidate the insurance business into a smaller number of entities.

4.11 Solvency Standards

Clause 54(2)(a) of the Bill makes allowance for a solvency standard approved under the Act to include matters relating to "the preparation of financial statements, group financial statements, or other financial information under, or in accordance with, the Financial Reporting Act 1993 (with the effect that the standard must be complied with as an approved financial reporting standard under that Act)".

Further, Clause 54(3) states that if there is an inconsistency between a solvency standard and a financial reporting standard, the solvency standard prevails.

NZ IFRS 4 issued by the Financial Reporting Standards Board, is the financial reporting standard applicable to insurance contracts in New Zealand. It specifies in the appendices, the disclosures in the financial statements that need to be made with regard to solvency.

NZ IFRS 4 Appendix C 17.8 is applicable to life insurers and states that a "life insurer shall disclose the amount of equity retained as solvency reserves and the basis of establishing the amount. A group shall disclose the solvency position of each life insurer in the group".

NZ IFRS 4 Appendix D 17.8E is applicable to other than life insurers and states that the "amount of equity retained for the purpose of financial soundness and the basis of establishing that amount must be disclosed. A group must make this disclosure for each insurer in the group".

The International Accounting Standards Board (IASB) is currently working on a project that will result in a global standard for the accounting for insurance contracts, the aim of which is to allow comparability between entities in different jurisdictions around the world.

With this aim in mind, we do not believe that the RBNZ should be making any particular standards with regard to the financial reporting of profit of an insurance company, except as allowed for under the Financial Reporting Act 1993, unless there is no conflict with the requirements of IFRS.

With regard to the Bill being proposed, the solvency standard should only have relevance to the two clauses of NZ IFRS 4 outlined above. It would be appropriate for the solvency standards to stipulate what should be disclosed as the solvency calculation for financial reporting purposes.

Clause 54(2)(a) and 54(3) should therefore be clarified so that it is clear that they apply only in respect of solvency.

Clauses 53 and 54 stipulate what can be prescribed in a solvency standard. There is a danger that in doing so, the Act might not enable all the things that may be required in a solvency standard, for example, the duties/requirements of the actuary. We recommend that clause 54 be amended to make it clear that it sets out the core content that might be included in a solvency standard, but that other items specified in an approved solvency standard have equal validity.

4.12 Ratings

We recommend the removal of the requirement to disclose the date on which a rating was given.

The draft Bill requires licensed insurers to disclose not only the insurer's current credit rating, but also *'the date on which it was given'* (clause 65 (1) (a)).

The definition of '*current credit rating'* requires it to be no more than 12 months' old. The rating must be disclosed to the insured in writing and is often achieved through printed documents such as proposal forms. As the date of the rating must change every 12 months, insurers' documentation must be changed every 12 months also, even although the rating itself may remain the same for years. That is costly to insurers and very little is added to consumer protection by disclosing how far through a particular 12 month cycle the rating is.

The cost of providing this limited added protection must be weighed against the significant cost (both monetary and environmental) of the paper wastage it creates and we consider that it is sufficient for consumers to know that the rating cannot be more than 12 months old.

4.13 Financial statements

For an overseas insurer, the financial statements in respect of clause 80 would be for the entity which is the overseas insurer or statutory fund. That would be consistent with the New Zealand liabilities being part of the overall liabilities of the overseas insurer. In that case there needs to be an exemption to allow an overseas insurer to provide its overseas financial statements within the terms of the home country reporting requirements and timetable where the home country financial reporting standards are acceptable to the RBNZ. To have to provide additional financial statements to satisfy what may be minor variations from New Zealand financial reporting standards, would be inefficient and a substantial cost.

Reporting to RBNZ – Timing

Under Clause 80, the financial statements, auditor's report and insurer's actuary's report must all be provided within three months after the end of the accounting period. At present insurers have nine months to file financial statements under the Insurance Companies Deposit Act 1953 and the Life Insurance Act 1908, and 5 months and 20 days to file financial statements due under Section 18 of the Financial Reporting Act 1993.

Clause 78 (2) specifies that the Financial Condition Report (FCR) is due on or before the date that financial statements are due under Section 18 of the Financial Reporting Act 1993

While we understand that a 3 month timetable would be consistent with the Reserve Bank Act, we recommend that the timeframes for the filing of financial statements should be as required by Section 18 of the Financial Reporting Act 1993.

Reporting to RBNZ – Requirements

Clause 75 of the Bill requires that actuarial information, or information that is derived from or based upon actuarial information, be audited by the insurer's actuary.

There is, however, no definition of actuarial information in the draft Bill and it is unclear what exactly would constitute actuarial information, particularly when there is no requirement at present for any information in the financial statements to be calculated by an actuary. We recommend that the term actuarial information be clearly defined.

We believe that the word "audit" has been used in this clause inadvertently. The word "audit" has many connotations, for example independence, that would not be able to be met by an employee of the entity. We recommend the term "audit" be avoided in relation to this section. Terms such as "review", "certify" or "calculate" as appropriate would be more suitable.

Clauses 127 and 128 set out a requirement for the auditor or the insurer's actuary to disclose information to the RBNZ if they believe the insurer (or an associated person) is insolvent or is likely to become insolvent or is in serious financial difficulties.

While there is a requirement under Clause 57(1) for the insurer to remain solvent at all times, in reality, unless there is reason to believe that there has been a change in circumstance that would impact the solvency of the insurer, the actual solvency position of the insurer will only be formally calculated twice a year.

The insurer's actuary under clause 79 has access to information, but in general would only seek such information when there is a specific need or requirement. It would be impossible for the actuary to continually check for information he/she might otherwise not have been made aware of.

The Bill does not provide the auditor with any additional access to information than at present. The auditor and insurer's actuary might therefore not be aware of changed circumstances within the insurer that would potentially impact solvency.

We recommend that clause 127 and 128 should be amended to put the onus on the insurer to notify the auditor and actuary of any change in circumstances that might have a detrimental impact on solvency. Furthermore, the onus should be on the insurer to notify the RBNZ if the company becomes or is likely to become insolvent.

4.14 Insurance concepts and definitions

Definition of insurance

There is no definition of 'insurance' in the Bill. We appreciate that there are significant complexities in both drafting and applying an exhaustive definition of 'insurance'. However, in our view the RBNZ has an opportunity to clarify the New Zealand law and we would support a definition of 'insurance' being included.

We believe that it is essential to have some guidance on what is 'insurance' in order to ascertain whether a product (and product provider) comes within the ambit of legislation. Further, there are provisions within the Bill that refer to business that is 'not insurance' (for example clauses 19(2)(e) and 54(1)(b)) and it is difficult to assess what this is when there is no positive definition of 'insurance'.

We recommend that the draft Bill should include a definition of '*contract of insurance*'. Our recommendation is:

Contract of insurance means a contract between an **insurer** and a **policyholder** whereby the risk of an uncertain future event, from the **policyholder's** point of view, is transferred to the **insurer**, requiring the **insurer** to compensate the **policyholder** if that event occurs and adversely affects the **policyholder**.

The definition may require certain financial risks to be to be expressly excluded from it, for the avoidance of doubt.

Compliance with the draft Bill is required if a person '*carries on insurance business in New Zealand*' (clause 13 (1)). That is partly determined by whether the person is an '*insurer*' that enters into a '*contract of insurance*' (clause 8 (1)).

Whether or not a particular financial product is a *'contract of insurance*' could be central to whether an organisation is subject to the regulation of the draft Bill or not.

One of the principles to be taken into account under the draft Bill is 't*he desirability of consistency in the treatment of similar institutions'* (clause 4 (g)). In order to ensure that all institutions that issue a product that is, in substance, insurance are governed by the draft Bill and are treated consistently a clear and unambiguous definition of insurance is needed in the draft Bill.

Insurance companies must currently comply with International Financial Reporting Standard 4 which defines insurance contract as follows (with the related definitions added):

Insurance contract: A contract under which one party (the **insurer**) accepts significant **insurance risk** from another party (the **policyholder**) by agreeing to compensate the policyholder if a specified uncertain future event (the **insured event**) adversely affects the policyholder.

Financial risk: The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

Insurance risk: Risk, other than **financial risk**, transferred from the holder of a contract to the issuer.

Insurer: The party that has an obligation under an **insurance contract** to compensate a **policyholder** if an **insured event** occurs.

Insured event: An uncertain future event that is covered by an **insurance contract** and creates **insurance risk.**

Policyholder: A party that has a right to compensation under an **insurance contract** if an insured event occurs.

Laws of New Zealand defines insurance as follows:
Uncertainty as to the happening of a specified event Every insurance policy, whatever its nature, envisages that a sum of money will be paid by the insurer if a specified event happens. There must be uncertainty as to the happening of the event, either as to whether it will happen or not, or, if it is bound to happen (for example, the death of a human being), as to when it will happen.[1]

The High Court in New Zealand[3] had to consider what amounted to insurance in *Motor Cycle Specialists Limited v The Attorney-General* (1988) 5 ANZ Insurance Cases 75,611. Drawing on English common-law precedents, the High Court applied a test of three essential elements:

- The insured must be contractually entitled to receive money or money's worth upon the happening of some event, and
- The event must involve some element of uncertainty from the insured's point of view, and
- The insured must have some interest in the subject matter of the insurance so as to be prejudiced by a loss happening to it.

These three elements are present in the IFRS 4 definition and we recommend a definition similar to it using the defined words in the draft Bill.

We suggest that the definition of ‘insurance’ include the facility for specific products to be included or excluded by regulations. That would mean that the definition of ‘insurance’ would not need to be amended to accommodate new insurance products that may be introduced in the future.

Definition of life insurance

ISI has previously submitted that a definition of life insurance is desirable. The definition should include all forms of continuous disability insurance that are commonly associated with life insurance such as trauma, Total and Permanent Disablement insurance (TPD) and income protection. Common New Zealand industry practice is for products such as these to be provided in conjunction with traditional life insurance.

We note that some of the concepts for the definition of life insurance are based on the equivalent Australian legislation and in general we agree with this approach. It is sensible to borrow these concepts where possible. However, we also note that the definition of life insurance in the draft Bill, although incorporating parts of the Australian definition, does not include it all which creates some uncertainty.

In general, we recommend that the definitions more closely reflect the definitions and Explanatory Concepts in the Australian Life Insurance Act 1995. This will also have benefit when considering the operation of the statutory funds.

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[3] For English law see 25 *Halsbury’s Laws of England* (4th ed, 2003 Reissue) para 2.
For Australian law see 15 *Halsbury’s Laws of Australia* [235-1] - [235-55].
1 *Prudential Insurance Co v IRC* [1904] 2 KB 658 at 663, *Department of Trade and Industry v St Christopher Motorists Association Ltd* [1974] 1 WLR 99 at 105; [1974] 1 All ER 395 at 400.

Other Definitions

Accounting Period: We recommend that a definition of "accounting period" should be included in the Bill and that it should be consistent with the definition in the Financial Reporting Act 1993.

Audited: In various parts of the Act the word "audited" is used in relation to an actuarial audit. We suggest that another word is chosen, as "audited" has a specific technical meaning applicable only in the context of financial statements.

Priority: We request that references to "priority" in clauses 84(1), 84(2), 100(1) and 100(2) be clarified and that clause 90(3) be abolished, so that the statutory fund can borrow on security to support its life insurance investments.

"Meaning of carrying on insurance business in New Zealand": The definition in clause 8 is relevant to the assessment of:

- Who may apply to be a licensed insurer; and
- Who is acting unlawfully if not a licensed insurer.

Clause 1 (b) is appropriate in that it links to a contract of insurance (via the definition of "insurer" and therefore excludes persons who enter into arrangements that have certain characteristics of, but are not in fact, contracts of insurance (e.g. a manufacturer under a product warranty). However clause 1 (c) will catch, for example, a foreign insurer that satisfies clause 1 (b) but whose only connection to New Zealand is liability under a contract of insurance that has been assigned to a New Zealand resident or was issued to a person who subsequently moves to New Zealand. Further, because clause 1 (c) currently is conjunctive, the definition will not catch an insurer that is incorporated or established in New Zealand but is liable only under contracts entered into outside New Zealand with non residents. We submit that there are strong policy reasons to ensure that such insurers are appropriately regulated in order to protect New Zealand's international reputation. These issues can be addressed by reworking the definition as follows:

"For the purposes of this Act a person carries on insurance business in New Zealand if:

(a) the person:

(i) is – [current (a)(i) to (iii)] ; and

(ii) acts, or has at any material time acted, as an insurer in New Zealand or elsewhere; or

(b) the person is liable as an insurer under a contract of insurance entered into with a person in New Zealand."

There is a related issue concerning the status of a New Zealand agent for a foreign insurer. A foreign insurer that has no place of business or assets in New Zealand nevertheless would be carrying on insurance business in New Zealand if it entered into contracts of insurance with persons in New Zealand through a New Zealand agent. In practice, however, the New Zealand prudential regime will be unenforceable against that insurer. Accordingly, to close the loophole, the Bill should make it an offence for any person to act in New Zealand as an agent of a person that carries on insurance business in New Zealand and is not a licensed insurer.

4.15 Breaches and Penalties

As a general comment, we note that in many instances breaches of the legislation are an offence resulting in a liability to pay a fine. The draft Bill does not contain provisions for warnings, notices, orders or directives to be given to licensed insurers who may be in breach of a requirement, nor does it provide for opportunities to rectify any breaches. In our view, it would be appropriate for this to be addressed in the Bill or in regulations.

We would also like clarification of the implications for the validity of an insurer's license if there are breaches of the legislation, for example, whether there is the ability for the RBNZ to issue directives, or revoke or suspend licences.

5.0 RBNZ Specific Questions

Restriction on content of constitutions of licensed insurers who are companies incorporated under the Companies Act 1993

The RBNZ has asked for views on whether it is necessary or appropriate to include a provision that the constitution of an insurer, where it is a subsidiary company, must not include a provision permitting directors to act otherwise than in the best interests of the insurer.

ISI does not consider that such a provision is necessary or appropriate. The draft Bill and accompanying regulations will prescribe the prudential requirements applying to an insurer. These requirements will constitute legal obligations of the insurer. The directors of an insurer cannot direct the insurer to breach legal obligations, and ISI does not consider it necessary to remove the application of section 131(2) of the Companies Act to an insurer to ensure that the insurer is obliged to comply with the Bill.

In addition, as the draft Bill does not require local incorporation, such removal would affect New Zealand companies only. ISI considers it is not appropriate to impose a restriction on the provisions of the constitution of New Zealand companies where no equivalent restriction can be imposed on insurers that are not New Zealand companies.

List of ISI Members

ISI MEMBERS

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Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Dorchester Life
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