LAW·COMMISSION
TE·AKA·MATUA·O·TE·TURE

Preliminary Paper 53

LIFE INSURANCE

A discussion paper

The Law Commission welcomes your comments on this paper
and seeks your response to the questions raised

Submissions should be forwarded to the Law Commission
PO Box 2590, DX SP23534, Wellington
com@lawcom.govt.nz
by 17 March 2004

This discussion paper is also available on the Internet at the Commission's website:
http://www.lawcom.govt.nz

December 2003
Wellington, New Zealand

The Law Commission is an independent, publicly funded, central advisory body established by statute to undertake the systematic review, reform and development of the law of New Zealand. Its purpose is to help achieve law that is just, principled, and accessible, and that reflects the heritage and aspirations of the peoples of New Zealand.

The office of the Law Commission is at 89 The Terrace, Wellington
Postal address: PO Box 2590, Wellington 6001, New Zealand
Document Exchange Number: SP 23534
Telephone: (04) 473–3453, Facsimile: (04) 471–0959
Email: com@lawcom.govt.nz
Internet: www.lawcom.govt.nz

National Library of New Zealand Cataloguing-in-Publication Data

Life insurance : a discussion paper.
(Preliminary paper (New Zealand. Law Commission) ; v 53.)
Includes bibliographical references.
ISBN 1–877187–98–4
1. Insurance, Life—New Zealand. 2. Insurance, Life—Law and legislation—New Zealand. I. New Zealand. Law Commission.
II. Series.
368.3200993—dc 21

Disclaimers

Preliminary Paper/Law Commission, Wellington 2003
ISSN 0113–2245 ISBN 1–877187–98–4
This preliminary paper may be cited as: NZLC PP53

Contents

Preface

This discussion paper has been triggered by a request to the Law Commission from its Minister under section 7(2) of the Law Commission Act 1985 to prepare a report responding to the following Terms of Reference:

> The Law Commission will consider and report on the framework for regulation and supervision of life insurers and life insurance products in New Zealand and the most appropriate way to regulate the provision of life insurance in New Zealand. In particular it will:
>
> Identify the problems that arise out of the unique nature of life insurance and require regulation, the position of life insurance in New Zealand and the aims of regulation;
>
> Given CER, the unique characteristics of the New Zealand market and the significant input of overseas, particularly Australian, insurers into that market, assess how New Zealand regulation could best accommodate overseas regulation and overseas insurers in order to meet its aims;
>
> Research current global trends, best international practice and the regulatory regimes applicable in Australia and other similar jurisdictions. This will include an analysis of their aims, a review of their advantages and disadvantages, and an assessment of which characteristics of these regimes would be suitable for New Zealand;
>
> Identify possible regulatory interventions to address the problems identified and achieve the aims sought;
>
> Assess the costs and benefits of each intervention and what aims it would meet; and
>
> Consider whether the approach taken to the regulation of life insurers and life insurance products has implications for the regulation of other insurers and insurance products.
>
> Process
>
> The review will involve consultation with the industry and other stakeholders and with the Minister of Commerce and Ministry of Economic Development.
>
> The Law Commission will report to the Minister Responsible for the Law Commission by 31 October 2004.

The Commissioners principally responsible for this project are Hon Justice J Bruce Robertson and Richard Clarke QC. The researchers are Victoria Stace and Elizabeth Craig. Phil Barry of Taylor Duignan Barry Limited has acted as consultant to the Law Commission on various aspects of this discussion paper.

ACKNOWLEDGEMENTS

The Commission acknowledges and thanks the following people and organisations who have assisted it in preparing this discussion paper:

Australian Law Reform Commission	Investment Savings and Insurance Association of New Zealand Inc
Australian Prudential Regulation Authority	John Melville, former Government Actuary
Australian Securities & Investments Commission	Ministry of Economic Development
Banking Ombudsman	Ministry of Foreign Affairs and Trade
Consumers' Institute of New Zealand	Munich Reinsurance Company of Australasia Limited
David Benison, Government Actuary	New Zealand High Commission, Canberra
Dick Jessup, Actuary	New Zealand Law Society
Financial Planners & Insurance Advisers Association Inc	New Zealand Society of Actuaries (Inc)
Financial Services Authority (United Kingdom)	Office of the Superintendent of Financial Institutions (Canada)
Financial Services Board (South Africa)	Reserve Bank of New Zealand
Geoff Rashbrooke, former Government Actuary	Retirement Commissioner
Health Funds Association of New Zealand	Adv Andrew D Schmulow
Inland Revenue Department	Securities Commission
Institute of Chartered Accountants of New Zealand	Standard and Poor's
Investment & Financial Services Association Limited (Australia)	The Treasury, Australia
Insurance & Savings Ombudsman	The Treasury, New Zealand

The Commission also acknowledges that, in preparing this discussion paper, it has been much assisted by the *Discussion Paper on Life Insurance Law and Practices* issued by the Securities Commission in December 1997.

PROCESS

Submissions on this discussion paper are invited by 17 March 2004.

The Commission intends to prepare a draft report after considering all submissions received. The draft report will be copied to submitters for comment.

After considering all comments received on the draft report, the Commission will finalise the report for presentation to the Minister Responsible for the Law Commission by 31 October 2004.

Use of submissions

The Law Commission's processes are essentially public, and it is subject to the Official Information Act 1982. Thus copies of submissions made to the Commission will normally be made available on request, and the Commission may mention submissions in its reports. Any request for the withholding of information on the grounds of confidentiality, or for any other reason, will be determined in accordance with the Official Information Act 1982.

Glossary

ABI	Association of British Insurers (United Kingdom)
accident insurance (or "accident policy")	a policy that provides for a benefit to become payable should death occur as the result of an accident
Accounting Standards Review Board	Accounting Standards Review Board established under the Financial Reporting Act 1993
ACL case	*ACL Insurance Limited* v *ACL Limited* (in liquidation) HC, Auckland M2121/89, 6 March 1995
A.M. Best	A.M. Best Company, a worldwide insurance rating and information agency
annuity	a contract where in return for a lump sum a regular income stream is paid until death or for a number of years (see paragraph 4.34)
APRA	Australian Prudential Regulation Authority
ASFONZ	Association of Superannuation Funds of New Zealand
ASIC	Australian Securities and Investments Commission
ASIC Act	Australian Securities and Investments Commission Act 2001 (Australia)
Banking Ombudsman	Banking Ombudsman established under the Banking Ombudsman Scheme, established 1992
Basel Committee	Basel Committee on Banking Supervision, established 1974
billion	one thousand million
bundled insurance (or "bundled policy")	a contract that does not split or identify the portion of the premium going into each component part of the policy
CEP	New Zealand Singapore Closer Economic Partnership
CER	Australia New Zealand Closer Economic Relations Trade Agreement

consumer protection regulation	regulation aimed at ensuring retail consumers have adequate information, are treated fairly and have adequate avenues for redress (see paragraphs 2.8 and 2.9)
critical illness insurance (or "critical illness policy")	a policy where the sum insured is paid on diagnosis of a defined ailment
debt security	any interest or right to be paid money that is deposited with, lent to or otherwise owing by any person
deed of participation	a deed of participation required for participatory securities under the Securities Act 1978
defined benefit scheme	a superannuation scheme that operates on defined benefit principles (see paragraph 17.31)
defined contribution scheme	a superannuation scheme that operates on defined contribution principles (see paragraph 17.31)
derivatives	contracts such as options, futures and swaps where the price is derived from the price of the underlying financial asset
disability insurance (or "disability policy")	a policy that provides for payment (lump sum or regular) if the insured becomes "disabled" as defined by the policy
endowment insurance (or "endowment policy")	a policy that provides a guaranteed amount of money to be paid at a specified date or age or on earlier death (see paragraph 4.34)
equity security	any interest in or right to a share in or in the share capital of a company
EU Directives	directives issued by the European Union
Fair Insurance Code	Fair Insurance Code of the ICNZ
financial condition report	the annual actuarial report required under section 18 of the Life Insurance Act 1908
financial market integrity regulation	regulation aimed at promoting confidence in the efficiency and fairness of markets (see paragraphs 2.6 and 2.7)
Financial Ombudsman Service	Financial Ombudsman Service set up under the Financial Services and Markets Act 2000 (United Kingdom)
Financial Reporting Standard 34	Financial Reporting Standard No. 34 issued by the Institute of Chartered Accountants in November 1998

financial safety regulation	regulation that prescribes particular standards or qualities of service and which aims to reduce the risk of financial failure (see paragraphs 2.10 to 2.14)
FOS	Financial Ombudsman Service (United Kingdom)
FPIA	Financial Planners and Insurance Advisers Association
FRS-34	Financial Reporting Standard 34
FSA	Financial Services Authority, established under the Financial Services and Markets Act 2000 (United Kingdom)
FSA Handbook	Handbook of Rules and Guidance issued by the FSA
FSB	Financial Services Board (South Africa)
FSCS	Financial Services Compensation Scheme (United Kingdom)
FSR Act	Financial Services Reform Act 2001 (Australia)
Futures Industry (Client Funds) Regulations	Futures Industry (Client Funds) Regulations 1990
GAD	Government Actuary's Department (United Kingdom)
GATS	WTO General Agreement on Trade in Services
general insurance	fire and general insurance
GIF	group investment fund (see paragraph 3.1)
GN5/ Guidance Note No. 5	Guidance Note No. 5 issued by the NZSA on 31 December 1999
Government Actuary	the Government Actuary who is part of the Insurance and Superannuation Unit of the Ministry of Economic Development
health insurance (or "health policy")	a policy that provides a benefit payable in the event of sickness
HFANZ	Health Funds Association of New Zealand Incorporated
HIH	HIH Insurance Group
HIH Royal Commission	the Royal Commission led by The Hon Justice Owen that reported on the reasons for the failure of the HIH Insurance Group
IAA	Institute of Actuaries of Australia

IAIS	International Association of Insurance Supervisors
IAIS Insurance Core Principles (or "IAIS Principles")	IAIS Insurance Core Principles, October 2000
IASB Proposals	International Accounting Standards Board proposals for international financial reporting standards for insurance contracts
ICNZ	Insurance Council of New Zealand
ICP	Insurance Core Principle of the Revised IAIS Principles
IFRS	International Financial Reporting Standards
IFSA	Investment and Financial Services Association Limited (Australia)
income protection insurance (or "income protection policy")	a policy that provides cover for loss of income through sickness, accident or an inability to work
income replacement insurance (or "income replacement policy")	the same as income protection insurance
Insurance and Savings Ombudsman	Insurance and Savings Ombudsman established under the ISO Scheme (see paragraphs 4.58–4.64)
Insurance and Superannuation Unit	Insurance and Superannuation Unit of the MED
insurance bond	a policy where a single deposit or series of deposits is paid into a savings or superannuation portfolio and which includes an element of life cover (see paragraph 4.34)
Insurance Core Principles 2000	the IAIS Principles
insurance supervisor	insurance supervisor referred to in the IAIS Principles
Interim Prudential Sourcebook for Insurers	Interim Prudential Sourcebook for Insurers issued by the FSA
investment linked insurance (or "investment linked policy")	a form of life policy used for savings, where the savings element of premiums paid is pooled with other policies of the same class (see paragraph 4.34)
Investment Savings and Insurance Association	the representative body for the life industry (which resulted from a merger of the LOA and the Investment Funds Association of New Zealand)
ISI	Investment Savings and Insurance Association

ISI Manual	Investment Savings and Insurance Association Manual of Practice Standards
ISO Scheme	Insurance and Savings Ombudsman Scheme established in 1995 (see paragraphs 4.58 to 4.64)
LAC Guidelines	Legislation Advisory Committee Guidelines on Process and Content of Legislation, 2001 edition and 2003 supplement
LBA	Life Brokers Association
Life Act	Life Insurance Act 1908
Life Act (Aust)	Life Insurance Act 1995 (Australia)
life insurance (or "life policy")	"life insurance" as defined in the Insurance Companies (Ratings and Inspections) Act 1994 and includes insurance for death by accident or as the result of a specified sickness or disease (see paragraph 1.1)
Life Insurance Actuarial Standards Board	Life Insurance Actuarial Standards Board established under the Life Insurance Act 1995 (Australia)
life insurer	an entity offering life insurance whether alone or in conjunction with other financial or insurance products
Life Offices Association	the representative body for the life insurance industry until 1996
LOA	Life Offices Association
LOA Code of Practice (or "LOA Code")	the Life Offices Association Code of Practice
long term policy	a policy under which the insurer's liability extends beyond 12 months, or under which the policyholder has a right to renew annually on payment of the premium
MED	Ministry of Economic Development
Minister	the Minister of the Crown for the time being responsible for the administration of the Life Act (currently the Minister of Commerce)
mortgage insurance or mortgage protection insurance	a life policy that provides for repayment of the policyholder's liability under a mortgage in the event of the policyholder's death
MOU	Memorandum of Understanding entered into between Australia and New Zealand on co-ordination of business law, dated August 2000

NAIC	National Association of Insurance Commissioners (United States)
non-renewable risk only policy	a risk protection only life policy for a short duration or specified event with no right of renewal (see paragraph 1.10)
NZSA	New Zealand Society of Actuaries
NZSA standards	the standards issued by the New Zealand Society of Actuaries
OECD	Organisation for Economic Co-operation and Development, an international organisation that groups 30 member countries sharing a commitment to democratic government and the market economy (www.oecd.org)
OSFI	Office of the Superintendent of Financial Institutions (Canada)
PPFM	Principles and Practices of Financial Management (United Kingdom)
PS1/Professional Standard No. 1	Professional Standard No. 1 issued by the NZSA on 1 January 1990
Registrar of Companies	Registrar of Companies established under the Companies Act 1993
renewable risk only policy	a risk protection only life policy renewable each year by the policyholder at standard premiums (see paragraph 1.10)
Retirement Commissioner	Retirement Commissioner established under the Retirement Income Act 1993
Revised IAIS Principles	IAIS Insurance Core Principles and Methodology, October 2003
risk only policy	a life policy that does not include a savings element
savings policy	a life policy that includes both a savings element and risk protection (see paragraph 1.10)
Securities Commission	Securities Commission established under the Securities Act 1978
Securities Commission discussion paper 1997	Discussion Paper on Life Insurance Law and Practices issued by the Securities Commission in December 1997
short term policy	a policy that has a maximum duration of 12 months

Standard and Poor's	Standard and Poor's, a worldwide provider of investment data, valuation, analysis and credit ratings
total and permanent disability insurance (or "total and permanent disability policy")	a policy that provides payment (usually a lump sum) should the insured become "totally and permanently disabled" (as defined in the policy) through an accident or illness
trauma insurance (or "trauma policy")	the same as critical illness insurance
trillion	a million million
trustee corporation	the Public Trust or the Maori Trustee or any corporation authorised by any Act (such as the Trustee Companies Act 1967) to administer the estates of deceased persons and other trust estates
unbundled insurance (or "unbundled policy")	a policy that splits or identifies the portion of the premium going into each component part of the policy (see paragraph 4.34)
UNCITRAL Model Law	the UNCITRAL Model Law on Cross-Border Insolvency
Wallis Report	Financial System Inquiry Final Report, March 1997 (Australia), Australian Government Publishing Service
whole of life insurance (or "whole of life policy")	a policy under which the sum assured, plus any bonuses, is paid on the death of the life insured (see paragraph 4.34)
WTO	World Trade Organisation

Questions for submissions

Matters to consider when answering questions

When responding to the questions set out in this paper, please consider and comment on the following issues to the extent that they apply in any particular case:

- the significance of any problem to which the question relates;
- the benefits or otherwise of harmonising with Australia's life insurance regime in addressing any such problem;
- the benefits or otherwise of harmonising with other overseas jurisdictions and/or the IAIS Principles (and Revised Principles) in addressing any such problem;
- the regulatory and non-regulatory options to address any such problem;
- the likely costs of those regulatory and non-regulatory options;
- the extent to which those regulatory and non-regulatory options will help or hinder a sustainable and competitive life insurance market in New Zealand.

Questions

Q1 Do you have any comments on chapter 1 (role of life insurance)?

Q2 Do you have any comments on chapter 2 (philosophy of financial regulation)?

Q3 Do you have any comments on chapter 3 (regulation of New Zealand financial markets)?

Q4 Do you have any comments on chapter 4 (New Zealand life industry)?

Q5 Do you have any comments on chapter 5 (New Zealand life insurance law)?

Q6 Do you have any comments on chapter 6 (Australian life insurance law)?

Q7 Do you have any comments on chapter 7 (United Kingdom life insurance law)?

Q8 Do you have any comments on chapter 8 (life insurance in other overseas jurisdictions)?

Q9 Do you have any comments on chapter 9 (international obligations and guidelines)?

Chapter 10 – Introduction to the issues

Q10 Do you agree with the statement of risks set out in paragraphs 10.2 and 10.3? Are there any other risks?

Q11 Do you agree with paragraph 10.9 that regulation of New Zealand life insurers is not needed to protect the stability of New Zealand's financial system?

Q12 Are there any issues relevant to the regulation of the New Zealand life insurance industry that are not addressed in chapters 10 to 18?

Chapter 11 – Financial market integrity issues

Q13 Life insurance market integrity – Are there areas other than those set out in paragraphs 11.5 to 11.65, where New Zealand's existing law may be regarded as unsatisfactory in relation to life insurance market integrity?

Q14 Financial reporting – Do you have any comments on the possible problems and options in paragraphs 11.11 to 11.15? Are there any problems or options we have not considered?

Q15 Valuation of assets and liabilities – Are there any problems with the current requirements for valuation of assets and liabilities? If so, what could be done to remedy these problems?

Q16 Financial records – Are there any problems with the current requirements for financial record keeping by life insurers? If so, what could be done to remedy these problems?

Q17 Directors (and senior management) – Do you have any comments on the problems and options in paragraphs 11.31 to 11.34? Are there any problems or options we have not considered?

Q18 Actuaries – Are there any financial market integrity issues relating to actuaries other than those in paragraphs 13.33 to 13.36 and chapter 15?

Q19 Auditors – Do you have any comments on the possible problem and option in paragraphs 11.43 and 11.44? Are there any problems or options we have not considered?

Q20 Transfers and amalgamations – Do you have any comments on the possible problem and options in paragraphs 11.49 to 11.52? Are there any problems or options we have not considered?

Q21 Surrender values and terms – Do you have any comments on the possible problem and options in paragraphs 11.55 to 11.57 Are there any problems or options we have not considered?

Q22 Allocation of profits – Do you have any comments on the possible problem and options in paragraphs 11.63 to 11.65? Are there any problems or options we have not considered?

Chapter 12 – Consumer protection issues

Q23 Consumer protection – Are there areas other than those set out in paragraphs 12.5 to 12.70, where New Zealand's existing law may be regarded as unsatisfactory in relation to consumer protection?

Q24 Product disclosure – Do you have any comments on the possible problems and options in paragraphs 12.10 to 12.15? Are there any problems or options we have not considered?

Q25 Financial advisers and brokers – Do you have any comments on the possible problems and options in paragraphs 12.23 to 12.31? Are there any problems or options we have not considered?

Q26 Terms of policies – Do you have any comments on the possible problems and options in paragraphs 12.35 to 12.40? Are there any problems or options we have not considered?

Q27 Secondary markets – Do you have any comments on the issue referred to in paragraph 12.41? Are there any issues we have not considered?

Q28 Human Rights Act – Do you have any comments on the issue referred to in paragraph 12.42? Are there any issues we have not considered?

Q29 Genetic information – Do you have any comments on the issue referred to in paragraphs 12.43 to 12.47? Are there any issues we have not considered?

Q30 Complaints handling – Do you have any comments on the possible problems and options in paragraphs 12.57 to 12.62? Are there any problems or options we have not considered?

Q31 Insured's duty to disclose – Do you have any comments on the issue referred to in paragraphs 12.63 to 12.70? Are there any issues we have not considered?

Chapter 13 – Financial safety issues

Q32 Does New Zealand need financial safety regulation for life insurers or for particular kinds of life policies?

Q33 Should New Zealand simply "tidy up" its existing financial safety regulation of life insurers or is a higher level of regulation needed in relation to all or some life policies?

Q34 Should New Zealand have a financial safety regulator of life insurers along the lines of the Australian Prudential Regulation Authority in Australia?

Q35 Should life insurers in New Zealand be required to obtain an annual credit rating from one of the internationally recognised credit rating agencies?

Q36 Should life insurers in New Zealand be required to put in place an independent trustee and trust deed in relation to all or some kinds of life policies?

Q37 Should life insurers in New Zealand be required to operate all or some (being particular kinds of policies) of their life business through a statutory fund?

Q38 Should life insurers (or life insurers who issue particular kinds of policies) in New Zealand be required to register with a Government agency? If so, should a "fit

and proper" assessment of management and/or assessment of business plan soundness be undertaken at the time of registration?

Q39 Should life insurers in New Zealand be prohibited from carrying on business other than life insurance? If so, how would "life insurance" be defined for the purposes of this prohibition and would the definition include, for example, products such as insurance bonds and disability insurance?

Q40 Should the bond requirement be retained; and if so, should the bond amount be increased to, say, $5 million (or another amount)?

Q41 Should life insurers be required to maintain a minimum amount of paid-up capital?

Q42 Could a system of regulation be supported by a requirement that life insurers in New Zealand obtain an annual credit rating from an international credit rating agency?

Q43 Should there be rules limiting the ability of life insurers to enter into transactions with related parties?

Q44 Should corporate governance standards be introduced for life insurers in New Zealand, in particular, setting out principles of best practice in relation to risk management systems? If so, should these standards have a statutory basis?

Q45 Should an "appointed actuary" regime be introduced in New Zealand?

Q46 Should life insurer actuaries have "whistle blowing" obligations to a Government regulator or trustee?

Q47 Are there other issues concerning the current role of actuaries in the life insurance regime that need to be considered (for example, rights of access to company information)?

Q48 Should the whole financial condition report be filed with the Government Actuary or another Government regulator?

Q49 Should the whole of the actuary's annual financial condition report on a life insurer be made publicly available?

Q50 Should the financial condition report required under the Life Act be required to be prepared in accordance with PS1?

Q51 Should GN5 be given statutory recognition by requiring compliance with it when an actuary advises on solvency for the purposes of the Financial Reporting Act and Life Act?

Q52 Are there other ways that solvency and/or capital adequacy standards could be incorporated into New Zealand's life insurance regime? For example, a body such as the Australian Life Insurance Actuarial Standards Board could be established with the power to establish standards with which all actuaries must comply, or

this role could be given to the (New Zealand) Accounting Standards Review Board.

Q53 Should there be a requirement for an actuarial audit of the financial condition report? If so, who should undertake the audit and who should receive the audit report?

Q54 Should the actuarial report required under the Life Act (whether it be the existing abstract or an expanded report) have to be filed earlier than nine months after balance date? If so, what is an appropriate time limit?

Q55 Should there be a requirement for more regular (possibly three-monthly) reporting by actuaries to the board and/or to a Government regulator?

Q56 Should the Government Actuary be entitled to refuse a request under the Official Information Act for disclosure of a financial condition report or other commercially sensitive information received in the course of his or her review of a life insurer's operations?

Q57 Should the Government Actuary or another entity be given the power to set standards on any or all of the matters set out in paragraph 13.42 or any other matters relating to the business of life insurance?

Q58 Does the Government Actuary (or another regulator) require a greater degree of investigative power than already exists under the Life Act (and other Acts)?

Q59 Should overseas life insurers operating in New Zealand be required to operate through a company incorporated in New Zealand? If so, why?

Q60 Does the concept of policy-only liability insurance as an alternative to Government regulation require further consideration and investigation?

Q61 Should a guarantee system be established along the lines set out in paragraph 13.46 (or in another form) to assist payments to policyholders in the event of a life insurer insolvency?

Q62 Should friendly societies be brought within the ambit of the Life Act?

Q63 Are there any other measures that should be taken to increase the prudential supervision of life insurers in New Zealand?

Q64 Are there any other issues in relation to financial safety that have not been addressed (for example, the possibility of a two-tiered system of regulation that recognises that different financial safety issues may apply to larger insurers (who are likely to be subject to offshore regulation) as compared with smaller insurers)?

Chapter 14 – Reinsurance

Q65 Reinsurers – Are there areas other than those set out in paragraphs 14.11 to 14.22, where New Zealand's existing law may be unsatisfactory in relation to reinsurers?

Q66 Reinsurance arrangements – Do you have any comments on the problems and options in paragraphs 14.12 to 14.17? Are there any other problems or options we have not considered?

Q67 Regulation of reinsurers – Do you have any comments on the problems and options in paragraphs 14.18 to 14.22? Are there any other problems or options we have not considered?

Chapter 15 – Regulation of actuarial profession

Q68 Regulation of actuarial profession – Do you have any comments on the problems and options in paragraphs 15.22 to 15.27? Are there any other problems or options we have not considered?

Chapter 16 – Cross border issues

Q69 Are there areas of possible reform in relation to cross border issues that are not mentioned in paragraphs 16.10 to 16.32?

Q70 Differences in treatment of foreign versus domestic policyholders by overseas law and regulators – Do you have any comments on the problems and options in paragraphs 16.10 to 16.16? Are there any problems or options we have not considered?

Q71 Taking action against overseas insurers who operate in New Zealand – Do you have any comments on the problems and options in paragraphs 16.18 to 16.21? Are there any problems or options we have not considered?

Q72 Maintenance of operations and records in New Zealand – Do you have any comments on the problem and options in paragraphs 16.23 to 16.26? Are there any problems or options we have not considered?

Q73 Offshore branches and subsidiaries of New Zealand insurers – Do you have any comments on the problem and options in paragraphs 16.28 to 16.30? Are there any problems or options we have not considered?

Q74 Foreign insurers acting through brokers in New Zealand – Do you have any comments on this issue, which is discussed in paragraphs 16.31 and 16.32?

Chapter 17 – Other insurance and long-term financial products

Q75 Are there any problems with the financial market integrity regulation, consumer protection regulation or financial safety regulation of general insurers in New Zealand? If so, give details.

Q76 Do you support the extension to the Insurance Companies (Ratings and Inspections) Act, which requires credit ratings to be obtained, to health insurers?

Q77 Do you support the extension of the Insurance Companies (Ratings and Inspections) Act to other unrated (non-life) insurers?

Q78 Do you have other suggestions for the financial safety regulation of health and other unrated (non-life) insurers? In particular, do you support including certain products, which might not include a life element, such as disability, income protection and trauma insurance, within the life insurance regime?

Q79 Do you consider there are other issues (such as in relation to financial market integrity or consumer protection) concerning health and other unrated (non-life) insurers? If so, give details.

Q80 Are there any problems with the regulation of superannuation schemes that are similar to the problems with the regulation of life insurance? If so, give details.

Chapter 18 – Regulators

Q81 Who should be the regulator – Do you have any comments on the options in paragraphs 18.4 to 18.10? Are there any other options we have not considered?

Q82 Liability of a regulator – Do you have any comments on the options in paragraphs 18.11 to 18.17? Are there any other options we have not considered?

Part 1
Preliminary Considerations

Chapter 1
Role of life insurance

1.1 The first issue to consider in this discussion paper is the meaning of the term "life insurance". The Life Insurance Act 1908 does not define "life insurance" but defines a (life insurance) "company" as:

> … any person or association, corporate or unincorporate, which issues or is liable under policies of insurance upon human life in New Zealand, or which grants annuities upon human life in New Zealand, or which is liable under any contract of reinsurance in respect of the issue in New Zealand of policies of insurance upon human life, or of the granting in New Zealand of annuities upon human life …

The Insurance Companies (Ratings and Inspections) Act 1994 defines "life insurance" as:[1]

> … insurance for the payment of money on the death of any person (not being death by accident or as the result of a specified sickness or disease) or on the occurrence of any contingency dependent on the termination or continuance of human life …; and includes—
>
> (a) An instrument that evidences a contract that is subject to the payment of premiums for a term dependent on the termination or continuance of human life; and
>
> (b) An instrument securing the grant of an annuity for a term dependent on the continuance of human life.

For the purposes of this discussion paper the term "life insurance" will be taken to mean the same as in the Insurance Companies (Ratings and Inspections) Act, but it will also include insurance for death by accident or as the result of a specified sickness or disease.

1.2 It is worth noting that "life insurance" does not include financial products such as superannuation schemes registered under the Superannuation Schemes Act 1989, unit trusts established under the Unit Trusts Act 1960, group investment funds established under the Trustee Companies Act 1967, and deposits and other debt securities even though these products are often provided by life insurers or other members of their company groups.

---

[1] The Insurance Law Reform Act 1977 contains a similar definition. It defines "life policy" as:

> … a policy insuring payment of money on death (not being death by accident or specified sickness only) or on the happening of any contingency dependent on the termination or continuance of human life …; and includes an instrument evidencing a contract which is subject to the payment of premiums for a term dependent on the termination or continuance of human life and an instrument securing the grant of an annuity for a term dependent upon human life.

1.3 Life insurance has, broadly speaking, two important roles in New Zealand:[2]

- to enable people and businesses to manage the financial risk of individuals' deaths. In this way, it promotes individual financial stability and facilitates commerce; and
- to provide a vehicle for savings and investment. This assists individuals to save for their retirement and other needs, and benefits economic development in New Zealand.

1.4 In New Zealand traditionally, life insurance has been provided through policies, such as whole of life and endowment policies, that combine both financial risk protection and savings and investment. In recent decades the balance has changed with the proportion of risk protection only policies growing strongly, and other financial products being used for savings and investment. However, there is a continuing use of life insurance as a legal vehicle for savings and investment. These "insurance bonds" usually offer minimal death cover, but provide a means of pooling investors' funds for investment in classes of assets generally selected by the investors. There is also a continuing (but perhaps decreasing) practice of life insurance being included as part of another financial product. For example, many superannuation schemes and disability insurance policies include a life insurance element.

1.5 Life insurance is used to manage the financial risk of death in various circumstances, for example:

- protecting a family against the financial effects of a caregiver's death;
- protecting a, generally, small-to-medium size business against the financial effects of a key person's death (sometimes called "key man" insurance);
- preserving the value of an estate, although this is less necessary than before the abolition of estate duty;
- protecting against the financial effects of a homeowner's death (sometimes called "mortgage protection" insurance).

1.6 Insurance bonds and the savings components of traditional whole of life and endowment policies continue to be methods to provide retirement benefits. Even though, in recent years, long term savings have tended to move from life policies to alternative products such as unit trusts and superannuation funds, there still exist a great many traditional life policies and insurance bonds. Furthermore, risk only policies continue to play a significant role in funding the wellbeing of surviving partners.

1.7 The life insurance industry has an important role in the New Zealand economy. As at 30 June 2003 life insurers carrying on business in New Zealand managed assets totalling $7.98 billion,[3] which were invested for the benefit of both the policyholders and shareholders of the life insurers.

---

2 For a more detailed description of the role of life insurance, see chapter 2.

3 Reserve Bank of New Zealand *Household Financial Assets and Liabilities* (Wellington, June 2003). Note: This figure is split into $1.87 billion for insurance bonds and other unitised products, and $6.12 billion for non-unitised products, that is, whole of life and endowment life policies. By contrast, unit trusts and group investment funds manage assets totalling $12.73 billion, and superannuation schemes manage assets totalling $16.59 billion.

1.8 At an individual level, life insurers regularly settle claims and pay benefits. Typically, these claims and benefits are used to pay off mortgages, provide retirement income, pay for a significant planned event or item, or replace income after an income earner's death.

1.9 Life insurers also provide annuities for people who wish to exchange a capital sum for a fixed regular payment for life. While this has been a traditional retirement income product in other countries, it has not been much used in New Zealand.

Types of life policy

1.10 An important element in considering life insurance regulation is the different types of life policy.

- Some policies, notably traditional whole of life and endowment policies and insurance bonds, combine a savings arrangement (a proportion of premiums plus income paid on death or maturity of the policy) and risk protection (an amount additional to savings paid on the death of the life insured, although this is usually minimal in the case of insurance bonds). Traditional whole of life and endowment policies often exist for many decades. For example, a child's life policy commenced soon after birth by a parent may not mature for 80 or more years. Terms that seemed appropriate, and an insurer that was financially robust and prudently managed, when the policy was taken out may no longer be so many years later. In this discussion paper, these policies are called "savings policies".
- Other policies are risk protection only policies that are renewable every year[4] by the policyholder at standard premiums (the premium usually increases with the policyholder's age, but is not adjusted for any non-standard health or other characteristics of the life insured). This right of renewal is valuable to a policyholder, because, if the policyholder's health deteriorates, life cover on standard terms and conditions (or life cover at all) may not otherwise be obtainable. In this discussion paper, these policies are called "renewable risk only policies".
- Some risk protection only policies are for short durations or specified events (for example, a specified aeroplane flight or death from a specified sickness or disease) and contain either no right of renewal or no right to renew at standard premiums. These policies are generally regarded by the life insurance industry as being accident or sickness policies rather than life insurance. In this discussion paper, these policies are called "non-renewable risk only policies".

The above policies can be long term or short term. In practice, most savings policies and renewable risk only policies are intended as long term arrangements.

1.11 It is worth noting that:

- traditional whole of life and endowment policies have some similarity with superannuation schemes, where savings are often locked up for many decades before the product matures;

---

[4] Until, in some cases, a specified age, for example, 65.

- insurance bonds have some similarity with superannuation schemes, unit trusts and group investment funds, each being a kind of managed fund;
- renewable risk only policies have some similarity with other renewable insurance products, such as income protection and health and disability insurance, where the insured relies on the right of renewal for his or her long term protection;
- non-renewable risk only policies have some similarity with other non-renewable insurance products, such as fire and general insurance, where the insurance is usually short term and there is no right of renewal on expiry.

Q1	Do you have any comments on chapter 1?

Chapter 2
Philosophy of financial regulation

Acknowledgement

2.1 In preparing this chapter, the Commission has used as its starting point the ideas and principles in chapter 5 of the Wallis Report "Philosophy of Financial Regulation".[5] The concepts of financial market integrity, financial safety and consumer protection elaborated on in this chapter, have also been drawn from the Wallis Report.

Introduction

2.2 Free and competitive markets generally help to provide an efficient allocation of resources and a strong foundation for economic growth and development. However, market regulation, which necessarily imposes costs and restraints, can be justified for three broad purposes. First, to ensure that markets work fairly and efficiently (general market regulation). Secondly, to prescribe particular standards or qualities where goods or services carry risk (safety regulation). Thirdly, to achieve social objectives.

Role of financial markets

2.3 Financial contracts play a fundamental role in the efficient functioning of commerce, facilitating the settlement of trade and channelling resources. The basic elements of financial contracts are promises, to make payments at specified times, in specified amounts and in specified circumstances. Financial promises incorporate risk, including the risk that the promise will not be kept.

2.4 The financial system provides a framework within which financial promises are created and exchanged. Financial institutions have developed to supply information and transaction services, including the management of risk. There are two mains forms of financial institutions, one, intermediaries, such as banks and insurance companies, that transact with promisors and promisees on their balance sheet; and funds managers and other agents (such as advisers and brokers) who act to bring promisors and promisees together.

Role of insurers

2.5 Financial services generally and insurance in particular are of fundamental importance to economic development. Research has shown that life insurance (along with other forms of insurance and banking) has a significant role in explaining national

[5] *Financial System Inquiry Final Report* (Australian Government Publishing Service, Australia, March 1997).

productivity gains.[6] Life insurance provides various categories of service that collectively constitute the mechanisms by which life insurance contributes to economic growth. Those categories include the following:

- life insurance can promote financial stability by helping to stabilise the financial situation of those who suffer loss by the death of a provider;
- life insurance can substitute for and complement state-provided social security. Life insurance can therefore relieve pressure on the social welfare system;
- life insurance can facilitate trade and commerce. Insurance coverage is a condition for engaging in some activities;
- life insurance can enhance financial system efficiency. Life insurers can reduce the transaction costs of bringing together savers and borrowers, and create liquidity (by reducing the illiquidity inherent in direct lending). They can also facilitate economies of scale in investment;
- life insurance can enable risk to be managed more efficiently. Life insurers price risk and provide for risk transformation, pooling and reduction. Efficient risk management services lead to more efficient allocation of resources;
- life insurance can foster capital allocation efficiency. Insurers gather substantial information in their role as issuers of insurance and in their role as lenders. Individual savers and investors may not have the time, resources or ability to undertake this information gathering exercise. Insurers have an advantage in this regard and may be better at allocating financial capital and insurance risk-bearing capacity.

General market regulation and financial market integrity regulation

2.6 All markets, financial and non-financial, face potential problems associated with conduct of market participants, anti-competitive behaviour and incomplete information. Regulatory intervention to address these types of market failure includes:

- conduct regulation, such as criminal sanctions for fraud and prohibitions on anti-competitive behaviour; and
- disclosure regulation, such as general prohibitions on false and misleading statements.

In the financial markets, a case can be made for additional regulation imposing specific further disclosure requirements (such as prospectus rules) and additional conduct rules (such as prohibitions on insider trading). The complexity of financial products and markets, their intrinsic risks, and the detailed knowledge required to deliver efficient regulation in this area argues strongly for specialised regulatory arrangements. This type of additional regulatory protection is called "financial market integrity" regulation.

2.7 Financial market integrity regulation aims to promote confidence in the efficiency and fairness of markets. It seeks to ensure that markets are sound, orderly and transparent. In addition to additional disclosure requirements, financial market integrity regulation

---

[6] Information in this paragraph has been sourced from "Liberalization of Insurance Markets: Issues and Concerns" Harold D Skipper Jr, contained in *Policy Issues in Insurance No. 3: Insurance Regulation and Supervision in the OECD Countries* (OECD, 2001).

might, for example, in the context of life insurance companies, justify the imposition of additional duties on directors to have regard to certain classes of creditors (such as policyholders) in priority to others. It might also justify the imposition of specific rules regarding allocation of profits to policyholders, and rules relating to how surrender values are calculated. Such rules are aimed at ensuring the life insurer is treating policyholders fairly.

Consumer protection regulation

2.8 Financial market integrity regulation in the retail market is closely linked to consumer protection regulation. Consumer protection regulation is aimed at ensuring that retail consumers have adequate information, are treated fairly, and have adequate avenues for redress. Financial market integrity regulation and consumer protection regulation both use the same tools, namely disclosure and conduct regulation. Prospectus requirements, for example, can promote both consumer protection and confidence in the efficiency and fairness of retail financial markets. Specialist consumer protection can be justified on two grounds. First, the complexity of financial products increases the risks of retail consumers being misled or misunderstanding the nature of financial promises. Combined with the potential consequences of dishonour, this has led most countries to establish a disclosure regime for financial products that is more intense than for non-financial products. Secondly, financial complexity increases the incidence of misunderstanding leading to dispute. In response, and partly due to the high costs of litigation, some countries have imposed specific regulatory regimes for financial sales and advice, and established low cost complaints schemes for resolving disputes.

2.9 While it is possible to use the term "consumer protection" to justify the imposition of any regulation in the area of life insurance, we have applied a narrower definition. In summary, for the purposes of this discussion paper, consumer protection regulation involves additional disclosure requirements for retail customers, regulating sales and advice of financial products, and requiring financial service providers to make complaints services available. It also encompasses laws that seek to ensure that policyholders are treated fairly, such as certain provisions of the Insurance Law Reform Act 1977 that limit the circumstances in which an insurer may avoid liability by reason of a misstatement by the insured.

Financial safety regulation

2.10 The second broad purpose of regulation is to prescribe particular standards or qualities of service. This more intensive type of regulation is restricted to areas where consumption of goods or service carry risk, so that safety is a focus of concern. While in some industries, safety regulation aims to eliminate risk almost entirely (for example, in food preparation), this is not appropriate for the financial system. One of the vital economic functions of the financial system is to manage, allocate and price risk. Financial safety regulation can be justified, however, when the following three factors are present, and the case for regulation increases when promises rank highly on all three factors. The three factors are: the promise is judged to be difficult to honour; it is difficult to assess the creditworthiness of the promisor; and there are highly adverse

consequences of breach. In markets where promises of this nature are exchanged, there are two potential sources of market failure,[7] being:

- the risk of third party losses due to systemic instability, and
- the problem of information asymmetry for consumers, which means that consumers cannot reliably assess risk, particularly the creditworthiness of the promisor.

Systemic instability

2.11 Systemic instability arises when certain promises have an inherent capacity to transmit instability to the real economy. In particular, systemic issues are central to the regulation of banks. Banks have a pivotal position in the financial system, especially in the clearing and payments systems. The key systemic point is that banks are potentially subject to runs, which can have a contagious effect. Failure of an insolvent bank can cause depositors of other banks to withdraw deposits. A bank may then be forced to dispose of its assets which cannot usually be disposed of except at reduced value. Systemic risk is considerably less evident in other, non-banking, financial institutions (such as life insurance companies). Contagion is less likely (it is not easy to withdraw from a life insurance contract in a hurry, and often there is a heavy penalty for doing so). Life insurance companies are not required to meet claims "on demand" in the same way as banks. In the case of risk only insurance (renewable and non-renewable) there is nothing to withdraw. Also, there is no potential disruption to the payments system. In addition, life insurance companies have different funding structures to banks. [8]

Information asymmetry

2.12 Both buyers and sellers must be well informed in a competitive market. Asymmetric information problems exist when one party to a transaction has relevant information that the other does not. For many financial products, consumers lack (and cannot efficiently obtain) the knowledge, experience or judgment required to make informed decisions. Information asymmetry exists when disclosure alone is not sufficient to address information problems. In relation to many financial products, further disclosure, no matter how high quality or comprehensive, cannot overcome market failure. One possibility is to substitute the opinion of a third party for the consumers themselves. Ratings agencies undertake this role. In many countries governments provide prudential regulators to take on this role.

Information asymmetry in relation to life insurance

2.13 The nature of life insurance involves a contract that makes a present promise of future performance on the occurrence of a stipulated event. Individuals purchase policies in good faith, relying on the integrity of the life insurance company and its representatives. Even assuming insureds could be induced to have regard to their insurer's financial condition, few are sufficiently knowledgeable to do so without assistance. Insurance is

---

7 "Market failure" means imperfections in the market which mean that the market is not operating efficiently and competitively.

8 Diversification of a life insurer into other financial services which include "on demand" products could increase the systemic risk, at least to the point where a "run" may be possible within an insurer offering a range of products.

by its nature an extremely complex business, in particular because of the requirement to calculate risk. Governments around the world seek to rectify the unequal positions between life insurance buyer and seller by mandating certain disclosures, by monitoring life insurers' financial condition, by regulating market practices, and by other means. Because the value of the contract depends on the behaviour of the insurer after the contract is signed, ongoing monitoring of the life insurer's financial condition is required.

2.14 In relation to non-renewable risk only policies where the contract terminates within 12 months and there is no ongoing obligation on the insurer to provide insurance, the case for regulation on the grounds of information asymmetry is much weaker. In relation to fire and general insurance, a classic form of non-renewable risk only insurance, requiring insurers to obtain a credit rating may be regarded as sufficient. There are, however, issues with ratings, such as the fact that ratings assessments tend to recognise problems after the fact, and may not provide a satisfactory framework for assessing problems at an early stage.

Regulation for social objectives

2.15 A further case for regulation is sometimes made on the grounds that financial institutions have "community service obligations" to provide subsidies to some customer groups. Obliging financial institutions to subsidise some activities may compromise their efficiency. If the Government considers that community service obligations require subsidies, it is usually better for the Government itself to provide these subsidies to the financial institutions, rather than regulating.

Costs of regulation

2.16 An assessment of the merits of regulation must consider not only the potential benefits of regulation but also the costs. The costs of regulation are widespread and can be a major inhibitor to sustainable economic development. The costs of regulation can include:

- undermining allocative, productive and dynamic efficiency. An import quota, for example, can have all three effects by misallocating resources (as protected activities are favoured at the expense of internationally competitive ones); by reducing the incentives for firms in the domestic economy to minimise costs; and by reducing the pressures for the protected firms to innovate, invest in new technology and adopt best practice;
- moral hazard problems as consumers and the industry become more complacent about taking risks if they know there is a regulator acting as a watchdog;
- creating (rather than alleviating) monopoly situations and opening up opportunities to be exploited for anti-competitive purposes;
- the transfer of wealth from the less well off to the better off as well-intentioned regulations can have perverse effects;
- the costs of complying with the regulations ("compliance costs"); and
- the budgetary expenses of regulators who administer the regulations ("administrative costs").

2.17 The administrative and compliance costs of regulation, while significant, are dwarfed in size by the broader economic costs of regulation noted above. For example, while the annual cost of running regulatory agencies in the United States is estimated around US$17 billion, the total costs of regulation are estimated to be between around US$280 billion and US$700 billion (or comparable to the size of Canada's entire economy).[9]

2.18 The costs of regulation arise in large part because of the difficulties in designing and operating even the best intentioned regulatory interventions. These difficulties can arise because of:

- weaknesses in the political system, for example, when laws are passed in response to pressure from particular interest groups (but which a majority of voters would oppose) or when alarmist or populist pressures on politicians result in the passage of unwise regulations in response to problems of the moment ("political failure");
- the regulatory body becomes captured by the regulated industry ("regulatory capture");
- pressures for the scope and depth of regulations to grow over time ("regulatory creep") as, for example, more regulations are needed to offset the unintended consequences of earlier interventions;
- inappropriate bureaucratic behaviour as government bureaucracies seek to promote their own interests rather than the public interest ("bureaucratic failure"); and
- a sometimes slow, costly and uncertain legal process ("judicial failure").

2.19 These potential costs of regulation need to be weighed against the potential benefits of regulation when designing public policy. That there are widespread costs of regulation does not mean there should be no rules. However, it does mean caution should be exercised when new or further rules are promoted and existing rules should be subject to regular, careful evaluation of whether their benefits outweigh their costs and whether they are achieving their intended objectives.

2.20 The aim of regulation should be for a positive sum gain, which means both consumers and the industry benefit from regulation, and these efficiency benefits offset the administrative and compliance costs. There are many ways in which an industry such as the life insurance industry could benefit from regulation including:

- enhanced competition and efficiency;
- enhanced consumer confidence;
- greater competition shifting business from less to more efficient suppliers;
- removal of "cowboys", enhancing the industry's reputation;
- greater likelihood of competitors acting fairly;
- reduced risk of business failure.

---

[9] The United States Office of Management and Budget (OMB) estimates the costs of regulation in the United States at US$279 billion, while TD Hopkins *Regulatory Costs in Perspective* (Center for the Study of American Business, Washington University, St Louis, Minnesota, 1996), estimates the costs at around US$500 billion to US$700 billion.

2.21 Consumers can gain through enhanced competition. They can also gain through economies of scale which result from a regulatory entity monitoring life insurance companies, and having a safer market to invest in.

2.22 There are also other factors to consider when assessing the need for or form of regulation of the financial system. Regulation cannot and should not aim to eliminate risk in the financial markets completely. Primary responsibility for risk should remain with those who make financial promises (that is, the boards of the insurers), and consumers should not be stripped of incentives to take care when making a choice as to which insurer to select. It is also important that risk is not shifted from the promisor to the regulator. The tax system should not underwrite the financial risk. It is important that consumers and the industry are made aware that there are no Government guarantees of any risk in the financial system.

2.23 It is also important to be aware of the potential for regulation to distort the market place, as the existence of a regulatory regime can encourage consumers to favour one financial service over another. As a general principle, any regulation of the financial markets, and the life insurance market in particular, should be designed to balance, in the most optimal fashion, the benefits sought from regulation with the compliance, administrative, efficiency and moral hazard costs of imposing a regulatory agency.

Other rationale for regulating

2.24 There are other factors which become relevant when considering the need or otherwise for regulation of the New Zealand life insurance industry. These include:

- the benefits or otherwise of New Zealand aligning itself with the regulatory regimes of Australia or other overseas jurisdictions;
- the merits of adopting a regime which is in line with internationally accepted practice, in particular, the IAIS Insurance Core Principles;
- the merits of self-regulation compared with Government regulation, and recognition of the spectrum between self-regulation and Government regulation.

Q2	Do you have any comments on chapter 2?

Chapter 3
Regulation of New Zealand financial markets

Financial products and services

3.1 The financial products and services provided by the New Zealand financial sector have grown and become more sophisticated over time, and now include:

- *credit contracts*, where money is lent to retail or wholesale borrowers by banks, finance companies and other financial institutions;
- *equity securities,* issued by stock exchange listed and other companies;
- *debt securities*, issued by registered banks, finance companies, co-operative companies, trading companies, building societies and credit unions;
- *participatory arrangements*, such as property, horticultural and livestock partnerships;
- *insurance arrangements*, provided by life insurers, health insurers, fire and general insurers, the Accident Compensation Corporation, friendly societies and mutual companies;
- *superannuation arrangements*, provided by employer-based schemes, publicly offered schemes, and schemes designed for an individual or a family;
- *interests in unit trusts,* which invest in all or any of property, equity securities and debt securities;
- *group investment funds*, which are participatory securities offered by trustee companies;
- *options, swaps, futures and other financial derivatives,* either transacted directly between two parties (normally financial institutions) or via an exchange such as the Sydney Futures Exchange;
- *advice on the above products and services*, provided by stockbrokers, insurance agents and brokers, investment advisers and financial planners.

Some organisations provide many of the above products and services, and many are provided on a "packaged" or "bundled" basis (for example, life insurance cover is a part of some superannuation arrangements).

Appendix C contains a table setting out the various financial products and services available and summarises the legal requirements for each.

Brief historical overview of financial markets regulation in New Zealand

3.2 In the decades up to the mid-1980s, New Zealand financial markets, like indeed most sectors of the economy, were heavily regulated. At the financial industry level, the regulatory regime was extensive with different legislation applying to different financial

institutions, restrictions on entry and competition, limits on the extent of foreign ownership, direct controls on many aspects of financial market activity (including at times interest rates), restrictions on assets and liabilities, controls on various categories of lending, and tight limits on international capital flows. In addition, the Government was a major owner and guarantor of financial institutions and the taxpayer was exposed to a wide range of fiscal risks as a result. At the economy-wide level, legislation imposed multiple, often conflicting, objectives on monetary policy, whose implementation relied directly on the wide-ranging controls noted above, together with a managed exchange rate.

3.3 From 1984 onwards, a broad-based reform of financial policy was implemented with the aims of promoting a more efficient financial sector, enhancing the stability of the financial system and alleviating the macroeconomic imbalances (such as high inflation) that had built up. Prices were deregulated, the exchange rate floated, entry restrictions relaxed, ownership structures liberalised, international capital flows opened up, and banking and securities legislation reformed. The Reserve Bank was given the sole objective of targeting price stability and a market-based approach to monetary policy was implemented.

3.4 While the reforms did not follow a smooth path, with in particular a financial boom-bust period in the late 1980s, the benefits of the more light-handed regulatory regime are now widely recognised. The OECD in its survey of New Zealand's financial markets reforms concluded that:[10]

> … overall, financial reform has proved successful … the financial system appears now much more efficient. In particular, in banking, there is evidence of lower costs and margins and, in recent years, the quality of bank balance sheets has improved. Reflecting this, borrowing and lending activity has expanded enormously as has the range of financial instruments available, and there has been a marked improvement of service and consumer choice. Also, taxpayers are carrying significantly fewer risks in the form of either explicit or implicit government guarantees in the financial sector. At the macro(economic) level … reforms have allowed monetary policy to focus on and achieve low inflation.

3.5 An outline of the current regulatory position follows.

Financial market integrity regulation

3.6 In New Zealand, financial market integrity regulation can be found in the Crimes Act 1961, Financial Transactions Reporting Act 1996, Commerce Act 1986, Fair Trading Act 1986, Companies Act 1993, Corporations (Investigation and Management) Act 1989, Consumer Guarantees Act 1993, Securities Markets Act 1988 and Financial Reporting Act 1993. A further description of these Acts (other than the Securities Markets Act) and how they apply to life insurance is contained in chapter 5. The Securities Act 1978 may also be regarded as financial market integrity regulation, but this Act is discussed in the next section on consumer protection regulation because it is aimed primarily at issues of securities to the public.

---

10 OECD (1998) *Economic Survey of New Zealand*, Paris, 9–10.

3.7 The Crimes Act, Financial Transactions Reporting Act, Commerce Act, Fair Trading Act, Companies Act, Corporations (Investigation and Management) Act, and Consumer Guarantees Act apply across the whole economy. The Crimes Act makes it an offence for a promoter, a director or an officer to make false statements or publish a false prospectus with intent to induce or deceive or defraud, or to falsify accounts with intent to defraud. It is also an offence for a person to make false representations with fraudulent intent to induce another to act on them, or to obtain money or other property by false pretences. The Financial Transactions Reporting Act relates to the prevention and detection of money laundering. The Commerce Act regulates anti-competitive behaviour. The Fair Trading Act prohibits misleading or deceptive business conduct, and the giving of false or misleading information. It also empowers the making of consumer information standards in relation to goods or services, including disclosure obligations, and the making of safety standards.

3.8 The Companies Act imposes certain duties on directors: to exercise care, diligence and skill in the performance of tasks, to act in good faith and in the best interests of the company, and to avoid reckless trading. Certain persons are not permitted to become directors, and directors must be satisfied before entering into new obligations that those new obligations will not cause the company to become insolvent. The Companies Act also includes requirements for accounting records to be maintained that:

- correctly record and explain the company's transactions;
- enable, at any time, the company's financial position to be determined with reasonable accuracy;
- enable financial statements (including group financial statements) to be prepared in accordance with the Financial Reporting Act;
- enable the company's financial statements of the company to be readily and properly audited.

3.9 The Corporations (Investigation and Management) Act confers power on the Registrar of Companies to obtain information about and investigate companies, and if companies are found to be operating fraudulently or recklessly, to act so as to preserve the interests of members, creditors, beneficiaries or the public interest. Operating "fraudulently or recklessly" means contracting debts which the officers of the company did not honestly believe the company would be able to pay, or carrying on business in a reckless manner, or carrying on business with intent to defraud creditors or members. This Act can also be used where it is desirable that it should apply to preserve the interests of members, creditors or beneficiaries or for any other reason in the public interest, if those members, creditors, beneficiaries or the public interest cannot be adequately protected under the Companies Act or in any other lawful way.

3.10 The Consumer Guarantees Act implies a guarantee that services will be carried out with reasonable skill and care. In particular, in relation to financial services, investment advice must be provided with reasonable care and skill, and investment products must be reasonably expected to deliver the outcomes expected where an investor makes known a desired purpose or result.

3.11 The Securities Markets Act and Financial Reporting Act prescribe additional financial market integrity rules for the financial markets. The Securities Markets Act provides civil remedies for insider trading in relation to publicly listed shares and requires

continuous disclosure of certain information material to the price or value of securities. The Financial Reporting Act requires issuers of securities to the public to file on a public register, financial statements that comply with generally accepted accounting practice, and give a true and fair view of affairs. Auditors reports are required on those financial statements. The Act also gives legal force to accounting standards.

Consumer protection regulation

3.12 The Securities Act 1978 imposes certain disclosure obligations on issuers of securities to the public (prospectus and investment statement requirements, and advertising regulation). Renewable risk only policies and non-renewable risk only policies are not covered by the Securities Act. The Securities Act also requires only initial disclosure; there are no ongoing disclosure requirements (unless requested). The Securities Act disclosure regime only applies to offers made to the public. It does not apply to offers made to persons who are in the business of investing money. It does not, for example, apply to issuers of reinsurance contracts. Nor does it apply to offers made only to relatives or close business associates of the issuer.[11] The Securities Act may be regarded as consumer protection regulation in the sense that it is aimed primarily at retail clients.

3.13 Similarly, the Credit Contracts and Consumer Finance Act 2003[12] is primarily consumer protection regulation. The Credit Contracts and Consumer Finance Act requires disclosure of the cost of credit and other terms associated with consumer credit contracts (these are credit contracts where the debtor is a natural person and the contract is for personal, domestic or household purposes). It also carries over the provisions of the Credit Contracts Act 1981 that allowed the court to re-open oppressive credit contracts.

Financial intermediaries

3.14 Sales of and advice on financial products is regulated primarily by the Investment Advisers (Disclosure) Act 1996. This Act prescribes minimum disclosure requirements for people who, as intermediaries, give investment advice to the public or receive money for investment from the public. The Consumer Guarantees Act also impacts on the provision of investment advice (it must be provided with reasonable care and skill). The Secret Commissions Act 1910 prohibits secret commissions. The Insurance Intermediaries Act 1994 includes provisions relating to the payment of money to intermediaries (for example, payment by the insured to a broker or an agent constitutes discharge of the insured's liability). It imposes duties on brokers in relation to premiums and claims payments received, and requires the establishment of client accounts. Further discussion of these Acts is contained in chapter 5. A review of the laws relating to financial intermediaries by the Ministry of Economic Development is planned (see paragraphs 12.16 to 12.31).

---

11 A fuller description of the Securities Act as it applies to life insurance is in chapter 5, paras 5.55 to 5.74.

12 This Act has replaced the Credit Contracts Act 1981.

Complaints schemes

3.15 As regards avenues for redress, there is an Insurance and Savings Ombudsman for complaints about services provided by insurance and savings providers, and a Banking Ombudsman for complaints about services provided by banks. Both are voluntary, industry-based schemes.

Consumer protection in relation to life insurance

3.16 Certain provisions in the Life Insurance Act 1908 (the "Life Act") and the Insurance Law Reform Act 1977 may be regarded as consumer protection measures. These provisions are designed to ensure that policyholders are treated fairly. For example, section 64 of the Life Act provides that a policy does not become void by reason of non-payment of premiums (so long as the premiums and interest in arrears are not in excess of the surrender value).

3.17 The Insurance Law Reform Act 1977 (see further, paragraphs 5.51–5.53) provides, for example, that an insurer may not avoid liability under a contract of life insurance by reason of a misstatement by the insured, except in limited circumstances. In particular, a misstatement as to age does not allow an insurer to avoid liability (but does allow adjustment of amounts payable).

Financial safety regulation

3.18 Certain sectors of the financial industry in New Zealand, such as banks, and certain types of securities, are also subject to specific financial safety regulation.

Existing prudential supervision of life companies

3.19 As regards life insurance companies, presently, the only industry-specific regulatory requirements for financial safety involve:

- The financial disclosure requirements and obligations to submit annual audited returns and an actuarial abstract to the chief executive of the Ministry of Economic Development, under the Life Act. The statements and abstract received by the Ministry of Economic Development are copied to the Government Actuary who reports back to the Minister. (The Financial Reporting Act also requires financial statements to be filed, but that Act does not explicitly contemplate review of the filed statements by any authority. Filing is intended only to facilitate public access to the information.)
- The requirement for actuarial reports to be undertaken on an annual basis, under the Life Act (the full report being provided only to the board of the life company).

3.20 Section 15 of the Life Act (which requires life funds to be kept separate) may have been an attempt at financial safety regulation, but this section has proven to be so unclear as to be no real protection. Similarly, the $500 000 bond required under section 3 of the Life Act provides no real security (although it may be described as a threshold requirement for smaller insurers).

3.21 Part 1A of the Life Act provides a procedure for a Court-appointed manager to take over the affairs of a life company where it appears, based on the financial statements or

other material, that there is a likelihood that the company will be unable to meet its liabilities to policyholders. Similarly, the Corporations (Investigation and Management) Act could be used to investigate and place under statutory management, a life company that was falling into financial difficulties.

Prudential supervision of banks

3.22 Under the Reserve Bank of New Zealand Act 1989, the Reserve Bank undertakes the prudential supervision of registered banks with the objectives of promoting the maintenance of a sound and efficient financial system and avoiding significant damage to the financial system that could result from the failure of a registered bank.[13] Only a bank registered under that Act can trade under a name that includes the word "bank".

3.23 The approach taken by the Reserve Bank in pursuit of its objectives is to:

- Encourage individual banks to carry out their business in a prudent manner, and ensure that directors, managers and shareholders remain responsible for maintaining the soundness of their institutions.
- Avoid imposing excessive administrative burdens or unnecessarily constraining banks from pursuing commercial objectives.
- Minimise the perception that the Government underwrites the prudential soundness of individual banks. Should a bank fail, the Reserve Bank has statutory powers to limit the risk of that failure creating more widespread disruptions to the financial system. However, it is not the Reserve Bank's responsibility to provide a "safety net" for insolvent institutions, or to shelter depositors from losses.

3.24 The Reserve Bank's system of supervision draws on and enhances the market disciplines which are naturally present in the financial system. It places considerable emphasis on requirements that banks disclose, on a quarterly basis, information about their financial performance and risk positions, and directors regularly attest to certain key matters. Directors face civil and criminal sanctions for false or misleading disclosure statements.

3.25 Registered banks are exempt from the disclosure requirements of the Securities Act, but must comply with the Reserve Bank disclosure regime. This regime requires a "key information summary", aimed at non-expert investors, and a more comprehensive "general disclosure statement" to be prepared quarterly. Year-end statements must be externally audited. Auditors also have a "whistle blowing" role in relation to information that indicates a bank is in serious financial difficulty.

3.26 Registered banks are required to comply with certain minimum prudential requirements, which are applied through conditions of registration. These include constraints on exposure to connected entities, and minimum capital adequacy requirements based on the Basel Committee on Banking Supervision minimum capital standards.[14] In

---

[13] Information in this section has been obtained from the Reserve Bank website (www.rbnz.govt.nz).

[14] The Basel Committee is an international group of bank supervisors that formulates broad supervisory standards and guidelines and recommends statements of best practice. See further, the committee's website, www.bis.org/bcbs/.

addition, locally incorporated banks are required to have a minimum capital of NZ$15 million, and for branches, the Reserve Bank must be satisfied that the global bank has a level of capital exceeding NZ$15 million.

3.27 The Reserve Bank is working on a policy that will require "systemically important" banks (that is, banks whose failure could have a material impact on the financial sector as a whole and/or the wider economy) to incorporate in New Zealand. Certain other banks will also be required to incorporate here if their home jurisdiction legislation gives a preferred claim to home depositors or creditors on liquidation, or if they have inadequate disclosure requirements in their home jurisdiction.

3.28 The Reserve Bank is proposing to introduce a mandatory credit rating requirement for registered banks. At present, registered banks are required to disclose in their key information summary whether they have a rating, and if so, the bank must disclose the rating.

3.29 The Reserve Bank has certain failure management powers, including the ability to require a bank to have its financial and accounting systems independently reviewed, the power to have a bank investigated, the ability to give directions, and the power to recommend that a bank be placed in statutory management or be deregistered. One of the Reserve Bank's objectives is to avoid significant damage to the financial system. Information provided by the Reserve Bank states it would generally use its failure management powers only when a bank's failure or other crisis posed a significant threat to the soundness and efficiency of the financial system. It also states that any intervention would seek to avoid putting taxpayers' funds at risk in responding to bank failure. The Reserve Bank generally would attempt to ensure that losses are borne by shareholders and creditors. On liquidation, depositors would not receive any priority over other creditors. When the system of bank supervision is compared with any proposed system of life insurer supervision, it is important to bear in mind the different objectives of supervision, given that it is generally accepted that a life insurer's failure will not give rise to systemic risk issues (as discussed in paragraph 2.11).

3.30 To the extent that a bank conducts life insurance activities as part of its group, there might be some indirect supervision of that life insurance activity via the Reserve Bank supervision regime, as the Reserve Bank regime focuses on the whole group. The minimum capital requirements and limits on lending to connected parties are applied to the group as a whole, and disclosure requirements generally apply in respect of the whole group. However, the Reserve Bank generally does not supervise individual entities within the banking group or receive information on individual subsidiaries.

3.31 Recent amendments to the Reserve Bank of New Zealand Act increase the Reserve Bank's powers and penalties for breaches of the Act, focusing, in particular, on banks with offshore ownership.

Prudential supervision of certain types of securities

3.32 Issuers of debt securities are subject to financial safety regulation under the Securities Act. They are required to have a trust deed with a trustee acting as agent for the security holders. Similarly, issuers of participatory securities (such as interests in horticultural and livestock partnerships) are required to operate under a deed of participation with an independent supervisor. Unit trusts are regulated by the Unit

Trusts Act 1960, which requires schemes to be established as trusts under a trust deed and a manager and trustee to be appointed who have fiduciary duties to act in the unit holders' best interests, and includes restrictions on who may be a trustee (primarily, trustee corporations). Superannuation schemes are regulated by the Superannuation Schemes Act 1989. The Government Actuary registers superannuation schemes, investigates complaints and monitors schemes to ascertain whether they are operating in accordance with the Superannuation Schemes Act, and whether the financial position, security of benefits and management of the scheme are adequate. Group investment funds, which are participatory arrangements offered by trustee companies and operate similarly to unit trusts, also require a deed of participation and a statutory supervisor.

Prudential supervision of non-life insurers

3.33 Fire and general insurance companies are required to obtain ratings under the Insurance Companies (Ratings and Inspections) Act 1994 (see chapter 17 for further discussion of this Act.) The Government report that preceded and resulted in the passing of that Act considered the rationale for a prudential regime and recommended that the requirement to obtain an internationally recognised rating was the most appropriate form of prudential supervision for fire and general insurance companies.[15] One reason was that imposing a Government monitoring system could increase the public perception that there was, or give rise to a moral obligation on the Government to provide, a Government guarantee when insurance companies failed.

3.34 The philosophy behind requiring ratings was that the Government has a role in insisting that investors be well informed. However, in the case of fire and general insurance companies, it was recognised that something more than the ordinary "Securities Act" type disclosure was required, because of the complexities of the business. Requiring fire and general insurers to obtain a rating from an approved private rating agency was seen as the answer, in particular because rating agencies, in determining the claims paying ability of an insurer, review the extent and quality of reinsurance arrangements, and the nature of any support given by the parent company, as well as other factors such as the track record of management and capital adequacy.

3.35 Providers of health and other forms of non-life insurance (other than fire and general insurers) are not required to have a rating, by virtue of section 9 of the Insurance Companies (Ratings and Inspections) Act. Section 9 enables any insurer who is not offering disaster or general insurance to elect not to be rated. Cabinet decided in June 2002 to extend the rating requirements of that Act to health insurers and other issuers of non-life insurance not already covered, but legislation effecting that change has not, as yet, been passed.

Prudential supervision of finance companies

3.36 Debt securities of finance companies that are offered to the public are subject to the trustee and trust deed requirements of the Securities Act. The Companies Act provisions also apply (such as the obligations to avoid reckless trading and taking on

[15] Brash and McLean *A Prudential Regime for Insurance Companies* (Wellington, New Zealand, Office of the Minister of Justice, 1993).

liabilities that the company is unable to meet). In addition, under the Credit Contracts and Consumer Finance Act, the Court can prohibit certain persons from providing credit, offering consumer leases (such as hire purchase contracts), or acting as a director or an employee of a finance company.

Accident Insurance Act 1998

3.37 While personal accident insurance is now covered by the Injury Prevention, Rehabilitation, and Compensation Act 2001, it is interesting to note that under the Accident Insurance Act 1998 (repealed), which allowed private insurers to compete with the Accident Compensation Corporation, the Government set up a system of prudential supervision of insurers. This included having a register, requirements for ratings, and a requirement that each insurer appoint a "prudential supervisor" to monitor the solvency of the insurer and put in place a trust deed that created a charge over the insurer's assets and gave the prudential supervisor certain powers.

Options, swaps, futures and other derivatives

3.38 Derivative products such as swaps, options and futures are generally private contracts between two parties. Often one or both parties will be a bank, which itself (at least for banks operating in New Zealand) will be subject to the Reserve Bank's supervision regime. In addition, any product traded through an exchange (normally options and futures) such as the Sydney Futures Exchange, will be subject to the rules of the exchange. Such rules commonly require initial collateral to be posted, and further collateral to be posted when contracts move "out of the money". For swaps, these products are usually documented under an ISDA (International Swaps Dealers Association) standard form contract. Such contracts might include collateral mechanisms. Generally these "financial safety" measures have resulted from self-regulation rather than government-imposed regulation. To some extent the Securities Markets Act regulates futures and options contracts by allowing only authorised persons to carry on a business of dealing in futures contracts. The Futures Industry (Client Funds) Regulations 1990 prescribes rules relating to the handling and investing of client funds placed with authorised futures dealers. Authorised futures dealers are also exempt from the disclosure requirements of the Securities Act.

Role of self-regulation

3.39 It is worth noting that many areas of the financial industry have developed systems of self-regulation that go some way towards meeting financial safety concerns. Many industries, such as the fire and general insurance industry, the life insurance industry, and the health insurance industry, as well as the NZX (New Zealand Stock Exchange) have industry bodies who impose (in varying degrees) rules, sometimes relating to financial market integrity and consumer protection (such as codes dealing with sales and advice), and sometimes relating to financial safety (such as imposing solvency standards on members). More details of these self-regulatory regimes are contained in chapter 4.

Q3 Do you have any comments on chapter 3?

Part 2
The New Zealand Life Industry and Law

Chapter 4
New Zealand life industry

BRIEF HISTORY OF THE NEW ZEALAND LIFE INDUSTRY

Life insurance industry

4.1 The first life assurances evolved from the early days of marine insurance (which go as far back as the fourth century BC in Greece) and were very different from modern long term policies. The premiums charged were not based on any careful calculations or estimates, but were decided on after bargaining between the broker and underwriter.

4.2 In the United Kingdom, the first annuity scheme was put to the City of London Authorities in about 1674. In subsequent centuries, with the expansion of trade and industry and the development of large commercial and financial companies, there became an increasing need to protect the public from dishonest or irresponsible promoters of life insurance. The Life Assurance Act 1870 was the United Kingdom's response to this need.[16]

New Zealand

4.3 In New Zealand before 1869, life insurance facilities were described as "very inadequate".[17] At that time, a large proportion of life insurance companies in England had become insolvent and the New Zealand Government saw a need to become directly involved in the New Zealand industry.[18] In 1869, the Government established the Government Life Office (now known as TOWER), to augment the life insurance facilities existing at that time and as a way to offer policyholder protection.

4.4 The Government Life Office sold life insurance policies, annuities and pension benefits through a nation-wide distribution structure in partnership with the New Zealand Post Office. Its purpose was to meet the personal financial security needs of New Zealanders, and its products were guaranteed by the State.[19]

4.5 By 1883, there were six mutual life offices established in New Zealand. Each made a feature of ensuring that all funds accumulated in New Zealand were invested in New

---

16 Consumers' Institute of New Zealand *Life Assurance in New Zealand* (Wellington, 1973).

17 Securities Commission *Discussion Paper on Life Insurance Law and Practices* (Wellington, 1997).

18 Giolla, XX *The Common Sense of Life Insurance: A review, historical and critical, of the various Life Insurance Offices established in New Zealand* (Brown, Thompson & Co, Wellington, 3rd edn, 1889).

19 Information obtained from the Tower website (www.towerlimited.com).

Zealand for the benefit of New Zealand policyholders.[20] Limited liability/shareholder companies did exist within the life industry, but these were exceptions and tended to be smaller companies.

4.6 As the industry developed the number of offices conducting life insurance in New Zealand increased. By the early to mid 1990s, several larger mutual companies had demutualised, that is, changed their structure to become shareholder owned as opposed to policyholder owned. The majority of life companies today are shareholder owned companies.

4.7 During the mid-1980s, New Zealand started to dismantle the State's participation in business. Deregulation of state operations occurred on a major scale as the Government exited from a range of business activities. The Government Life Office continued to operate, but as a state-owned enterprise and without Government guaranteed products and services.

4.8 In 1990, the Government Life Office was corporatised by the Government and renamed TOWER. It became a mutual organisation owned by its 400 000 members.[21]

4.9 At the end of 1992, there were 33 registered companies transacting life insurance business in New Zealand.[22] At that time, approximately two-thirds of New Zealand life insurers were branches or subsidiaries of overseas corporations.

4.10 Corporate mergers and acquisitions and demutualisation activity have brought about many changes in the industry. This restructuring has seen English based insurers exit from the New Zealand market and Australian based insurers gain prominence. American insurers were also active in early times, but have reduced their involvement in recent years. The industry continues to be tied closely to overseas corporations, with the majority of life insurers in New Zealand being Australian based.

4.11 There are also bank owned life insurers (the Bank of New Zealand, Westpac New Zealand, ANZ New Zealand, the National Bank of New Zealand, and the Commonwealth Bank of Australia through the acquisition of ASB Bank and Sovereign Assurance). Bank owned life insurers have exhibited rapid growth almost entirely through renewable risk only policies (see paragraph 1.10) and largely in conjunction with real estate mortgages.

Life products

4.12 Until the early 1990s the business of life insurance largely comprised:

- *Savings policies:* These were whole of life and endowment policies generally participating in annual bonus distributions. These policies are a combination of risk and investment characteristics.

---

20 Life Offices' Association of New Zealand *The Life Insurance Industry in New Zealand* (Wellington, New Zealand, 3rd edn, 1979).

21 Information obtained from the Tower website (www.towerlimited.com).

22 M Adams *Reflections on the New Zealand Life Insurance Industry* (Palmerston North, 1993).

- *Renewable risk only policies*: These represented a relatively small proportion of the industry and generally were limited to policies known as level premium term, where the annual premium stayed the same throughout the term of the policy.
- *Superannuation*: Until the late 1970s, superannuation benefits were commonly written through endowment contracts with annual increases (in contributions or salary) recorded in the form of increments to individual policies. In the 1980s, superannuation was written through trust deeds under the Superannuation Schemes Act 1989.
- *Annuities*: Defined contribution superannuation schemes (some classes of which for a time received certain tax advantages) created a market for annuities (which are only available through a life insurer).
- *Real estate mortgages*: The life industry throughout the 1960s and 1970s was second only to the State Advances Corporation as the provider of mortgage finance (residential and commercial).
- *Insurance bonds*: These were lump sum investment products providing some additional limited life insurance for the term of the investment.

4.13 For a long time, life insurance policies served the dual purposes of risk protection and savings, and were a key financial service.

4.14 However, the withdrawal of tax incentives for life insurance in the 1980s and the increasing popularity of renewable risk only policies caused a continuing decline in the sale of savings policies. The sale of renewable risk only policies increased dramatically, and the range of these products expanded considerably. The level premium term product was largely replaced by a yearly renewable term product under which the annual premium increased each year.

4.15 The taxation changes in the late 1980s also resulted in life insurers segregating superannuation business into separate superannuation companies. Existing historic endowment policies providing superannuation benefits still exist within life insurers but for about the last 15 years all new superannuation business has been written through separate entities. Also, banks have become the major providers of real estate mortgage finance.

4.16 There has never been a large annuities market in New Zealand, and the level of new annuities purchased has continued to decline. While annuities were sometimes purchased by superannuation schemes to cover their pension liabilities, pensions have become increasingly less popular. Unit trusts have emerged since the 1980s as a major competitor for savings that would previously have been invested in life and endowment policies. Unit trusts have also largely replaced insurance bond products.

Industry associations

4.17 The Life Offices Association ("LOA") was the representative body for the life insurance industry from 1918 until 1996. The LOA began as a branch of the Australian association, and became independent in the early 1970s. The aim of the organisation was to represent the interests of the life insurance industry.

4.18 By the late 1980s, with the introduction of the new investment-linked products, the pressure for regulation of selling processes had increased, especially in relation to the

projection rates used in policy illustrations. Changes were made to the Securities Act 1978 (see chapter 5) and the LOA Code of Practice came into being. Compliance with the LOA Code was a condition of authorisation under the then Securities Act regime.

4.19 The LOA Code set out the types of information that were to be disclosed to prospective policyholders, either on request or as of right. The LOA Code also provided for a "free look" period of 7 days for single premium policies and 14 days for policies with periodic premiums. During the free look period the new policyholder was entitled to withdraw from the investment and to receive a full refund of the premium paid without penalty.

4.20 The LOA Code covered life insurers' use of benefit projections in the selling process and, in particular, included provisions to ensure realism in the projection rates used. Benefit illustrations were to be provided to the client in writing and were not to be misleading or give unrealistic expectations. The LOA Code also included a complaints procedure, which ended on the establishment of the Insurance and Savings Ombudsman in early 1995.

4.21 During the 1990s, the savings aspect of life insurers' businesses came to dominate the risk aspect. As a result, in 1996, the LOA merged with the Investment Funds Association of New Zealand (previously the Unit Trust Association of New Zealand) to become the Investment Saving and Insurance Association of New Zealand ("ISI"), which is the current industry organisation.

4.22 The LOA Code was amended to reflect the change, but became defunct after the new disclosure regime was introduced to the Securities Act in 1996 (see chapter 5). The primary purpose of the Code had been to regulate the information given to customers at the point of sale, and this role was assumed by the investment statement now required by the Securities Act.

4.23 The ISI has introduced a Manual of Practice Standards. The only part of the LOA Code retained in the ISI Manual is the regulation of risk only and disability business, as that is not covered by the Securities Act disclosure requirements.

Actuaries

4.24 Actuaries have played a role in the regulation of United Kingdom life insurers since 1819, and the appointed actuary regime for life insurance companies was introduced in the United Kingdom in 1974.

4.25 In New Zealand, the actuarial profession has been advising life insurers for over 150 years, and is now given a limited regulatory role by various statutes.

4.26 All actuaries practising in New Zealand belong to the New Zealand Society of Actuaries ("NZSA"). The NZSA was originally known as the New Zealand Actuarial Club, and was formally incorporated under its present name in 1976. At the end of 1976 there were 35 Fellows and 18 Associates.[23] As at October 2003, there are 101 qualified actuaries practising in New Zealand.[24]

---

[23] Information obtained from the NZSA website (www.actuaries.org.nz).

[24] Information obtained from the NZSA.

Government Actuary

4.27 Until 1996, the Government Actuary's Office was a part of the Treasury. It performed regulatory functions, carried out reporting and provided actuarial services and policy advice on superannuation, life insurance, friendly societies, credit unions, the Government Superannuation Fund and the Accident Compensation Corporation, as specified by statute or as requested by the Treasury or other Government agencies.[25]

4.28 In September 1996, the Insurance and Superannuation Unit (within the Business and Registries Branch of the Ministry of Commerce) replaced the Government Actuary's Office.

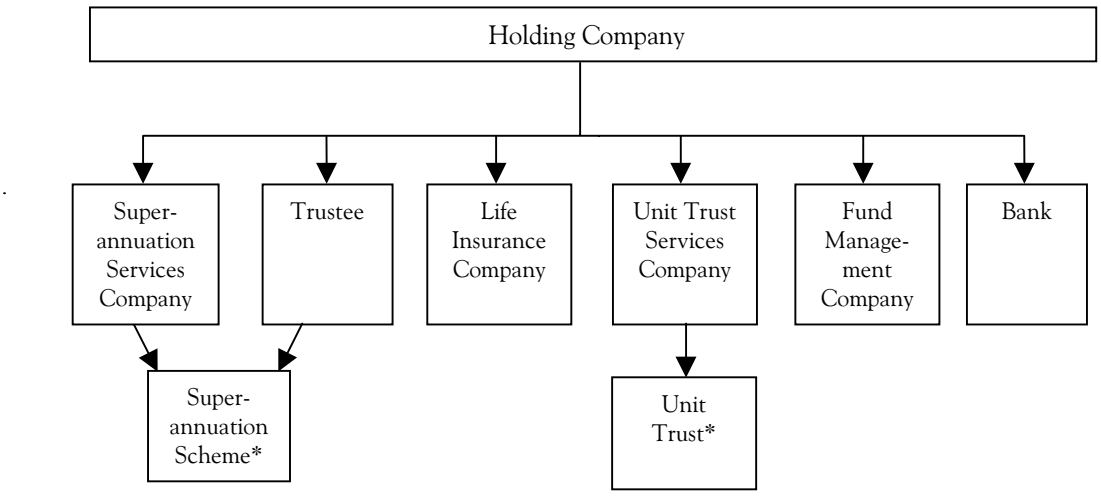
4.29 In 2000, the Ministry of Economic Development replaced the Ministry of Commerce. The Insurance and Superannuation Unit is located within the Business Services Branch of the Ministry of Economic Development, and the unit incorporates the work and functions of the Government Actuary.

THE CURRENT LIFE INDUSTRY IN NEW ZEALAND

Life insurers operating in New Zealand

4.30 Approximately 40 companies have a deposit lodged with the Public Trust as required under the Life Insurance Act 1908 ("Life Act"). Several of those companies have been taken over by another company or are no longer issuing life insurance policies. See Appendix A for a full list of life insurers operating in New Zealand.

4.31 Life insurers may exist as stand-alone entities or as separate companies within a group. A group structure could be as follows:



* The superannuation scheme and unit trust are not owned by the holding company.

[25] Ministry of Justice *Directory of Official Information* (Wellington, December 1995).

Role of overseas life insurers in the New Zealand market

4.32 Overseas owned life insurers form a major part of the New Zealand life insurance market. Overseas life insurers may be incorporated in New Zealand or may be an overseas company carrying on business in New Zealand. As discussed in paragraph 4.10, mergers and acquisitions and the emergence of bank owned life insurers have resulted in an increase in Australian, and a decline of English, owned companies. See Appendix A for a broad picture of the ownership of life insurers.

Life products

4.33 Life insurers offer a wide range of policies, some of which involve savings or investment elements as well as risk cover, and others that involve risk cover only.

4.34 Types of policies:

- *Whole of life insurance*: A typical "whole of life" policy contains both a pure insurance element and a savings/investment element. Like risk only insurance, it offers immediate and continuing death cover, for a specified sum, in return for a yearly premium. It also usually contains an investment element in the form of reversionary bonuses, which are monetary additions made to the policy, usually yearly, out of the surplus profits of the insurer (in such a case the policy is a "participating" policy). The longer the life insured survives, the greater the amount payable on his or her death. Insurers, however, do not always guarantee the payment of such bonuses.
- *Endowment insurance*: Endowment insurance is similar to whole of life insurance, but provides for the payment of the sum insured on a specified date (the maturity date) or on the death of the life insured if that occurs earlier. Reversionary bonuses may be declared during the life of the policy (in which case the policy is a "participating" policy) and it will usually have a "cash" value payable on surrender of the policy. Like whole of life insurance the premium remains constant during the term of the policy.
- *Unbundled policies*: For unbundled policies (sometimes called "investment" or "endowment" policies) the savings element is explicitly identified and the return on savings is reported to the policyholder periodically. Typically, these policies allow the policyholder to decide what proportion of the premiums is allocated to death cover and what is allocated to savings. Thus, the insured can tailor his or her death cover to commitments during the early years of the policy so that savings increase as the contract advances. In addition, the insured can usually convert the policy into a fully paid-up policy at the end of the contract period if desired and can draw on the savings portion for interest-free loans. Bonuses are not usually paid on such policies.
- *Annuities*: An annuity is a right to a series of payments similar to a pension. Under the usual life insurance policy, premiums are payable throughout the term of the policy with a lump sum payable on maturity or death (although single premium unbundled policies are becoming increasingly popular). In the case of annuities, a lump sum is usually paid to the insurer to purchase the annuity, which is then payable by instalments (usually monthly or quarterly) until the annuitant (that is the recipient of the annuity) dies (an annuity can be purchased by periodical payments).

The owner of the annuity and the person to whose life it relates are usually the same, although if the annuity arises under a superannuation fund the annuity is usually owned by the trustees of the fund.

- *Risk only insurance*: Risk only insurance (sometimes called term insurance or temporary insurance) simply provides death cover during a specified period. In other words, risk only insurance provides a benefit on the death of the life insured in much the same way as fire insurance provides a benefit in the event of the insured property being damaged or destroyed by fire during the period of insurance. The period of cover under the risk only insurance may be one year or a specified number of years or until the life insured attains a certain age. In most cases, if the life insured survives to the end of that period, the insurer will make no payment.

  Most risk only insurance policies contain no investment element (and are thus "non-participating policies"). Premiums are relatively low if the life insured is in good health. The premiums for annual risk only insurance increase, however, as the life insured gets older (and the risk of death increases). Premiums for level risk only insurance remain the same throughout the policy duration. Generally, after the policy is taken out, no further medical assessments are required, and the policyholder has a right of renewal, so long as the premiums continue to be paid.

- *Personal accident, disability and sickness insurance*: The term "life insurance" can also apply to personal accident, disability and sickness (such as trauma and terminal illness) insurance if they have a life cover element. Many policies link the amount recoverable to the insured's salary and provide that after a stated period no further payments will be payable.

- *Insurance bonds*: An insurance bond is technically a life insurance policy, but they are much more akin to a managed investment fund such as a unit trust. The key difference is that they are taxed differently because of their insurance status. Under an insurance bond, the bond holder pays a single deposit or a series of deposits into a savings or superannuation portfolio and there is an element of life cover. The benefit bond holders receive is their contribution, plus the profits made by their investment portfolios, less the costs involved in maintaining them. Like other life insurance policies, bonds may be capital stable or investment-linked and proceeds are tax-paid in the hands of the bond holder.

- *Investment linked policy*: An investment linked policy is a form of life insurance used for savings. It is similar to an investment account policy[26] except the policyholder does not have a separate savings account with the company to which interest is credited periodically. Instead, the savings element of premiums paid is pooled with all other policies of the same class to form a separate fund. The value of a policyholder's savings is represented by his or her share of the market value of the underlying assets less any fees that may be payable on realisation.

- *Group life insurance*: Group life insurance is usually issued to an employer or trustee of a superannuation scheme under a master contract for the benefit of

[26] For an investment account policy, the premium less the cost of life cover and expenses is paid to an individual investment account to which tax paid interest is credited.

employees. The policyholder is the employer or trustee who also pays the premiums and has an agreement with the employees regarding the payment of benefits. The advantage of this form of cover is that the premiums per employee are less expensive than those for individual policies, and cover can be provided without the need for individual medical examinations up to certain levels.

Current life business

4.35 The following figures provide a picture of the levels of new business being written by, and in force business of, New Zealand life insurers and the strong trend to risk only, income replacement and trauma insurance.[27]

Product	Annual premiums for quarter ending 30 June 2003 ($000)	
	New business	*In force at end of quarter*
Traditional		
Whole of life and endowment	1461	187 383
Unbundled	93	79 707
Annuities	36	21 166
Risk		
Term	17 974	413 607
Guaranteed acceptance	1035	18 616
Trauma – risk	4424	65 321
Replacement income – risk	6159	142 275
Lump sum – disablement	979	15 876
Accidental death	1008	21 138
Credit insurance	2580	39 375
Group		
Life – death and disablement	1007	43 113
Replacement income – group	509	11 613
Trauma – group	78	1272

Trends over the 10 years to 30 June 2002

4.36 The ISI has observed the following trends from a comparison of the number of policies as at 30 June 2002 and the number of policies from 10 years earlier, 30 June 1992:

- a decline in new business written for whole of life and endowment policies;
- a dramatic increase in renewable risk only policies;
- a decline in unbundled policies;
- little change in levels of annuity business (volumes very low);
- a massive increase in replacement income, accidental death and trauma insurance.

In summary, the industry has exhibited strong growth, but the product mix has changed markedly.

[27] All statistics were obtained from the ISI and relate to life insurers operating in New Zealand who were ISI members.

Role of actuaries

4.37 Life insurance involves an understanding of risk over a much longer time period than for most commercial businesses. The role of the actuary, as an assessor of long term risk, is critical to maintaining financially sound life insurers.

4.38 Before beginning study for qualification as an actuary, a person must join the NZSA and an overseas actuarial body that offers an actuarial qualification. To become a qualified actuary, trainees must pass several professional exams, which usually take between 5 and 8 years to complete.[28]

4.39 Under the NZSA Code of Conduct, every NZSA member must abide by NZSA professional standards and should "pay proper regard to" the NZSA's guidance notes. Guidance notes become professional standards after they are reviewed by the NZSA. An actuary may depart from a standard if the circumstances require, but good reasons are required to support any such departure.

Statutory requirements relating to actuaries

4.40 Section 18(1) of the Life Act states "every company shall, once in every year, cause an investigation to be made into its financial condition by an actuary". In practice, actuaries use Professional Standard No. 1 and Guidance Note No. 5 (produced by the NZSA) to prepare financial condition reports.

4.41 Under section 24 of the Financial Reporting Act 1993 financial reporting standards may be approved by the Accounting Standards Review Board. The approved Financial Reporting Standard 34 ("FRS-34") states that policy liabilities of a life insurer must be calculated using the actuarial guidelines and standards issued by the NZSA. The actuary's name and qualification must be disclosed in the notes to the accounts. In practice, the actuary also calculates the amount of equity to be retained for solvency reserves.

4.42 There is a statutory role for actuaries in certifying tax reserves for the policyholder base tax calculation (see paragraphs 5.134 to 5.136).

Business role of actuaries

4.43 Actuaries are employed in a variety of roles within life insurers. Actuarial responsibilities generally undertaken by actuaries include:

- statistical analysis of claims and other expenses;
- calculation of policy liabilities;
- management of solvency/capital adequacy issues;
- product pricing and designing products;
- dealing with reinsurance issues;
- management reporting;
- setting bonus and crediting rates.

---

[28] Information obtained from the NZSA website (www.actuaries.org.nz).

4.44 Consulting actuaries also play an important role in the industry, particularly for the smaller life insurers. Consulting actuaries are often used by auditors to review actuarial calculations included in financial statements.[29] They may also be engaged on project work including product development or process improvement.

Life reinsurance

Reinsurers in New Zealand life business

4.45 Reinsurers carrying on life business in New Zealand may include New Zealand incorporated companies, New Zealand branches of overseas companies, and overseas companies without New Zealand branches. Reinsurers include specialist reinsurers and life insurers that also provide reinsurance. In a group structure where there are several life companies, there may also be a degree of "self reinsurance" between the group companies. See Appendix A for a list of reinsurers.

4.46 There are currently no New Zealand owned reinsurance companies carrying on business in New Zealand.

4.47 Reinsurers are required to deposit a bond with the Public Trust under section 3 of the Life Act.

Typical reinsurance arrangements

4.48 The main purpose of reinsurance is to transfer some of the claims risk of the life insurer to another party. Reinsurance is also used to manage the capital position of a life insurer. Using reinsurance also allows a life insurer to access the specialist expertise of reinsurers.

4.49 Many types of reinsurance arrangements exist, for example:

- facultative placement, where the reinsurer pays the sum assured in excess of a specified amount on a specified life;
- surplus treaty, where the reinsurer pays the sum assured in excess of a specified amount on all lives in a specified portfolio;
- catastrophe, which covers claims on a single event normally with a minimum number of deaths, for example, 10;
- quota share treaty, where the reinsurer pays a specified percentage of each policy in a portfolio, often to a maximum per life with any remainder reinsured under a surplus treaty;
- quota share with financing, which is similar to quota-share but the reinsurer pays an amount for commission/acquisition expenses (these reinsurance arrangements often have complicated profit share arrangements);
- stop loss, where the reinsurer pays the loss on a portfolio over a specified amount during a specified year; and
- portfolio, where the whole of a portfolio is reinsured.

[29] Information obtained from the NZSA Life Committee.

Industry and other bodies

Investment Savings and Insurance Association

4.50 The ISI is a voluntary organisation representing the interests of investment, savings and insurance companies (excluding fire and general insurance).

4.51 The ISI's formal mission is to play a leading role in the development of the social, economic and regulatory framework in which its members operate to:

- promote a legislative, regulatory and tax environment in which member companies can operate successfully;
- promote integrity in the industry;
- deliver a strong cohesive industry body; and
- enhance the industry's image and reputation.[30]

4.52 The ISI represents almost all the life insurers operating in New Zealand and the majority of fund managers. The Chair is elected from within the board by members, and the position may be held for a maximum of 4 years.

4.53 The ISI produces a Manual of Practice Standards, which relates to aspects of preparation and presentation of those parts of members' selling and marketing material that are not covered by the statutory disclosure requirements.

4.54 There are no statutory disclosure requirements for term life (renewable and non-renewable risk only insurance) or disability products. Therefore, the standards for the sale of these products are provided by the ISI Manual, which states the minimum information requirements for both insurers and intermediaries.

4.55 The ISI Manual also aims to provide consistency of presentation in such areas as the measurement of investment returns, the calculation of benefit projections and the management expense ratio.

4.56 Compliance with the ISI Manual is mandatory for all relevant retail products being offered in New Zealand by ISI members or any of their subsidiary or associated companies.

4.57 All ISI members must participate in the Insurance and Savings Ombudsman Scheme.

Insurance and Savings Ombudsman

4.58 The Insurance and Savings Ombudsman ("ISO") was established in 1995 as an independent body to help consumers resolve complaints against participating insurance

[30] The Investment Savings and Insurance Association of New Zealand Inc *Annual Review for the Year Ended 30 June 2003* (Wellington, 2003).

and savings companies. The service is free to consumers and operates independently of the insurance and savings industry. Members of the ISI, Insurance Council of New Zealand[31] and Health Funds Association of New Zealand[32] fund the Scheme.

4.59 The primary objective of the ISO is to provide a fair, impartial and independent dispute resolution service, which is accessible and free to the public. Its operational aims are economy, efficiency and effectiveness.[33]

4.60 The ISO's jurisdiction is determined by its terms of reference, which were amended in July 2002 by the ISO Board. Broadly, the ISO may deal with complaints about certain services provided within New Zealand by participating insurance and savings companies, including:

- fire and general insurance services;
- medical insurance services;
- life insurance services; and
- savings services.

4.61 The ISO is excluded by its terms of reference from dealing with complaints:

- about insurance provided for business or commercial purposes;
- where the amount claimed is over $100 000 (unless the company agrees otherwise);
- relating to disability benefits that provide for regular payments in excess of $750 per week;
- made by an uninsured third party;
- that are, or have been, the subject of proceedings in another forum, for example, a decision has already been made in Court;
- about a company's commercial decision making, for example, policy renewals, underwriting practices, conditions imposed on insurance cover, premiums, charges, returns, earnings rates and investment practices;
- pursued in a vexatious manner or in bad faith;
- against a company that does not participate in the ISO Scheme; and
- relating to employment superannuation schemes.

4.62 Insurers participating in the ISO Scheme are obliged to have internal complaints processes. Complaints must go through a company's internal complaints procedure first and will be referred to the ISO if a "deadlock" is reached and jurisdiction is established.[34] The ISO decides the procedure to be adopted in considering complaints and must generally adopt an inquisitorial approach.

---

31 The Insurance Council of New Zealand is an industry organisation representing fire and general insurers.

32 The Health Funds Association of New Zealand is the industry body representing health insurers in New Zealand.

33 Information obtained from the ISO website (www.iombudsman.org.nz).

34 "Deadlock" means the company has fully considered the complaint through its internal complaints procedure and has decided the complaint cannot be resolved by that procedure.

4.63 While the ISO aims to settle most disputes by way of mediation and conciliation, when agreement cannot be reached, the ISO has the power to make recommendations to resolve the dispute, and may award up to $100 000. The ISO's ruling is binding on the company, but not on the complainant, who may reject it and take the matter to Court or any other authority.

4.64 For the 2001–2002 financial year, the ISO received 236 complaints for consideration and resolved 234. One-third of all complaints received were in the life and savings area, and of those over 60 per cent were in some way related to health and disability claims including non-disclosure of pre-existing conditions, total permanent disablement claims and partial disablement claims.[35]

Banking Ombudsman

4.65 The Banking Ombudsman scheme was set up in 1992 as a free, external and independent process to help people resolve disputes with banks and their subsidiaries (including life insurer subsidiaries).

4.66 The jurisdiction of the Banking Ombudsman is determined by its terms of reference. Broadly, the Banking Ombudsman may deal with complaints about certain services provided by participating banks within New Zealand if:

- a complaint is about a specific banking service;
- the bank's actions have caused a complainant to suffer financial loss or damage and/or inconvenience;
- the amount of financial loss claimed is less than $120 000, or $150 000 in the case of banking services relating to insurance;
- the complaint is about something that happened after 1 January 1992.

4.67 Banks participating in the Banking Ombudsman scheme are obliged to have internal complaints processes. Complaints must go through a bank's internal complaints procedure first and will be referred to the Banking Ombudsman if a "deadlock" is reached and jurisdiction established.

4.68 The Banking Ombudsman has the power to make recommendations and/or award compensation to cover direct financial loss or damage up to $120 000, or $150 000 in the case of banking services relating to insurance, and to compensate for inconvenience up to $4000. The Banking Ombudsman's decision is binding on the bank, but not on the complainant who may reject it and take the matter to Court, to the Disputes Tribunal or any other complaint resolution body.

4.69 For the 2002–2003 financial year, 5 per cent of all complaints received by the Banking Ombudsman related to insurance.

---

[35] Insurance and Savings Ombudsman *Insurance and Savings Ombudsman Annual Report 2002* (Wellington, 2003).

New Zealand Society of Actuaries

4.70 The NZSA is a professional body to which all qualified actuaries practising in New Zealand belong voluntarily.

4.71 The objectives of the NZSA are to:

- establish, promote and maintain high standards of competence and conduct within the actuarial profession;
- develop New Zealand actuarial standards and guidance notes;
- be a reference source on actuarial matters for Government, official and other interested bodies;
- provide a formal link with actuarial bodies elsewhere in the world;
- assist student actuaries in their studies;
- facilitate taking such action as the NZSA may agree in respect of any matter relevant to the actuarial profession;
- afford NZSA members the opportunity to discuss actuarial and other matters of interest to actuaries; and
- promote fellowship amongst the actuarial profession.

4.72 There were 101 qualified actuaries practising in New Zealand as at 31 October 2003.[36] Fellowship is obtained by becoming a fellow of one of the following organisations:

- Faculty of Actuaries (Scotland);
- Institute of Actuaries (United Kingdom);
- Institute of Actuaries of Australia;
- Canadian Institute of Actuaries;
- Society of Actuaries (United States).

4.73 The NZSA council must also be satisfied that the applicant is familiar with New Zealand conditions. The NZSA is not an examining body. Its role in the examination process is generally limited to organising venues in which examinations can be held.

4.74 The NZSA produces a Code of Conduct by which all members practising in New Zealand must abide. When it is alleged a member has acted in a professionally objectionable manner, the NZSA's Professional Conduct Committee will take such steps as it thinks fit, and if necessary will set in motion disciplinary procedures.

4.75 The NZSA also produces professional standards and guidance notes. The following standards and guidance notes apply to actuaries who are members of the NZSA when providing services for life insurance companies in New Zealand:

- PS1 – A Professional Standard for Reports and Advice to an Organisation Carrying on Long Term Insurance Business;
- PS3 – A Professional Standard for Determination of Life Insurance Policy Liabilities;

[36] Information obtained from the NZSA.

- GN1 – A Guidance Note for Compliance with Actuarial Advice Requirements of Code of Business Practices for Life Insurance Companies; and
- GN5 – A Guidance Note for Life Insurance Company Prudential Reserving.

Retirement Commissioner

4.76 The Office of the Retirement Commissioner was established under the Retirement Income Act 1993.

4.77 The Retirement Commissioner's role is to educate and inform New Zealanders about the importance of making private provision for retirement, and to encourage them to do so. The Commissioner acts as an impartial source of factual information on issues relating to retirement planning.

4.78 Under the Retirement Income Act, the functions of the Retirement Commissioner include:

- developing and promoting ways to improve the effectiveness of Government retirement policies, including by promoting education about retirement income issues and publishing information about these issues;
- monitoring the effects of retirement income policies;
- assisting in the preparation of periodic reports on the Government's retirement income policies;
- advising the Government on retirement income issues;
- monitoring the effectiveness of ombudsmen and other people appointed to consider complaints and disputes about savings and investments, and to consider issues those people refer to the Commissioner; and
- collecting and publishing information as is necessary for the office to fulfil its functions.

4.79 The Commissioner may recommend the Government changes legislation or its retirement policy.

Ministry of Economic Development

4.80 The Ministry of Economic Development has an Insurance and Superannuation Unit within its Business Services Branch. Among other things the Unit ensures insurance companies comply with their statutory obligations under the Life Act and Insurance Companies' Deposits Act 1953, and administers the Insurance Companies (Ratings and Inspections) Act 1994.[37]

4.81 The Insurance and Superannuation Unit incorporates the office of the Government Actuary, who carries out statutory and other functions.

4.82 The Business Law Group of the Regulatory and Competition Policy Branch of the Ministry is responsible for policy advice.

---

[37] Information obtained from the Ministry of Economic Development website (www.med.govt.nz).

Government Actuary

4.83 The Government Actuary is located within the Insurance and Superannuation Unit of the Ministry of Economic Development (see paragraph 4.81).

4.84 In general, the Government Actuary makes decisions on matters involving actuarial valuation and related technical issues, and is the regulator of registered superannuation schemes.

4.85 The Government Actuary also has a particular role in the supervision of life insurance. This is set out in the Life Act and in section CM18 of the Income Tax Act 1994.

4.86 Under the Life Act the Government Actuary reviews the various statements required under the Act, and may make a report based on his or her findings to the Minister.[38]

4.87 Under section CM18 of the Income Tax Act, on the transfer of a life insurance business, the Government Actuary reports to the Commissioner of Inland Revenue whether the business being transferred comprises all of the transferor's life insurance business (or all of its New Zealand life insurance business) and that no policyholder will be unduly disadvantaged as a result of the transfer.

Reserve Bank of New Zealand

4.88 The Reserve Bank of New Zealand is responsible for the registration and prudential supervision of registered banks, and helps ensure a sound and efficient financial system.[39] The Reserve Bank does not have supervisory responsibility for managed funds, insurance, or securities activities as such.

4.89 Banking supervision is conducted primarily in respect of the banking group, that is, the consolidated operations of the registered bank, which generally includes subsidiaries involved in banking activities and the provision of related financial services. Where securities trading or underwriting business is undertaken by banks or their subsidiaries, or where banks own finance company subsidiaries, the Reserve Bank's prudential and disclosure requirements (including market risk disclosure requirements) are applied to the consolidated group, which will include those activities. See paragraphs 3.22 to 3.31 for further discussion of the Reserve Bank's system of bank supervision.

Securities Commission

4.90 The Securities Commission was established under Part 1 of the Securities Act. The Commission is responsible for and administers the Securities Act, which governs primary offers of securities to the New Zealand market.

4.91 The Securities Commission regulates life insurers' compliance with the prospectus, investment statement and advertising provisions of the Securities Act.

---

38 Section 22 of the Life Act.

39 Information obtained from the Reserve Bank of New Zealand website (www.rbnz.govt.nz).

Financial Planners and Insurance Advisers Association

4.92 The Financial Planners and Insurance Advisers Association ("FPIA") is a voluntary body that represents financial advisers, including insurance agents, investment advisers and financial planners.[40] The FPIA is New Zealand's largest professional body representing over 1300 financial advisers nationwide. FPIA members advise on life insurance, among other products.

4.93 The FPIA's primary focus is to improve and enhance the professional status of financial advisers, and to advance the interests of members and their clients.

4.94 The FPIA aims to:

- raise advisory standards in ethics and professional conduct;
- provide education standards designed to inspire greater confidence and trust between advisers and the public; and
- identify and serve members' needs and interests.

4.95 The FPIA has a Code of Ethics, a Code of Procedure, and Disciplinary, Membership and Certification Bylaws.

4.96 The FPIA also offers a professional development programme that includes an annual convention, biannual professional development days, practical courses and papers by distance learning. FPIA branches arrange regular educational events in the regions.

Other agent/broker bodies

4.97 The Life Brokers Association ("LBA") has approximately 200 members and membership is directly related to the sale of life insurance products. Members of the LBA must abide by the LBA Code of Ethics.

4.98 The Corporation of Insurance Brokers of New Zealand and the Independent Insurers Brokers Association of New Zealand have announced they will merge to become the Insurance Brokers Association by April 2005.

Friendly societies

4.99 The traditional friendly society is a member owned association set up to provide financial and other assistance to members and their families in times of need – principally sickness, old age and death. Its operations are based on insurance principles and mutual sharing of risk, with benefits being paid from funds accumulated from member's contributions. Its activities are regulated by formal rules, adopted and amended from time to time by the members. Within the framework of these rules, the society is governed by a committee and officers, who are elected by the members.

[40] Information obtained from the FPIA (www.fpia.org.nz).

4.100 At 30 June 2003 there were 199 organisations registered under Part II of the Friendly Societies and Credit Unions Act 1982, compared with 209 at 30 June 2002 and 227 at 30 June 2001.[41] Friendly societies are not covered by the Life Act.

4.101 A diverse range of societies may be registered under the Friendly Societies and Credit Unions Act. Friendly societies that issue life insurance are generally those set up to provide mainly insurance-related benefits for members and their families. These include benefits payable on sickness, annuities in old age, funeral benefits, life insurance and medical benefits.

4.102 Under the Friendly Societies and Credit Unions Act there is a statutory limit on the amount friendly societies may pay to any member under an insurance contract, being a maximum of $60 000 or $750 a year by way of annuity.

Credit unions

4.103 A credit union is a member owned co-operative financial organisation set up to provide savings and loan facilities to its members. The main objects of credit unions are the promotion of thrift among members by the accumulation of their savings, the lending of those savings back to members, and also the education of members in the wise use of money and financial affairs.

4.104 Credit unions do not offer life insurance. However, the New Zealand Association of Credit Unions, registered as an association under the Friendly Societies and Credit Unions Act, does offer life insurance and is covered by the Life Act.

4.105 A credit union is owned and democratically controlled by its members. Each credit union operates under membership rules that define the group of members with a mutual interest. Each member has one vote, regardless of the size of his or her account balance. Within the framework of its registered rules, a credit union is managed by a board of directors, who are elected by the members and appointed officers.

4.106 As at 30 June 2003, there were 61 credit unions and 2 associations of credit unions registered under Part III of the Friendly Societies and Credit Unions Act. Total assets of all credit unions, excluding the two associations, amounted to $428 million in 2002.[42]

Mutual associations

4.107 There is one farmers mutual association operating in New Zealand, being Farmers Mutual Group ("FMG"). FMG offers a range of insurance products, including life, general, health and disability insurance. Life insurance is offered through a subsidiary company, Farmers Mutual Life Limited which is not a member of the ISI.[43]

---

41 Information obtained from the *Friendly Societies and Credit Unions Report for the Year ended 17 September 2003* (Wellington, 2003).

42 Information obtained from the *Friendly Societies and Credit Unions Report for the Year ended 17 September 2003* (Wellington, 2003).

43 Information obtained from the FMG (www.fmg.co.nz).

Building societies

4.108 Building societies may issue some securities (including debt securities and participatory securities) under the Building Societies Act 1965. However, they cannot issue life or any other form of insurance. They may issue insurance through subsidiaries, and Southland Building Society does through its subsidiary Southsure Assurance Limited.

Institute of Chartered Accountants of New Zealand and Accounting Standards Review Board

4.109 The Institute of Chartered Accountants of New Zealand develops financial reporting standards, for approval by the Accounting Standards Review Board under the Financial Reporting Act 1993.

4.110 The financial reporting standard specific to life insurance companies is FRS-34. FRS-34 is aimed at matching expenditure and income to reflect emerging profits, however, it is under review (see paragraphs 5.90 to 5.93). Under International Accounting Standards Board proposals, FRS-34 will be replaced by an approach aimed at matching assets and liabilities. An exposure draft on life insurance (ED5) is currently being considered.

Current market conditions

4.111 Over the last 2 to 3 years (until early 2003), the New Zealand life insurance industry has been adversely affected by declining global equity values and declining interest rates.

4.112 The returns from managed funds have been low, because the overseas components of funds have been affected by reducing values of overseas shares, first, after the September 11 attacks, and more recently after the American accounting scandals. In addition, as the New Zealand dollar has been rising, overseas investments have been losing value in New Zealand dollar terms.[44]

4.113 The financial media have suggested there may be solvency problems in the global life insurance industry and that these problems may extend to the reinsurance market. Internationally, several life insurers and reinsurers have been forced to raise additional capital. In New Zealand's economic region, some life insurers have recently gone to the local market to raise additional shareholder capital.

Q4 Do you have any comments on chapter 4?

---

[44] KPMG *The State of the Investment Industry in Australia and New Zealand July–December 2002* (Australia: KPMG's Managed Investments Group, 2003) 40.

Chapter 5
New Zealand life insurance law

BRIEF HISTORY OF NEW ZEALAND LIFE INSURANCE LEGISLATION

5.1 The first New Zealand legislation relating directly to the life insurance industry was the Life Insurance Companies Act 1873. This Act was modelled on the United Kingdom's Life Assurance Act 1870, which was based on the concept of "freedom with publicity". A key aspect of "freedom with publicity" was that the financial condition of a life insurer would be regularly exposed to public scrutiny by placing actuary's report on the valuation of the insurer's assets and liabilities on the public record.

5.2 The Life Assurance Policies Act 1884 dealt with the terms of policies, including assignment and mortgaging of policies, protection of policies and minors' policies.

5.3 In 1908, the Life Insurance Companies Act 1873 was consolidated with the Life Assurance Policies Act 1884, to form the Life Insurance Act 1908 (the "Life Act"). The Life Act and its amendments, has been the principal enactment governing the operation and oversight of the life insurance industry in New Zealand ever since.

5.4 Many of the provisions of the Life Act are the original provisions from the 1873 and 1884 Acts, for example, section 15 of the Life Act states that "a separate account shall be kept of all receipts in respect of the life insurance and annuity contracts of the company", thereby forming a separate fund. Section 15 of the Life Act was taken directly from section 20 of the 1873 Act.

5.5 The only substantial changes to the Life Act occurred in 1983. The 1983 amendments introduced Part 1A, which provides for the appointment of a judicial manager if it appears there is a likelihood that the company is, or will be, unable to meet any of its liabilities to policyholders. The 1983 amendment also added sections requiring a company to provide information or explanations to the chief executive of the Ministry of Economic Development in certain situations.[45]

5.6 In 1973 an amendment to the Reserve Bank of New Zealand Act 1964 gave the Reserve Bank the authority to make recommendations to a life insurer with respect to the policy to be followed in its business and, from time to time, to give directives as to the holding of specific assets.[46] For example, a directive issued in 1974 required life offices to hold not less than 30 per cent of gross selected assets in Government or local authority stock of which at least 21 per cent was to be in Government stock. Additionally, the Reserve Bank required quarterly returns on new business, investments

[45] Sections 21 and 22 of the Life Act.

[46] Section 34 of the Reserve Bank of New Zealand Act 1964.

and interest rates.[47] In 1985 this directive was repealed as part of the Government's commitment to a free market.

Securities Act 1978

5.7 Life insurers are also subject to the provisions of the Securities Act 1978. When that Act was enacted, life policies were exempt by section 5(1)(a) from the prospectus, trustee/statutory supervisor, and advertising requirements of that Act.

5.8 This situation changed in 1989 when section 5(1)(a) was repealed and sections 7A and 7B were inserted. The effect of the new sections was that life policies became subject to the normal rules of law relating to the offering of securities to the public. However, the Securities Commission was empowered by section 7A(2) to "authorise" or exempt life insurance companies from the prospectus and trustee/statutory supervisor provisions. The Securities Commission was also empowered to set terms and conditions of exemption. The conditions set by the Securities Commission included:

- A limitation of 12 months on each company's period of authorisation. This meant each company had to apply for renewed authorisation each year.
- The exempted companies were required to comply with the Life Offices' Association Code of Practice (see paragraphs 4.18–4.23).
- Directors were required to sign a "directors statement" that contained a declaration as to the director's knowledge of any adverse circumstances that had arisen between the date of the company's last financial statements and the date of the statement's signing.

5.9 When authorising individual life insurers, the Securities Commission required financial and other information to be supplied to it within four-and-a-half months of balance date. Commission staff reviewed each life insurer and routinely discussed individual cases with the Government Actuary. As a result, the Commission would sometimes impose pre-conditions on a life insurer's authorisation. The Commission also had the power to vary or revoke existing authorisations (section 7A(4)).

5.10 In 1997 sections 7A and 7B of the Securities Act were repealed. At this time a "term life insurance policy" was defined and excluded from the Act. Life insurers are now required to comply with the prospectus, investment statement and advertising provisions of the Securities Act in relation to life insurance contracts that have an investment element. These changes reflect the philosophy of the Securities Act (which is the same "freedom with publicity" philosophy that underpinned the original United Kingdom 1870 Act) that investors need to be given full and meaningful information before committing themselves to an investment contract.

EXISTING NEW ZEALAND LAW FOR LIFE INSURERS

5.11 Life insurers in New Zealand are subject to the common law, various statutes, and some voluntary regulation. The Life Act governs all life insurers and reinsurers carrying on business in New Zealand. While the principal legal requirements are contained in this Act, other important requirements are found in the Insurance Law Reform Acts of

[47] Life Offices Association of New Zealand, above n 20.

1977 and 1985, the Securities Act 1978, Fair Trading Act 1986, Consumer Guarantees Act 1993, Financial Reporting Act 1993, Companies Act 1993, Financial Transactions Reporting Act 1996, Corporations (Investigation and Management) Act 1989, Commerce Act 1986, Human Rights Act 1993, Insurance Intermediaries Act 1994, Investment Advisers (Disclosure) Act 1982, Secret Commissions Act 1910, Securities Markets Act 1988, Friendly Societies and Credit Unions Act 1982, Co-operative Companies Act 1986, Mutual Insurance Act 1955, Crimes Act 1961 and various tax statutes. (See also the comparative table in Appendix B, which summarises New Zealand law compared with other jurisdictions.)

LIFE INSURANCE ACT 1908

5.12 Broadly speaking, the Life Act provides as follows.

Part 1 – Life insurance companies

Definition of a "company" (section 2)

5.13 A "company" means "any person or association, corporate or unincorporate, not being established under any Act relating to friendly societies, which issues or is liable under policies of insurance upon human life in New Zealand, or which grants annuities upon human life in New Zealand, or which is liable under any contract of reinsurance in respect of the issue in New Zealand of policies of insurance upon human life, or of the granting in New Zealand of annuities upon human life: and includes companies established out of New Zealand as well as those established in New Zealand, and includes mutual associations as well as proprietary".[48]

Deposit (sections 3 to 14)

5.14 Every company "carrying on in New Zealand the business of insurance upon human life or the grant of annuities, or of reinsurance in respect of policies of insurance upon human life or the grant of annuities", must deposit approved securities to the value of $500 000 with the Public Trust (section 3).

5.15 The purpose of the deposit is to provide protection for policyholders in the event of the liquidation of a life insurer, by ensuring there is a sum of money able to be applied towards any amount owed to policyholders (section 30B).

Separate account (section 15)

5.16 Every company transacting business besides that of life insurance must keep a separate account of all receipts in relation to its life and annuity contracts. The receipts should be carried to and from a separate fund (to be called the "Life Insurance Fund" of the company).

5.17 The fund is absolutely the security of the holders of the life policies and annuities, just as if it belonged to a company engaged only in life business.[49] In practice, this section

---

[48] This definition applies to Parts 1 and 1A of the Life Act.

[49] *Laws of New Zealand* (Butterworths of New Zealand Limited, Wellington 2001) "Insurance", Part X, Statutory Regulation of Insurance Companies, para 638.

has not been found to have that effect. The *ACL Insurance Limited v ACL Limited (In Liquidation)* HC, Auckland M2121/89 6 March 1995 case resulted in a report commissioned by the Department of Justice to consider section 15. The report noted "the actual wording [of section 15] … is an absurdity … the fact that it [section 15] has not been exploited more over the years is probably the most surprising aspect of any consideration of its effect".

5.18 Barker J in his judgment stated, "It is still not clear that the legislation requires a separate bank account for the life insurance fund".[50] The *ACL* case was concerned primarily with the claims of policyholders verses the claims of other unsecured creditors. In the absence of a separate life fund, policyholders lose any protection they might otherwise have had.

Company statements and reports (sections 16 to 20)

5.19 Each year every company must prepare both a statement of its revenue account and a statement of its financial position (sections 16 and 17). These are required to be prepared in the forms contained in the schedules to the Life Act (in practice, insurers prepare reports in the "spirit" rather than the "letter" of the schedules) and must be accompanied by a report from a qualified auditor (section 17A). These schedules have not been revised (apart from their titles) since the Life Act was passed in 1908. The fact that the statement of financial position (Schedule 3) includes such headings as investments in "Indian and Colonial Government securities" shows that the schedules are a relic from a bygone era.[51]

5.20 Once in every year, every company must "cause an investigation to be made into its financial condition by an actuary" (section 18). The New Zealand Society of Actuaries' ("NZSA's") Professional Standard 1 sets out the matters the NZSA considers the actuary should address when examining and reporting on a company's financial condition. Standard 4.2.3 of Professional Standard No. 1 states that the report should include a calculation of the solvency position, and refers the actuary to the NZSA's Guidance Note No. 5.

5.21 Each company must lodge an abstract of that actuarial report, which is to be prepared in accordance with the form prescribed in Schedule 6 of the Life Act.

5.22 Each year every company is required to lodge a statement of its life insurance and annuity business (section 19). The form for the statement is set out in Schedule 7 to the Life Act.

5.23 The present requirement is for statements and reports to be lodged with the chief executive of the Ministry of Economic Development within 9 months of the close of the company's financial year.

---

50 *ACL Insurance Limited v ACL Limited (In Liquidation)* HC, Auckland, 6 March 1995, M2121/89, 13.

51 MJ Weaver *Life Insurance Law in New Zealand* (Wellington, 1998).

Supervisory provisions (sections 21 and 22)

5.24 In practice, statements and reports are lodged by sending the documents to the Insurance and Superannuation Unit based within the Ministry of Economic Development, where the Government Actuary is actually based. The Government Actuary, on receiving the statements or reports, makes a report to the Minister as he or she thinks fit (section 22). The chief executive of the Ministry of Economic Development may require a company to provide information or explanations about any statement or report received, which may then be sent to the Government Actuary.

Access to company statements and reports by shareholders, policyholders or others (sections 23 and 26)

5.25 A life insurer must forward copies of its most recently deposited statements and reports to any shareholder or policyholder who requests them (section 23). Any person may inspect the statements that a life company is required to deposit, on the payment of any fees specified by the Minister (section 26).

Life insurers not registered under the Companies Act 1955 or 1993 (sections 24 and 25)

5.26 Every company not registered under the Companies Acts must keep a register of shareholders. The company must send a copy of the register to shareholders and policyholders who request it and pay the relevant fee. Further, companies not registered under the Companies Acts must provide shareholders and policyholders with copies of their deed of settlement or other Act, charter or instrument constituting and regulating their mode of business, on request, for a fee of not more than 25 cents.

Penalties

5.27 Companies that do not comply with any of the requirements of Part 1 of the Life Act (sections 2 to 40) are liable to a fine not exceeding $100, for every day during which the default continues (section 28). In the case of a foreign company, both the company and its general agent will be liable for this fine. Falsifying statements under Part 1 can result in a fine and imprisonment or, on summary conviction, a fine not exceeding $100 (section 29).

5.28 The Minister may prohibit a company from transacting business in New Zealand if the company defaults, for a period of 3 months, in complying with the provisions of Part 1 of the Life Act. A company will be fined $500 for every act done in breach of the prohibition (section 38).

Liquidation (sections 30 to 31)

5.29 Life insurance companies may be wound up in accordance with the Companies Act, except that where the company is liable under any life insurance contract, it cannot be placed in voluntary liquidation by shareholders or the board of the company (section 30).

5.30 The liquidator of the company is required to value each policy and give notice to each policyholder of the assessed value of each policy (section 30A(1)). The policyholder may appeal the liquidator's valuation, but that appeal must be filed with the High Court within 2 months of the notice being given to the policyholder by the liquidator (section

30A(4)). In addition, the liquidator must distribute any deposit repaid to the liquidator by the Public Trust in accordance with section 30B.

Foreign companies (sections 34 to 37)

5.31 A general agent must be appointed for branches or subsidiaries of foreign companies to do business in New Zealand. All lawful processes against a foreign company may be served on the general agent (with the same legal force and validity as if served on the company), with the same effect as if the company existed in New Zealand. Foreign companies must comply with all the requirements of the Life Act.

Part 1A – Judicial management of companies

5.32 Part 1A was inserted by the 1983 amendment to the Life Act. This part of the Act provides for the Minister to apply to the High Court for the appointment of a judicial manager if it appears likely that a company is, or will be, unable to meet any of its liabilities to policyholders. The Court may have regard to statements or other documents filed with the chief executive of the Ministry of Economic Development, any report of the Government Actuary prepared under section 22 of the Life Act, or other evidence.

5.33 The appointment of a judicial manager has the following consequences:

- The judicial manager takes over control of the company's management, and the directors and staff may act only in accordance with the judicial manager's permission (section 40D).
- A moratorium is imposed staying proceedings against the company, and preventing new proceedings from being commenced (section 40B).
- The judicial manager must report to the Court on the state of the business and affairs of the company and make recommendations about the business of the company, the transfer of that business, the liquidation of the company or any other matters relating to the business of the company (section 40F).

5.34 Where the judicial manager proposes the transfer of the business as part of his or her report to the Court, the report must also include a scheme of arrangement for the transfer of business identifying the affected policies, the assets and net value to be transferred and the terms of any agreement to the transfer of the business (section 40I).

5.35 An example of a company under judicial management is the *ACL* case. In 1989, the Government Actuary advised the Minister of Justice that the company was in breach of the Life Act and that there was a likelihood it would be unable to meet its liabilities to policyholders. The Minister invoked the powers under section 40A of the Life Act and applied to the Court to appoint a judicial manager to take over the affairs of the company.

Part 2 – Life insurance policies

Definition of a "company" for Part 2 of the Act (section 41)

5.36 A "company" means "any person or association, whether incorporated or otherwise, not being established under any Act relating to friendly societies, which issues or is liable under policies as herein defined; and includes companies now or hereafter established

out of New Zealand as well as those now or hereafter established in New Zealand, and mutual associations as well as proprietary; and also includes the Tower Corporation under the Tower Corporation Act 1990".

Interest (section 41A)

5.37 When money becomes payable under a policy because the life insured has died, and the money is not paid within 90 days, the insurer must pay interest at the rate specified in the Judicature Act 1908 or in the policy, whichever is greater, from the ninety-first day. There is a savings provision for group funds.[52]

Assignments and mortgages of policies (sections 42 to 63)

5.38 Every assignment of a policy (or a mortgaged policy) and every mortgage must be registered under the Life Act to be valid. The forms for assignments and mortgages of policies are set out in the schedules to the Life Act. A company may charge any fee, not exceeding 50 cents, for effecting any registration.

5.39 Special formalities are prescribed in substitution for registration, for the assignment and mortgage of policies issued by companies established out of New Zealand and not having a place of business in New Zealand.

5.40 The insurer may apply the surrender value or any part of it in payment of overdue premiums and interest to keep the policy in force (section 63). The money so applied is the first charge on the money payable under the policy and on its surrender value, and may be deducted from the insurance money against any mortgagee or assignee.[53]

Protection of policies (section 64)

5.41 No policy becomes void on the grounds that premiums have not been paid, as long as the premiums and interest in arrears are not more than the surrender value (section 64). The surrender value may be used to keep the policy in force (section 63).

Insurance of minors or on the lives of minors (sections 66A to 74)

5.42 The statutory provisions dealing with minors in the Life Act must be read subject to the Insurance Law Reform Act 1977 and the Insurance Law Reform Act 1985.

5.43 A minor under the age of 10 may effect a policy on his or her own life only if the policy contract is approved by the District Court under the Minors' Contracts Act 1969 (section 66A). A minor over the age of 10 but under the age of 16 may insure his or her own life, subject to the Court's power to take certain action (section 66B). The Life Act prescribes how a minor of or over the age of 16 may deal with his or her policy and provides for the Court to give relief where necessary. Where the minor is under the age of 16, all dealings with policies require District Court approval (section 66C).

5.44 Insurance on the life of a minor who is under the age of 16 may be effected by the parents or guardians of the minor, or one of them; a parent or guardian of the minor or

---

52 *Laws of New Zealand*, above n 49, "Insurance", Part VI, Life Insurance, para 524.

53 *Laws of New Zealand*, above n 49, "Insurance", Part VI, Life Insurance, para 507.

the spouse of that parent or guardian, jointly; or any person who has obtained District Court consent (section 67).

5.45 There is a statutory limitation on the amount payable under any life insurance policy on the death of a minor under the age of 10 (section 67B) and under the age of 16 (section 67C). These limitations must be set out and explained in a statement, which must be acknowledged and signed, before a policy is taken out on the life of a minor (section 67D).

5.46 If an insurer is unable to pay the benefit of the policy to any person as named by statute (section 67C), the amount is paid to the Public Trust (section 69). The Public Trust may apply the amount or the interest from it for the minor's maintenance, education, protection or advancement, and has absolute discretion as to the way in which this is done (section 71).

Annual statement and separate account of New Zealand business (sections 78 to 79A)

5.47 Every company is required to prepare and deposit a statement of all its policies at the close of each financial year, in addition to the other statements required under Part 1 of the Life Act, in the form contained in Schedule 20 of the Life Act (section 78).

5.48 Every company must keep a separate account of all its life business transacted in New Zealand, and of the entire assets of the company in New Zealand. In addition to the other statements required under the Life Act, every company must also prepare separate statements (each accompanied by an auditor's report) of its business transacted in New Zealand, in the forms contained in the schedules to the Life Act. All statements must be deposited with the chief executive of the Ministry of Economic Development within 9 months of the close of the company's financial year.

5.49 The chief executive of the Ministry of Economic Development may require a company to provide information or explanations about any statement, abstract or report received (section 79A).

Penalties (section 80)

5.50 Companies that do not comply with the provisions set out in Part 2 of the Life Act and continue in such default for 7 days after notice has been given are liable to a fine not exceeding $100 for every day during which the default continues.

INSURANCE LAW REFORM ACT 1977

5.51 The Insurance Law Reform Act 1977 made substantial changes to the law relating to misrepresentations by the insured. It also renders invalid any insurance clause requiring disputes to be submitted to arbitration before Court action may be taken (section 8), and places significant restrictions on the effectiveness of time limits for making insurance claims (section 9).

5.52 A life insurance policy cannot be avoided by reason only of a statement (other than a statement as to the age of the life insured), unless that statement was substantially incorrect, material and made either fraudulently or within a period of 3 years immediately preceding the date on which the policy is sought to be avoided or the date of the

death of the life insured, whichever is the earlier (section 4). The insurer cannot avoid a life policy by reason only of a misstatement of the age of the life insured (section 7).

5.53 A representative of an insurer is deemed to be the insurer's agent in certain circumstances (section 10).

INSURANCE LAW REFORM ACT 1985

5.54 The Insurance Law Reform Act 1985 abolished or restricted the common law requirement for an insurable interest for policies of indemnity and life insurance (sections 6 and 7). The Act also made amendments to the Life Act, specifically in relation to insurance of minors (see paragraphs 5.42–5.46).

SECURITIES ACT 1978

5.55 The Securities Act 1978 establishes the Securities Commission, sets out its functions and powers, and sets out the law relating to the offering of securities investments to the public.

Definitions

5.56 A "security" means an interest or right to participate in any capital, assets, earnings, royalties, or other property of any person and includes a life insurance policy (section 2D).

5.57 Broadly, a "life insurance policy" is defined as a policy of life or endowment insurance or a policy securing an annuity. A "term life insurance policy" is excluded from this definition (section 2).

5.58 A "term life insurance policy" is defined in regulation 2A of the Securities Regulations 1983 to mean a life insurance policy:

(i) Under which an amount (other than an amount not exceeding the sum of the premiums paid to the issuer) is payable only if during the term of the policy the life insured dies or becomes ill or disabled; and

(ii) That is for a specified term which is less than the life expectancy of the life insured (measured in accordance with generally accepted actuarial practice) at the time the policy is issued.

This exclusion recognises that "term life insurance" (referred to in this paper as renewable risk only policies and non-renewable risk only policies) contains no investment element.

Initial disclosure requirements

5.59 Issuers of life insurance policies are required to comply with the prospectus, investment statement and advertising provisions of the Securities Act (sections 33, 37 and 37A).[54]

5.60 The investment statement is designed to provide key information to assist the prudent, but non-expert, person to decide whether or not to subscribe for securities (section

[54] Information obtained from the Securities Commission website (www.sec-com.govt.nz).

38D). Schedule 3D to the Securities Regulations prescribes the information required to be contained in an investment statement. An issuer may not allot a security to a subscriber if the subscriber has not received an investment statement before subscribing for the security.

5.61 The investment statement is an "advertisement" for the purposes of the Securities Act, and is subject to the requirements of that Act and the Securities Regulations relating to advertisements for securities. The Securities Commission has the power to suspend or prohibit the investment statement (section 38F).

5.62 The prospectus contains more detailed information about the issuer and offer of securities than the investment statement. Unlike the investment statement, the prospectus must be delivered to the Registrar of Companies for registration (section 42).

5.63 The content of the prospectus is prescribed by the Securities Act and Securities Regulations (in particular, Schedule 3B to the Regulations). Generally, the prospectus must contain a true and fair description of all material matters about the offer of securities including the terms of the offer, the financial position and performance of the issuer, and the material interests of those who make or promote the offer. It must be signed by the issuer and any promoter and by their respective directors.

5.64 In the case of life insurance, the Securities Act and Securities Regulations do not prescribe detailed financial information to be contained in the prospectus. However, they require the prospectus to refer to financial statements that comply with, and have been registered under, the Financial Reporting Act 1993 and that these always accompany the prospectus (clauses 5 and 12 of Schedule 3B of the Securities Regulations). In addition, clause 5 of Schedule 3B requires summary financial statements to be included in the prospectus. The Securities Commission has the power to suspend or cancel the registration of a registered prospectus (section 44).

5.65 Advertisements must also comply with the provisions of the Securities Act and Securities Regulations (section 38). Generally, an issuer is free to advertise its offer as it pleases provided the advertisement does not contain any untrue statement or any information likely to deceive, mislead or confuse about any matter material to the offer. An advertisement must not contain any information that is inconsistent with the registered prospectus (regulation 9).

5.66 Generally, a certificate must be completed by the directors of the issuer in respect of each advertisement at the time the advertisement is distributed. This certificate must state that the directors of the issuer have read, seen or listened to the advertisement, that the advertisement complies with the Securities Act and Securities Regulations, that the advertisement is not likely to deceive, mislead or confuse with regard to any matter that is material to the offer of securities, and that the advertisement is not inconsistent with the registered prospectus (regulation 17, and Schedule 4 of the Securities Regulations).

5.67 The Securities Commission has the power to prohibit the distribution of an advertisement (section 38B).

5.68 Door-to-door sales of life insurance policies are allowed (section 35).

Obligations of issuers (including life insurers) (sections 51 to 54B)

5.69 Every issuer of securities offered to the public must keep a register in New Zealand of all the securities (section 51). The register is to be open to the inspection of any holder of the securities without a fee, and to any other person on the payment of the prescribed fee.

5.70 Every issuer of securities offered to the public must ensure proper accounting records are kept at all times (section 53). Financial statements must be audited, at least once a year, by a qualified auditor (section 53E).

5.71 Prescribed information must be sent periodically to security holders (section 54A). However, no such information has yet been prescribed. Issuers must disclose documents and information on request, including the prospectus and financial statements (section 54B).

Liability of issuers and offences (sections 55 to 60)

5.72 Issuers of securities and their directors are liable to pay compensation (civil), or to pay a fine or be imprisoned (criminal) for misstatements in an advertisement, investment statement or registered prospectus. Experts who give consent to the distribution of a prospectus are similarly civilly liable. Other offences involving the contravention of specific sections of the Securities Act render the offender liable to a fine or imprisonment.

Securities Commission powers to obtain information (sections 67 to 69V)

5.73 The Securities Act gives the Securities Commission a wide range of powers, including the power to require any person to produce for inspection any relevant documents or information in their possession, and to inspect and/or copy those documents or that information (sections 67 and 68).

5.74 The Securities Commission also has the power to summon witnesses to appear before the Commission to give evidence and/or produce documents, and to receive evidence on oath (sections 69C and 69D). The Commission has the power to require witnesses before the Commission to answer questions even when their statements may be incriminating (but with a corresponding privilege against that evidence being used in criminal proceedings (sections 69T and 69U)), and the power to hear proceedings in private and to make confidentiality orders about its proceedings (sections 69M and 69N).

FAIR TRADING ACT 1986

5.75 The Fair Trading Act applies to all aspects of the promotion and sale of goods and services. The Act prohibits certain conduct and practices in trade, provides for the disclosure of consumer information relating to the supply of goods and services, and promotes product safety. The Act applies to all aspects of the promotion and sale of goods and services – from advertising and pricing to sales techniques and finance agreements.

5.76 The Fair Trading Act prohibits people in trade from engaging in misleading or deceptive conduct generally (section 9). More specifically, the Act prohibits certain types of false or misleading representations about goods or services, including false

claims that goods or services are of a particular price, standard, quality, origin or history or that they have particular uses or benefits or that they have any particular endorsement or approval (section 13).

5.77 Life insurance contracts and life reinsurance contracts are defined as contracts for a "service" under the Fair Trading Act (section 2).

5.78 The Commerce Commission has the power to obtain and execute search warrants (section 47). Commission officers may, with such a warrant, search premises and seize and remove goods, documents, computer records and other items.

5.79 The Fair Trading Act is designed to allow enforcement of its provisions by actions brought against alleged infringers by rival traders, as well as by the Commerce Commission, or by persons who have suffered loss as a result of conduct in breach of that Act.

CONSUMER GUARANTEES ACT 1993

5.80 The Consumer Guarantees Act regulates the guarantees given, or deemed to be given, to consumers on the supply of goods or services, and the rights of redress against suppliers and manufacturers in respect of any failure of goods or services to comply with any such guarantees.

5.81 A right under a contract of "life assurance" is included within the definition of "service" (section 2). The following guarantees are implied in respect of the offer of insurance contracts:

- The obligations of the policy will be carried out by the insurer with reasonable care and skill (section 28).
- Where the consumer discloses their needs under the policy, the policy shall be reasonably fit for that particular purpose and of such a nature and quality that it can reasonably be expected to achieve any particular result (section 29).[55]
- Any responsibilities under the contract shall be carried out within a reasonable time (section 30).

5.82 Where there is a breach of the guarantees, policyholders may seek to exercise their rights of redress under the Consumer Guarantees Act, which may include remedy of any breach by the insurer or cancellation of the contract (section 32).

FINANCIAL REPORTING ACT 1993

Financial reporting requirements (Parts 1 and 2)

5.83 All companies and issuers (entities that issue securities to the public) are obliged to complete financial statements in accordance with the requirements of the Financial Reporting Act.

---

[55] The guarantee is subject to any evidence that the consumer does not rely on the insurer's skill or judgement or it is unreasonable for the consumer to rely on the insurer's skill or judgement.

5.84 Under the Financial Reporting Act, life insurers are "issuers" of securities (section 4), unless they only issue term life insurance (defined in this paper as renewable risk only and non-renewable risk only policies). As such they are annually required to deliver to the Registrar of Companies for registration audited financial statements (sections 16 and 18).

5.85 A life insurer that is an issuer must prepare additional separate financial statements in respect of its separate fund under section 15 of the Life Act (section 9A(3)).

5.86 All overseas companies carrying on business in New Zealand are required to prepare and file audited financial statements with the Registrar of Companies on an annual basis. Those financial statements must be prepared for the New Zealand business, the company itself and its group (if the overseas company is part of a group of companies) (section 19).

5.87 Financial statements must comply with the requirements of the Financial Reporting Act, including compliance with applicable financial reporting standards and generally accepted accounting practice (section 11). There are certain exemptions from these requirements, for example, an overseas company is exempt if the requirements of overseas accounting standards applicable to it are substantially the same as the requirements in New Zealand (section 11(3)). The financial statements must be delivered within 5 months and 20 days of the company's balance date (sections 10 and 18).

5.88 Life insurers that are not "issuers" (because they only issue term life insurance) are still required to comply with the Financial Reporting Act if they are a company other than an "exempt" company (generally, small companies, with total assets and turnover below a certain amount).

Accounting Standards Review Board (Part 3)

5.89 The Financial Reporting Act establishes the Accounting Standards Review Board. The primary function of the Board is to review and approve financial reporting standards, which are standards that prescribe the content of financial statements (section 24).

Approved accounting standards for life insurance – FRS-34

5.90 The principal approved financial reporting standard applicable to life insurance business is Financial Reporting Standard 34 ("FRS-34").[56] The Accounting Standards Review Board approved FRS-34 in November 1998 for accounting periods ending on or after 31 December 1999. FRS-34 is the result of a joint project between the Australian Accounting Standards Board and the Financial Reporting Standards Board (Institute of Chartered Accountants of New Zealand).

5.91 FRS-34 applies to life insurers and the parent entity of groups that include a life insurer. The purpose of FRS-34 is to prescribe the methods to be used for reporting on life insurance business and to require disclosures about life insurance business in the financial report. There is no requirement that an actuary has to perform these functions.

---

[56] Some provisions within other financial reporting standards also apply. However, FRS-34 relates directly to life insurance business and overrides the other standards.

5.92 Specifically FRS-34 requires:[57]

- a life insurer and the parent entity to recognise in its financial statements the assets, liabilities, revenues, expenses and equity of the entity, whether designated as relating to policyholders or shareholders;
- all assets of a life insurer to be measured at net market values, all liabilities of a life insurer to be measured at net present values, and a description of the key parameters for measuring policy liabilities;
- a life insurer that is a parent entity of a group must recognise and disclose any excess in the financial statements of the life insurer group (which will include any internally generated goodwill) or deficiency of the net market values of interests in subsidiaries over the net assets of those subsidiaries recognised in the consolidated financial statements;
- premiums and claims to be separated on a product basis into their revenue, expense and change in liability components unless the separation is not practicable or the components cannot be reliably measured (subject to a transitional provision);
- returns on all investments controlled by a life insurer to be recognised as revenues;
- participating benefits vested in relation to the reporting period, other than transfers from unvested policyholder benefits liabilities, to be recognised as expenses;
- reinsurance contracts to be recognised on a gross basis; and
- specific disclosures in the financial reports prepared by life insurers or groups that include a life insurer.

5.93 FRS-34 indirectly refers to Guidance Note No. 5 (Life Insurance Company Prudential Reserving) and specifically refers to Professional Standard No. 3 (Determination of Life Insurance Policy Liabilities) of the New Zealand Society of Actuaries ("NZSA").[58] FRS-34 is under review and will be replaced by an approach aimed at matching assets and liabilities under International Accounting Standards Board proposals.

Offences (Part 4)

5.94 Part 4 of the Financial Reporting Act provides for offences and penalties (and defences) for directors in relation to financial statements.

COMPANIES ACT 1993

5.95 The Companies Act provides for the incorporation of companies in New Zealand and the registration of overseas companies carrying on business in New Zealand. The Act sets out the basic corporate governance requirements of the company and its directors, and provides for enforcement where breaches of the Companies Act take place.

---

57 FRS-34, 4.

58 Except in this respect, the NZSA's professional standards and guidance notes do not have the force of legislation.

5.96 Almost all life insurers carrying on business in New Zealand are incorporated, or registered as overseas companies, under the Companies Act 1993. Many of the larger such life insurers are listed on the New Zealand Stock Exchange ("NZX"). Specific areas of company law relevant to life companies include directors' duties, shareholders' rights, financial record requirements, Registrar's powers of supervision, and provisions relating to overseas companies.

Director's duties

5.97 Directors have statutory duties to:

- act in good faith and in what they believe, on reasonable grounds, are the best interests of the company (section 131);
- exercise powers for a proper purpose (section 133);
- not act in a way that contravenes the Companies Act or the company's constitution (section 134);
- not allow the company's business to be carried on in a manner likely to create loss to creditors (section 135);
- not agree to a company incurring an obligation unless the company can reasonably meet that obligation (section 136);
- exercise the skill and care of a reasonable director in the same circumstances (section 137);
- disclose any material financial interest or benefit that they (or their relatives) have in any transaction with the company (section 140);
- generally not disclose information they hold as a director (section 145); and
- disclose certain details if they buy or sell the company's shares; any share purchase by a director must not be at less than fair value; any share sale by a director must not be at more than fair value (sections 148 and 149).

5.98 Directors do not owe a specific duty to policyholders, although they do have the duties referred to in paragraph 5.97 under sections 135 and 136 in relation to creditors. Breach of these duties confers no direct remedy on creditors, as the duties are owed to the company. However, if a company is placed in liquidation a policyholder can apply under section 301 for an order that a director or other relevant person pay compensation to the policyholder.

Shareholders

5.99 Shareholders have a number of rights and remedies under the Companies Act. These include the right to information (section 178), the right to inspect records (section 179) and the right to sue a director (section 174). Except in the case of mutual life insurance companies (of which only one is now operating in New Zealand), policyholders of a life insurer are not shareholders of that insurer unless they also own shares in the insurer.

Financial records

5.100 A company must keep accounting records that correctly record and explain the transactions of the company and that will, at any time, enable the financial position of the company to be determined with reasonable accuracy. The records must also enable the directors to ensure that the financial statements of the company comply with

section 10 of the Financial Reporting Act, and must enable the financial statements of the company to be readily and properly audited (section 194).

Supervision and regulation

5.101 The Registrar of Companies keeps a register of companies incorporated under the Companies Act and of overseas companies registered under that Act (section 360).

5.102 The Registrar of Companies or an authorised person has powers of inspection that include requiring a person to produce for inspection relevant documents within his or her possession or control, and the power to inspect and take copies of relevant documents. These powers may only be exercised for purposes that include ascertaining whether a company, or a director or officer of a company, is complying or has complied with the Companies Act or Financial Reporting Act (section 365).

Overseas companies

5.103 Before an overseas company may commence business in New Zealand, it is required to register as an overseas company with the Registrar of Companies (section 334). The company is required to file basic information to support registration, including providing an address and agent for service in New Zealand. There are no annual reporting requirements, although overseas companies are required to file financial statements under the Financial Reporting Act on an annual basis (section 340).

Amalgamations

5.104 There are no express provisions in the Life Act governing the transfer or amalgamation of life business. However, a number of life companies have used the provisions of Part 13 of the Companies Act to amalgamate, and in some cases offshore life business has been domesticated under Part 15 of that Act.

FINANCIAL TRANSACTIONS REPORTING ACT 1996

5.105 The Financial Transactions Reporting Act facilitates the prevention, detection, investigation and prosecution of money laundering. The Act also assists in the enforcement of the Proceeds of Crime Act 1991, by imposing certain obligations on financial institutions in relation to the conduct of financial transactions, and by requiring persons entering or leaving New Zealand to declare cash in excess of a prescribed amount.

5.106 A life insurance company is included in the definition of a "financial institution" under the Act (section 3).

CORPORATIONS (INVESTIGATION AND MANAGEMENT) ACT 1989

5.107 The Corporations (Investigation and Management) Act enables the Registrar of Companies to determine whether corporations are at risk, and to enable action to be taken in relation to such corporations in appropriate cases.

5.108 The Corporation (Investigation and Management) Act gives the Registrar certain powers to obtain information and investigate (sections 9 to 29). The Registrar may give advice, assistance or directions to a corporation at risk (sections 30 to 37). Corporations

or certain persons may be placed under statutory management (sections 38 to 62). However, the Act does not impose an obligation on the Registrar to supervise a corporation (section 7).

INSURANCE COMPANIES (RATINGS AND INSPECTIONS) ACT 1994

5.109 The Insurance Companies (Ratings and Inspections) Act defines an "insurance company" as a body corporate or an association that carries on or has, at any material time, carried on any insurance business (section 2). Life insurers are excluded from Part 1 of the Act (which deals with ratings) by section 4. Under Part 2 of the Act, for the purpose of determining whether an "insurance company" (which includes life insurers) is unable to pay its debts, the Registrar of Companies or an authorised person may:

- require the company or any of its employees to produce for inspection relevant documents within the possession or control of the company or that officer;
- require any other person, including a person carrying on the business of banking, to produce for inspection relevant documents within that person's control;
- inspect and take copies of relevant documents;
- take possession of relevant documents and remove them from the place where they are kept, and retain them for a reasonable time for the purpose of taking copies (section 26).

5.110 There are various penalties for obstructing the Registrar or any authorised person while exercising his or her powers, or for failing to produce the documents as required under the Act (section 26).

COMMERCE ACT 1986

5.111 The purpose of the Commerce Act is "to promote competition in markets for the long-term benefit of consumers" (section 1A). The Commerce Act applies to all individuals and businesses, including state-owned enterprises, local government and government departments in so far as they engage in trade.

5.112 In relation to anti-competitive practices, the Commerce Act:

- prohibits behaviour that restricts competition;
- allows the Commerce Commission to authorise on public benefit grounds proposed anti-competitive practices that would lead to the substantial lessening of competition in a market; and
- allows the Commerce Commission to recommend to the Minister of Commerce that specific goods and services be controlled.

5.113 Part 6 of the Commerce Act deals with enforcement, remedies and appeals. Part 7 sets out the Commerce Commission's investigation, inspection and search powers.

INSURANCE INTERMEDIARIES ACT 1994

5.114 The Insurance Intermediaries Act imposes certain requirements on intermediaries generally, certain duties on brokers specifically and prescribes how payments made to intermediaries affect the respective liabilities of insurers and the insured. The Insurance Intermediaries Act does not apply to contracts or proposed contracts of reinsurance

(section 19). The Act also overrides section 10 of the Insurance Law Reform Act 1977 that deems a representative of an insurer to be the insurer's agent in certain circumstances (section 20).

5.115 "Insurance intermediary" under the Insurance Intermediaries Act means a person who for reward arranges contracts of insurance in New Zealand or elsewhere and who does so as the employee of or agent for one or more insurers or as the agent for the insured, and includes a broker (section 2).

INVESTMENT ADVISERS (DISCLOSURE) ACT 1996

5.116 The Investment Advisers (Disclosure) Act applies to investment advisers and brokers, including those who promote or advise on life insurance policies. The Act defines investment advisers and investment brokers, and imposes certain disclosure requirements on them.

5.117 Investment advisers and investment brokers must disclose certain information, known as an "initial" disclosure, before giving investment advice (section 3). Initial disclosures include previous convictions against the Investment Advisers (Disclosure) Act, and a description of how payment or delivery of money or delivery of property should be made to the broker.

5.118 Information about an investment adviser's qualifications and experience, any pecuniary interest in giving the advice, relationships with relevant organisations and the types of securities about which advice is given need only be disclosed on request (section 4).

5.119 The Investment Advisers (Disclosure) Act also provides for civil and criminal liability for breaches, and for Court orders prohibiting investment advisers and brokers from acting as such (sections 7 to 12).

5.120 The Act does not provide for any minimum qualifications or standards for investment advisers.

SECRET COMMISSIONS ACT 1910

5.121 The Secret Commissions Act prohibits secret commissions to persons deemed to be "agents" within the meaning of the Act.

FRIENDLY SOCIETIES AND CREDIT UNIONS ACT 1982

5.122 The Registrar of Friendly Societies and Credit Unions administers the Friendly Societies and Credit Unions Act and has certain powers, such as the power to request and be supplied with information or reports and to inspect accounting records and other documents in order to detect offences against the Act (sections 7 and 8).

5.123 The Friendly Societies and Credit Unions Act enables a friendly society to become registered, and thereby obtain certain advantages, including an exemption from income tax.[59] However, the benefit of registration carries certain limitations, as a society may only act within its rules and the Act. The Registrar of Companies may suspend or

[59] Sections CB4(1)(a) and OB1 of the Income Tax Act 1994 (definition of "friendly society").

cancel the registration of a society or branch on various grounds (section 92). Friendly societies are not subject to the Life Act.

5.124 Every society or branch registered under the Act must have one or more trustees (section 28). All property belonging to a society registered under the Act vests in its trustees (section 29). The trustee may invest some or all of the society or branch's funds in accordance with the Act and subject to the Trustee Act 1956 (sections 49 and 52).

5.125 If a society or branch has issued securities to the public such that an investment statement or registered prospectus is or has been required, the society or branch must prepare the financial statements required under the Financial Reporting Act (section 61). There are only a few friendly societies that are classified as "issuers of securities".

5.126 Section 42 specifically relates to contracts of insurance and limits the amount a person may claim from a registered society or branch to a maximum of $60 000 by way of gross sum together with any bonuses or additions declared on assurances not exceeding that sum, or more than $750 a year by way of annuity together with any bonus or addition declared on that annuity. The term "assurance" includes all life and endowment assurance, and any assurance payable on the member's death provided by the society or branch in respect of any shares in or loans by a credit union.

MUTUAL INSURANCE ACT 1955

5.127 The Mutual Insurance Act provides for mutual insurance associations of farmers to be established to provide fire insurance for their members. The Act prescribes requirements for membership and the types of insurance cover the associations may provide. The Act confers corporate status on associations. It requires them to submit financial statements to the Ministry of Economic Development and imposes on them the same auditing requirements as apply to companies.

5.128 Regulations may be made to extend the powers of an association to grant its members other kinds of insurance (except life insurance) (section 13). "Life insurance" is defined to include endowment and annuity contracts (section 2).

CO-OPERATIVE COMPANIES ACT 1986

5.129 A "co-operative company" means a company, the principal activity of which is, and is stated in its constitution as being, a co-operative activity and in which not less than 60 per cent of the voting rights are held by transacting shareholders. The definition includes a subsidiary of that company, the principal activity of which is, and is stated in its constitution as being, a co-operative activity (section 2).

5.130 For companies registered under both the Companies Act and the Co-operative Companies Act, there are specific provisions of the Co-operative Companies Act that override the Companies Act.

SECURITIES MARKETS ACT 1988

5.131 Many life insurers operating in New Zealand are publicly listed companies. This makes them subject to the Securities Markets Act, and the Stock Exchange Rules. Both are aimed at protecting shareholders.

HUMAN RIGHTS ACT 1993

5.132 The Human Rights Act makes it unlawful for any person who supplies goods or services to the public to refuse to provide those goods or services, or to treat any other person less favourably in connection with the provision of those goods or services (section 44). However, section 48 states that offering life insurance policies on different terms and conditions for each sex or for persons with a disability or for persons of different ages is allowed if based on certain data, advice or opinion.

CRIMES ACT 1961

5.133 Several offences in the Crimes Act apply to life insurance, including:

- Fraud (sections 250 to 257). It is an offence for any promoter, director, manager or officer of any company or body corporate to make, circulate or publish, any prospectus, statement or account they know to be false, with intent to induce, deceive or defraud.
- False pretences (sections 245 to 247). A false pretence requires there to be a false representation made with a fraudulent intent to induce reliance on it. There are two alternative forms of "false representation": a representation known to be false, or a promise that is not intended to be kept.
- Aiding and abetting (section 66). It is an offence to aid any person to commit an offence or abet any person in the commission of an offence.
- Money laundering.

TAX LEGISLATION

5.134 Life insurers have a special tax regime under the Income Tax Act 1994, which works as follows.[60] Life insurers are viewed as receiving two different forms of income. First, investment income, and secondly, income from their risk spreading function (underwriting income). Both forms of income are taxed at the life insurer level. Amounts paid to policyholders, if paid as lump sums or annuities, are considered tax paid. Regular payments (other than annuities) may be taxable as income.

5.135 At the life insurer level, life insurers are first taxed on their "Life Base", which includes investment income (less expenses) plus underwriting income. The underwriting income, that is, the profit made from the risk spreading function, is arbitrarily legislated to be a mix of several different items. The main item is 20 per cent of expected death strain (an actuarial concept that puts a dollar cost on the amount of death risk the insurer is bearing). Tax is payable on the Life Base and this generates imputation credits. Secondly, life insurers are taxed on behalf of their policyholders. In effect, profits made are deemed to be distributed to policyholders. This is called the "Policyholder Base". This is an actuarial valuation of policyholder interests, being the extent to which the increase in policyholder interests, plus claims received, exceeds premiums paid in. Underwriting income is added back to the resulting amount, and the total is the Policyholder Base.

---

[60] The information in this section is a summary of tax law information produced by the Inland Revenue Department.

5.136 Imputation credits generated from payment of tax on the Life Base are used to offset tax payable on the Policyholder Base. Any excess credits may be attached to dividends paid to shareholders in the normal way.

COMMON LAW

5.137 At common law, all people who are competent to enter into contracts may be parties to any contract of insurance.

5.138 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.[61]

5.139 There is a common law duty of good faith that applies to all classes of insurance, although there are various differences in detail in the way in which the duty is applied. The application of this duty to written misrepresentations is modified by the Insurance Law Reform Act 1977 (see paragraphs 5.51 to 5.53).[62]

5.140 It is also well established at common law that an insured has a duty to disclose to the insurer any material information within his or her actual knowledge. Information is material if it would influence the mind of a prudent insurer in deciding whether to issue a policy and, if so, the terms on which it will provide insurance. For a policy of life insurance, the duty of disclosure applies at the inception of the policy.

5.141 The Law Commission has recommended reforming the law relating to non-disclosure by insertion of a new section 7A into the Insurance Law Reform Act 1977.[63]

VOLUNTARY REGULATION

Investment Savings and Insurance Association Manual of Practice Standards

5.142 The Investment Savings and Insurance Association ("ISI") produce a Manual of Practice Standards, to which its members must adhere as part of their voluntary ISI membership. The ISI Manual acts as an aid to ISI members when preparing and presenting their selling and marketing material, to the extent that this is not covered by the statutory disclosure requirements.

5.143 There are no statutory disclosure requirements for term life (renewable and non-renewable risk only policies) or non-life products. Therefore, the standards in the ISI Manual for these products are provided to set the minimum information requirements for both insurers and intermediaries.

5.144 The ISI Manual also aims to provide consistency of presentation in such areas as the measurement of investment returns, the calculation of benefit projections and the management expense ratio.[64]

---

61 *Laws of New Zealand* above n 49, "Insurance", Part 1.

62 *Laws of New Zealand* above n 49, "Insurance", Part 1.

63 New Zealand Law Commission *Some Insurance Law Problems: NZLC R46* (Wellington, 1998).

64 Information obtained from the ISI website (www.isi.org.nz).

Ombudsman schemes

5.145 The Insurance and Savings Ombudsman ("ISO") Scheme provides an impartial and independent arbitrator to facilitate the resolution of disputes between consumers and the providers of insurance and savings services. It is voluntary for life insurers to belong to the ISO Scheme, but all ISI members must belong to the Scheme. The ISO Scheme is funded by the industry.

5.146 The ISO Commission consists of an independent chairperson, two industry representatives appointed by the ISO Board and two consumer representatives appointed by the Minster of Consumer Affairs. The ISO Commission appoints an ISO, sets the ISO's annual budget, oversees the performance of the ISO Scheme, and approves the ISO's annual report at its annual meetings.

5.147 The ISO Board, made up of industry representatives, determines the ISO Scheme's rules and terms of reference. The terms of reference provide guidelines about which insurance and savings services may be considered by the ISO. It prescribes limitations on the powers of the ISO and the procedure to be adopted in the consideration of complaints (see paragraphs 4.58 to 4.64).[65]

5.148 The Banking Ombudsman Scheme provides an independent and impartial arbitrator to deal with unresolved disputes about the provision of banking services. It is voluntary for banks to belong to the Scheme, but all members of the New Zealand Bankers' Association must belong.

5.149 The Banking Ombudsman is appointed by, and is responsible to, the Banking Ombudsman Commission. The Commission consists of an independent chairperson, two consumer representatives and two banking representatives. The functions of the Commission are to ensure the independence and impartiality of the Banking Ombudsman, to give general guidance and to monitor the terms of reference.

5.150 The Banking Ombudsman's terms of reference give jurisdiction to deal with complaints about all types of banking business, including complaints about life insurance policies and in relation to the selling process for life policies (see paragraphs 4.65 to 4.69).[66]

Q5 Do you have any comments on chapter 5?

---

[65] Information obtained from the ISO website (www.iombudsman.org.nz).

[66] Information obtained from the Banking Ombudsman website (www.bankombudsman.org.nz).

Part 3
Overseas Law and Guidelines

Chapter 6
Australian life insurance law

INTRODUCTION

Life Insurance Act 1995

6.1 The statutory framework for regulation of life insurance companies in Australia is provided primarily by the Life Insurance Act 1995 ("Life Act (Aust)"). This Act substantially modernised the Life Insurance Act 1945 (Aust). The Life Act (Aust) sets out a regulatory framework that covers, among other things:

- requirements for registration and deregistration of life insurance companies;
- the operation of statutory funds in support of policyholders' interests;
- provisions requiring ongoing capital adequacy and solvency of statutory funds, and capital requirements for shareholders' funds;
- restrictions and requirements of a financial nature regarding allocation of expenses to statutory funds, treatment of assets, distribution of profits and capital from statutory funds, and the payment of dividends;
- obligations on directors to give priority to the interests of policyholders;
- requirements covering actuaries and auditors;
- provisions relating to financial records and reports;
- provision of a mechanism for approval of the transfer of groups of policies from one company to another;
- provisions relating to the monitoring, inspecting and investigating of life companies;
- provisions allowing the appointment of judicial managers and relating to winding up.

6.2 The Life Act (Aust) also provides for the establishment of a Life Insurance Actuarial Standards Board to make the actuarial standards required by that Act. There are currently actuarial standards on solvency, capital adequacy, valuation of policy liabilities, minimum surrender values and management capital, among other matters.

6.3 The Life Act (Aust) is supported by a structure of regulations, prudential rules, standards and circulars. All except circulars have the force of law.

ASIC and APRA

6.4 The current regulatory regime in Australia was shaped by the Financial System Inquiry Final Report ("the Wallis Report"), released in 1997. The Financial System Inquiry was asked to analyse the forces driving change in the Australian financial system and recommend ways to improve the current regulatory arrangements. Virtually all of the

Wallis Report recommendations were adopted. The main recommendations were as follows:

- There should be a single regulator for conduct and disclosure regulation. This body would establish a consistent and comprehensive disclosure regime for the whole financial system, and have responsibility for regulating advice and sales of retail financial products, including licensing financial advisers. It would also oversee complaints handling and dispute resolution. This led to the creation of the Australian Securities and Investments Commission ("ASIC").
- As regards financial safety regulation:
  - since there is a spectrum of risk in financial markets that should be preserved for reasons of economic efficiency, the degree of regulatory intervention for financial safety should be proportional to the intensity of potential market failure;
  - over time, the scope and intensity of prudential regulation should be adjusted to take account of changes in the intensity of these risks in the different parts of the financial system;
  - Government should not guarantee any financial promise, even where its safety is intensively regulated; and
  - it is important for participants and consumers to understand the goals of regulation, and for the framework of regulation to promote such an understanding.

6.5 To maximise public certainty as to the scope of financial safety regulation, the Wallis Report recommended that its coverage should be clearly defined by requiring licensing or other authorisation of providers. It recommended that a new regulatory entity should be established to undertake prudential regulation, which should be separate from the central bank. This new entity should be empowered to establish and enforce prudential regulation of licensed financial entities, issue or revoke licences, and assume control of licensed entities that fail or look likely to fail. These recommendations led to the establishment of the Australian Prudential Regulatory Authority ("APRA").

6.6 The Reserve Bank of Australia remains responsible for the systemic stability of the financial system, and for the payments system.

6.7 Mergers regulation continues to be administered by the Australian Competition and Consumer Commission ("ACCC") under the Trade Practices Act 1974. The ACCC is also responsible for overseeing anti-competitive and unfair market practices, product safety/liability, prices surveillance and restrictive trade practices.

6.8 The Life Act (Aust) was amended to take account of the creation of APRA and ASIC. APRA is responsible for the prudential supervision of life companies and was established by the Australian Prudential Regulation Authority Act 1998 ("APRA Act"). It is funded by levies collected annually from regulated financial institutions. ASIC is responsible for the consumer protection regime (and encompassed in this is regulation aimed at promoting financial market integrity). It is an independent Commonwealth Government body, funded through the budget. It was established by the Australian Securities and Investments Commission Act 1989. That Act also includes the general provisions on consumer protection in relation to financial services (which were

transferred to it from the Trade Practices Act). While these provisions are described as "consumer protection" in that Act, they might more comfortably be described as "financial market integrity" regulation, as defined in this paper. The provisions in question prohibit unconscionable conduct, misleading or deceptive conduct, false or misleading representations, pyramid selling, referral selling, unsolicited debit cards and so on.[67]

6.9 There is also a Council of Financial Regulators, which facilitates collaboration between the regulatory agencies, and comprises two representatives each from APRA, ASIC and the Reserve Bank.

IFSA

6.10 The life insurance industry body equivalent of New Zealand's Investment Savings and Insurance Association is the Investment and Financial Services Association Limited ("IFSA"). IFSA represents the retail and wholesale funds management and life insurance industries. IFSA's 100 members invest approximately AU$620 billion on behalf of over 9 million Australians. IFSA's primary role is to communicate with governments, regulators, other industry groups, media and the community on issues affecting its members.[68]

Financial Services Reform Act 2001

6.11 A development in Australia that has had a major impact in the area of financial market integrity and consumer protection regulation was the introduction of the Financial Services Reform Act 2001 ("FSR Act"). That Act came into force in March 2002, but financial services providers have until March 2004 to comply with its new regime. The FSR Act brings the superannuation, life and general insurance, and securities industries under one licensing regime, introduces a new disclosure regime, imposes standards of conduct for financial services providers dealing with retail clients, and introduces an amended market regulation regime. This Act is discussed in more detail in paragraphs 6.59 to 6.64.

DETAIL OF THE AUSTRALIAN REGIME

6.12 This chapter looks at the Australian regulatory regime in more detail, under the following headings:

- registration (paragraph 6.13);
- definition of "life policy" (paragraphs 6.14 to 6.20);
- restriction on type of business that may be carried on (paragraphs 6.21 and 6.22);
- statutory funds (paragraphs 6.23 to 6.26);

---

67 The Australian Securities and Investments Commission Act 1989 has been replaced by the Australian Securities and Investments Commission Act 2001. The 2001 Act contains provisions that correspond to most of the provisions of the 1989 Act. Generally, the only exceptions to this are the provisions of the 1989 Act that related to the fact that the ASIC law operated separately in each of the Australian states and territories (rather than as a single national law).

68 Information obtained from IFSA's website (ww.ifsa.com.au).

- capital adequacy, solvency, and capital requirements for shareholders' funds (paragraphs 6.27 and 6.28);
- financial management (paragraphs 6.29 and 6.30);
- monitoring and investigations (paragraph 6.31);
- prudential standards and rules (paragraph 6.32);
- directors' duties (paragraphs 6.33 and 6.34);
- transactions with related parties (paragraphs 6.35 and 6.36);
- reinsurance (paragraph 6.37);
- minimum surrender values (paragraph 6.38);
- transfers and amalgamations of life businesses (paragraphs 6.39 and 6.40);
- general financial market integrity and consumer protection regulation (paragraphs 6.41 to 6.58);
- Financial Services Reform Act 2001 (paragraphs 6.59 to 6.64);
- compliance with IAIS Insurance Core Principles (paragraph 6.65); and
- cross border issues (paragraphs 6.66 to 6.74).

Registration

6.13 Under section 17(1) of the Life Act (Aust), only a registered life company can issue, or undertake liability under, a life policy. Application for registration is made to APRA. The grounds on which APRA can refuse registration are set out in the Act (for example, a company is unlikely to be able to meet its obligations). APRA can also impose conditions on registration. In a 1999 paper, "Australia's Supervision of Life Insurance",[69] Craig Thorburn, General Manager, Diversified Institutions Division of APRA, wrote:

> Registration of life insurers is carried out after a detailed assessment of the company's proposals and application material. As a matter of course, registration is restricted to those that conform to our ongoing policy positions.
>
> Life insurers must have a minimum paid up share capital of $10 million, although up to $5 million can be utilised for short to medium term support of the insurer's statutory funds.
>
> Aside from the compliance with the Act and other regulatory requirements, the company and its officers are assessed regarding their capacity on a 'fit and proper' basis. This considers financial standing, ethics and expertise. Experience and expertise tend to be the most difficult issue for applicants.
>
> The understanding of long term commitments a company is planning to take on is tested. In particular, as capital can be an ongoing issue for a new company, advice is required to check that the company is capitalised sufficiently for its most optimistic business growth expectations over a ten-year time horizon.
>
> We do not register branches of overseas companies (on the basis that a subsidiary offers greater security – is better ring fenced). There are some branches still in existence for historic reasons. There is no pressure to register branches from potential applicants on

[69] "Australia's Supervision of Life Insurance" (November 1999, Melbourne), 6–7. This paper was presented as part of an international symposium on Enhancing Life Insurance Regulatory Regimes in Asia. It is referred to as the "Thorburn paper" in this chapter.

either taxation or capital grounds. Rather, the trend is for branches to domesticate to subsidiary status.

Definition of "life policy"

6.14 In this context it is important to look at the definition of the term "life policy", which is defined in section 9 of the Life Act (Aust):

> **9 Life policy**
>
> (1) Subject to subsection (2), each of the following constitutes a life policy for the purposes of this Act:
>
> (a) a contract of insurance that provides for the payment of money on the death of a person or on the happening of a contingency dependent on the termination or continuance of human life;
>
> (b) a contract of insurance that is subject to payment of premiums for a term dependent on the termination or continuation of human life;
>
> (c) a contract of insurance that provides for the payment of an annuity for a term dependent on the continuance of human life;
>
> (d) a contract that provides for the payment of an annuity for a term not dependent on the continuance of human life but exceeding the term prescribed by the regulations for the purposes of this paragraph;
>
> (e) a continuous disability policy;
>
> (f) a contract (whether or not it is a contract of insurance) that constitutes an investment account contract;
>
> (g) a contract (whether or not it is a contract of insurance) that constitutes an investment-linked contract.
>
> (2) A contract that provides for the payment of money on the death of a person is not a life policy if:
>
> (a) by the terms of the contract, the duration of the contract is to be not more than one year; and
>
> (b) payment is only to be made in the event of:
>
> (i) death by accident; or
>
> (ii) death resulting from a specified sickness.

6.15 The terms "investment account contract" and "investment-linked contract" (defined in section 14) extend the Act's coverage to types of arrangements that traditionally may not be regarded as life insurance, in recognition of the fact that life companies' business extends to these types of products. Section 17(2) states that the prohibition in section 17(1) does not prohibit a person from entering into investment account contracts or investment-linked contracts if the particular contract is not a contract of insurance.

6.16 An "investment account contract" is defined to be a contract:

- providing for benefits payable on death or on a specified date or dates or on death before the specified date(s); and
- where the benefits are calculated by reference to an account or units (which are guaranteed not to be reduced); and

- which provides for the account to be increased (for example, by premiums or interest payable).

6.17 The requirement for an account to be kept is implicit in so far as the last limb of the definition stipulates that the account can be increased. This is the case even though the second limb of the definition envisages that benefits can be calculated by reference to units as an alternative to a running account being maintained. A contract is not an investment account contract if it provides for the account to be reduced (otherwise than by withdrawals or charges).

6.18 An "investment-linked contract" is defined to be a contract:

- which has the principal object of providing benefits calculated by reference to units, the value of which is related to the market value of a specified class or group of assets of the party by whom the benefits are to be provided; and
- which provides benefits to be paid on death or on a specified date or dates or death before the specified date.

6.19 The pivot of the definition is that the units which are used to measure the value of the benefits reflect the value of underlying assets. Ordinarily the value of such assets will fluctuate and accordingly so will the value of the units. It is not, however, a requirement of the definition that the assets do in fact change in value.

6.20 APRA may make a determination that a particular contract is an "investment account contract" or an "investment-linked contract" (section 14(5)).

Restriction on type of business that may be carried on

6.21 Section 234 of the Life Act (Aust) is also relevant. That section provides that a life company must not intentionally carry on any insurance business other than life insurance business. However, an existing life company may carry on general insurance business if that company was carrying on that business immediately before the commencement of that Act. It is also worth noting that the definition of "life insurance business" is wider than merely the issuing and undertaking of liability under life policies. It extends to the issuing and undertaking of liability under sinking fund policies. The definition of "sinking fund policy" needs to be examined in this context. A sinking fund policy is not a life policy even though it is life insurance business. The Life Act (Aust) defines a sinking fund policy to mean a contract whereby:

- the company undertakes to pay money on one or more specified dates; and
- neither the payment of the money, nor the payment of premiums, is dependent on the death or survival of the person to whom the policy is issued or any other person.

It therefore can be contrasted with a life policy in so far as there is no necessary connection between the payment of money and a contingency dependent on the termination or continuance of human life.

6.22 Any business that relates to life policies and sinking fund policies is also "life insurance business", and this expressly includes the investment, administration and management of the assets of a statutory fund. APRA can declare that insurance business (other than

health or property insurance) or annuities business is to be treated as life insurance business. APRA can also declare that certain other financial business is life insurance business.

Statutory funds

6.23 The Life Act (Aust) requires that a life insurer operates a statutory fund that is:

- established in the records of the company; and
- relates solely to the life insurance business of the company or a particular part of that business.

6.24 Part 4 of the Life Act (Aust) relates to statutory funds. Section 30 gives an outline of requirements regarding statutory funds, and is set out below:

> **30 Outline of requirements regarding statutory funds**
>
> The principal requirements of this Part in relation to statutory funds may be summarised as follows:
>
> (a) all amounts received by a life company in respect of the business of a fund must be credited to the fund;
>
> (b) all assets and investments related to the business of a fund must be included in the fund;
>
> (c) all liabilities (including policy liabilities) of the company arising out of the conduct of the business of a fund must be treated as liabilities of the fund;
>
> (d) the assets of a fund are only available for expenditure related to the conduct of the business of the fund;
>
> (e) statutory funds may not be restructured or terminated without the approval of the APRA;
>
> (f) profits and losses of a statutory fund may only be dealt with in accordance with Divisions 5 and 6 (the object of those Divisions being to ensure that such profits and losses are dealt with in a manner that protects the interests of policy owners and is consistent with prudent management of the fund).

6.25 The Thorburn paper summarises the provisions relating to statutory funds with the following statements:

> Life insurance business must be conducted through statutory funds within a life insurer in order to provide a separate accounting of the policyholder business and assets from shareholder business and assets. Premiums must flow to statutory funds with claims and operating expenses paid from statutory funds. Any excess leads to an accumulation of assets with the investment income on those assets also flowing back to the relevant statutory fund. For new companies or new statutory funds capital injections from shareholders will often be required to cover set up costs and to finance new business growth. There is a tracking of shareholder capital as well as an annual determination of statutory fund profit, which is allocated between participating policyholders and shareholders, with a consequent tracking of each group's retained profits. Distribution of policyholder profits is subject to solvency requirements being met while distribution of shareholder profits is subject to capital adequacy requirements being met.

> In the investment, administration and management of assets of a statutory fund the life company must give priority to the interests of policyholders and the directors have a duty of care to policyholders and must place policyholder interests before shareholder interests.
>
> There are rules about the types of business that can be conducted in the same statutory fund and there are investment restrictions on statutory fund assets, such as no borrowing and very limited investments in related companies. There are also rules about the establishment, division, transfer and amalgamation of statutory funds.[70]

6.26 Note also that there is a prudential rule requiring a single bank account for statutory funds.

Capital adequacy and solvency requirements

6.27 Under the Life Act (Aust), statutory funds are subject to solvency and capital adequacy requirements. Solvency and capital adequacy standards have been set by the Life Insurance Actuarial Standards Board. The Thorburn paper summarises the intent of these standards and the consequences of failure to meet the standards:

> The solvency standard for a statutory fund is aimed at ensuring the fund can meet its existing liabilities as and when they fall due with a high degree of probability. Therefore it is a conservative assessment of the assets needed to run off existing liabilities. The detail is set in an actuarial standard and does provide for conservative future assumptions, the ability to withstand shocks to economic markets and the inadmissibility of assets likely to evaporate in a stressed situation.
>
> The capital adequacy standard for a statutory fund is aimed at ensuring the fund can remain financially viable, continue to write new business and is likely to meet the solvency requirement [in] 3 years time with a high degree of probability. Some of its elements are less conservative than the solvency standard because it is based on a continuing rather than a close down scenario, but the new business growth plans can make it more onerous than the solvency standard. Also, the capital adequacy requirements can not be less than the solvency requirements, so in practice they are quite similar for mature stable funds, but capital adequacy is more onerous for quickly growing funds.
>
> Failure to meet the solvency standard is regarded as extremely serious and unless it was clearly only temporary, or only in part of an insurer, we would usually move to place the insurer under judicial management with a view to having it sell its business on and move out of the industry.
>
> Failure to meet the capital adequacy standard would raise concerns with us and we would be ensuring the insurer fully understands how it got into such a situation, the serious[ness] of it and had realistic plans to become capital adequate within a reasonable time frame. There is the added incentive that shareholders' capital or retained profits can not be transferred out of capitally inadequate statutory funds without the regulator's approval.[71]

---

70 See above n 69, 7

71 See above n 69, 8.

Capital requirements for shareholders' funds

6.28 In addition, the Life Act (Aust) requires the setting of a management capital standard, to ensure that companies are adequately capitalised outside of their statutory funds. Section 73C of the Life Act (Aust) states that the purpose of the management capital standard is to ensure, as far as practicable, that:

(a) the financial position of a life company reflects an appropriate capital commitment, outside the statutory funds of the company, to the life insurance business of the company; and

(b) a life company will be able to meet its obligations in respect of any business it carries on that is not life insurance business as those obligations fall due.

Financial management

6.29 Part 6 of the Life Act (Aust) sets out certain requirements relating to the financial management of life companies. In summary, financial records must be kept, those records must be audited by an approved auditor, and the company must have an audit committee and have appointed an approved actuary. The appointed actuary is required to investigate the financial condition of the life company each year, and also acts as a watchdog in relation to the company's financial obligations under the Life Act (Aust) and the Financial Sector (Collection of Data) Act 2001 (Aust).

6.30 The Thorburn paper summarises these financial management provisions:

> Life companies are required to keep financial records to a particular level of detail and to produce and lodge annual audited financial statements with APRA. Through one set of integrated financial statements life companies must show their profitability on a realistic market value basis as well as their solvency position relative to the legislative minimum, which involves a conservative assessment of liabilities with a market value of assets. Life company auditors are approved by APRA and are responsible for certifying that the apportionment of income and outgoings in the financial statements are equitable. They also have a role to whistleblow to APRA regarding breaches or activities that prejudice the interests of policyholders.
>
> Each life company must have an audit committee made up of directors, with a majority of non-executives and the [chairperson of the] audit committee not being the chairman of directors.
>
> Each life company must have an appointed actuary who is responsible for advising the directors on premium rates, policy terms and conditions, unit pricing, surrender values and reinsurance; performing the annual valuation of policy liabilities; checking the company's compliance with the solvency and capital adequacy standards; producing a report on the financial condition of the company and advising on the financial consequences of distributions from statutory funds. The appointed actuary also has a whistleblowing role regarding breaches or activities that prejudice the interests of policyholders.[72]

[72] See above n 69, 8–9.

Monitoring and investigations

6.31 APRA has extensive powers to inspect records of and request information from a life insurer and to take action where it appears the insurer is or is likely to become unable to meet its liabilities. These actions extend to freezing assets, formally investigating an insurer, directing a company to take specific action (for example, to stop writing new business) and applying to the Court to place the company under judicial management or have the company wound up.

Prudential standards and rules

6.32 APRA has the power under Part 10A of the Life Act (Aust) to make prudential standards applying to all or specified classes of life companies, and to give directions in certain circumstances. Prudential standards have been made on topics such as the prudential capital requirement. Prudential rules can also be made (section 252). Many prudential rules have been made, on topics such as reporting reinsurance arrangements, the single bank account requirement for statutory funds and the consequences of transfer of policies between statutory funds.

Directors' duties

6.33 Under section 48 of the Life Act (Aust), a life company director has a duty to the owners of policies referable to the statutory fund of a company. The duty is to take reasonable care, and use due diligence, to see that, in the investment, administration and management of the assets of a fund, the life company complies with Part 4 of the Act and gives priority to the interests of owners and prospective owners of policies referable to the fund. Directors become liable for losses to statutory funds if they breach this duty. The directors also have liability for losses to statutory funds, if the life company contravenes the Act, resulting in a loss to the statutory fund, and the company is wound up (section 188).

6.34 These duties are in addition to the duties of care owed by all directors, under the Corporations Act 2001. In the Securities Commission discussion paper 1997, the Securities Commission commented on the duties imposed on directors under the Life Act (Aust), in paragraph 4.37:

> 4.37 These are relatively new rules of law. Their effect was described in the February 1997 edition of the *Australian Business Law Review* volume 25, page 62, in an article "Life Insurance Company Directors: Beyond the Call of Duty" by Amanda Morgan, a solicitor with Freehill Hollingdale & Page. Morgan concluded her article with:
>
> > "In addition to the duties which all directors face, directors of life insurance companies have additional duties. Under the 1995 Act, directors have a duty to ensure that in the investment, administration and management of statutory fund assets, policy owners are given priority. Such a duty is unique outside fiduciary law. That is, directors are not trustees via-a-vis policy owners, yet they are still required to exhibit one of the characteristics of a fiduciary, namely the duty to avoid a conflict of interest. Furthermore, the priority duty is unique in being owed to a third party and not to the company as a whole. Although some commentators have exaggerated the duty of priority, it does go further than previous legislation in spelling out

> the exact nature of the duty which leads to the personal liability of directors to make good any loss to a statutory fund. Furthermore, the introduction of the duty makes it clear that it is not enough simply to consider the interests of policy owners (…), their interests must be given priority …"

Transactions with related parties

6.35 The Life Act (Aust) contains provisions relating to the investment of the assets of a statutory fund in related parties. Below is an extract from the CCH *Australian and New Zealand Life Insurance Reporter*[73] on those provisions:

> The cardinal rule is that a life company may invest the assets of a statutory fund in a way that is likely to further the business of the fund. It should be noted that the provision (sec 43(2)) uses the word "may" and not "must". The section goes on to state that the general rule does not permit a life company to make an investment which it would otherwise be prohibited from making or would otherwise not have power to make (sec 43(3)(a) and (b)).
>
> Furthermore, the Act contemplates that the regulations may prohibit certain types of investments (sec 43(3)(d)). Regulation 4.01A of the *Life Insurance Regulations* sets out a prohibition relating to investment in subsidiaries. It prohibits the investment of the assets of a statutory fund in a subsidiary if:
>
> (a) the total of funds other than statutory fund monies invested in the subsidiary exceed the assets of all statutory funds invested in the subsidiary; or
>
> (b) the assets of the statutory fund that are invested with the subsidiary are reinvested into a related company which is not a subsidiary directly or indirectly (through interposed companies, trusts or partnerships).
>
> An important specific rule set down by the Act is that a life company cannot invest assets of a statutory fund in a related company which is not a subsidiary, except with the approval of APRA. Again, it should be noted that this prohibition only relates to assets of a statutory fund. It does not apply to shareholder assets.
>
> There are various exceptions to this rule; for example, the life company may invest in related companies where the investment is in ordinary voting shares of a listed corporation provided that the amount invested does not exceed 2.5% of the total value of the assets of the statutory fund. Similarly, the rule relating to investments in related companies will not apply if the life company invests money of a statutory fund in a related company which is a bank by way of a deposit with that bank.
>
> It should also be noted that the term "investment" includes an investment by way of loan (sec 43(7)). It is not clear whether a life company could make a loan for purposes other than an investment.
>
> The life company is obliged to report restricted investments. A restricted investment is defined to be an investment of the assets of a statutory fund in a related company which includes a subsidiary. The life company has the obligation to give APRA a restricted investments return in relation to each half year. The section sets out further stipulations in relation to the timing and content of the return.

---

[73] Para 28–000.

6.36 In this context, note also the provisions of section 42 of the Life Act (Aust) that limit the provision of investment performance guarantees by a statutory fund. The "investment performance guarantee factor" of a statutory fund, which is the proportion of the amount of current policy liabilities that represents the cost of providing the investment performance guarantees at any particular time, must not exceed 5 per cent. This section applies if the business of a statutory fund consists of the provision of investment-linked benefits, and any of the policies of the fund includes an investment performance guarantee.

Reinsurance

6.37 Any entity that took on liability under a life policy under a reinsurance contract would also be required to register under and comply with the Life Act (Aust). This requires incorporation in Australia, and involves supervision by APRA. In addition, reinsurance arrangements are supervised. Under section 123, every life company must give APRA a reinsurance report each financial year, setting out such particulars as may be required by prudential rules. Also, under section 125, prudential rules may declare certain classes of contract to be reinsurance contracts to which that section applies, with the effect that a life company can only enter into those contracts with the approval of APRA. Note also section 39, which prohibits reinsurance between statutory funds of a life company. There is a prudential rule on requirements for reporting reinsurance arrangements and another on reinsurance contracts that need approval. In addition, under section 116(2), a life company must not enter into a reinsurance arrangement unless the appointed actuary has given the company written advice as to the likely consequences of the proposed arrangement.

Minimum surrender values

6.38 Section 207 of the Life Act (Aust) gives policyholders certain rights in relation to surrenders of policies, and requires the setting of an actuarial standard for minimum surrender values. Under section 207, in respect of policies which require no payment of premium after the first year, or which have been in force for at least three years, the policy owner may request a surrender of that policy. Generally speaking, the surrender value must be no less than an amount calculated under the actuarial standard on minimum surrender values.

Transfers and amalgamations of life businesses

6.39 Various provisions of the Life Act (Aust) deal with the division, amalgamation and transfer of assets between statutory funds. Section 46 provides that business cannot be transferred from one statutory fund to a new statutory fund without the written approval of APRA. Written approval is also required for amalgamation of statutory funds. Under section 45, a procedure is set down for transfer of assets from one statutory fund to another. The assets must be transferred across at fair value and the transfer must be fair and reasonable in all the circumstances.

6.40 Part 9 of the Life Act (Aust) contains provisions dealing with the transfer and amalgamation of business between one life company and another separate life company. Transfers and amalgamations of business must be made under a scheme which must be sanctioned by the Court (unless the business is carried on outside of Australia). A copy of the scheme, together with any actuary's report, must be given to APRA, who may

commission an independent actuarial report. Part 9 sets out the threshold requirements which need to be satisfied before the scheme can be confirmed. The consent of all policyholders is not required, although a summary of the scheme must normally be given to policyholders. Part 9 provides an effective way of selling a life business, or merging a life business, without the consent of policyholders.

General financial market integrity and consumer protection regulation

ASIC

6.41 ASIC is the body responsible for general financial market integrity regulation, and the consumer protection regime. The range of activities regulated by ASIC covers:

- deposit-taking activities (for example, transactions or savings accounts);
- general insurance;
- life insurance;
- superannuation;
- retirement savings account;
- managed investments;
- securities (that is, shares and debentures);
- derivatives (for example, futures contracts);
- foreign exchange contracts.

6.42 Financial market integrity and consumer protection regulation for these products includes:

- requirements about information that must be disclosed to consumers about these products;
- a general prohibition against misleading or deceptive conduct and other unfair practices;
- licensing of people who give advice on or are dealing in financial products;
- requirements for conduct of financial service providers;
- approval of alternative dispute schemes and industry codes.

6.43 While these subject matters may generally be described as "consumer protection" (and in fact are by ASIC on its website), in terms of the definition in this paper, many of them may more correctly be described as financial market integrity regulation. ASIC also administers the consumer protection regime as defined in the narrow sense in this paper (including extra disclosure requirements for retail clients, the regulation of intermediaries and the provision of complaints schemes).

6.44 ASIC does not have responsibility for the level of fees and charges (as distinct from the disclosure of those fees and charges).

6.45 ASIC was set up on 1 July 1998 and took over financial market integrity and consumer protection supervision in relation to life insurance from the Insurance and Superannuation Commission. In effect, ASIC inherited a set of rules already applying to life insurers.

6.46 The recent Financial Services Reform Act has introduced single licensing and disclosure regimes for all financial service providers, which must be complied with as from March 2004.

6.47 Certain aspects of financial market integrity regulation that relate specifically to life companies are included within the Life Act (Aust). These include extra duties on directors, and rules about surrender values and allocation of profits.

History of consumer protection

6.48 Life insurance circulars came into existence in the 1970s in response to consumer dissatisfaction with the industry. They were issued by the Life Insurance Commissioner. Early circulars addressed the 14 day cooling off period, calculations of minimum surrender values, and the requirements for promotional material. Their use became more common in the 1990s. By 1994, customer information brochures were required, including a "key features statement", disclosure of the remuneration paid to intermediaries, and summaries of the main features of the product.

6.49 These circulars had no legislative basis, but the industry generally complied with them. The life insurance industry resisted being brought under the securities code (Chapter 7 of the Corporations Act). However, unease about the lack of requirements for investment products led the Insurance Commissioner to issue disclosure rules for investment bonds in 1989 in a circular. Subsequent circulars, notably Consumer Issues Circular GI1 issued in 1996, developed the disclosure requirements for promotional material in the life insurance industry. The other main document that governed this area was the 1995 Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry ("the Code"). The Code was intended to ensure that:

- high-quality advice was given about life policies, so that policies were appropriate to meet customers' needs, and customers could make informed choices;
- the industry would give an appropriate standard of customer service;
- life insurance advisers were competent and followed principles of fair dealing, and that life companies and life brokers played an active role in overseeing their conduct and competency;
- life companies and life brokers had adequate procedures for dealing with customer enquiries and complaints, and also had an adequate external dispute resolution mechanism for disputes that were not resolved under their internal processes.

These circulars and the Code have now been largely replaced by the FSR Act.

6.50 The Wallis Report recommended in 1997 that the financial sector should become regulated along functional lines. Specifically, a single regulator was proposed to regulate corporations, financial market conduct and consumer protection for the financial sector. Its key responsibilities would be to:

- establish a consistent and comprehensive disclosure regime for the whole financial system (albeit one with flexibility to apply different rules in response to different situations beyond a common core);
- regulate advice about and sales of retail financial products, including the licensing of financial advisers under a single regime; and

- oversee industry-based schemes for complaints handling and dispute resolution, and establish a common means of access for consumers.

6.51 This recommendation was accepted by the Government. The ASIC Act 1989 was amended to make regulation of these aspects of the financial sector the exclusive province of ASIC from 1 July1998.

6.52 A range of conduct is regulated by the ASIC Act when it relates to a financial product or financial service. A financial product includes a contract of life insurance (including a life policy or sinking fund policy) within the meaning of the Life Act (Aust). Unconscionable, misleading and deceptive conduct, and false or misleading representations, are all prohibited.

Insurance intermediaries

6.53 Most life insurance is arranged through third parties, who are acting either as the agent of the company, or the agent of the customer. The Insurance (Agents and Brokers) Act 1984 (the "Agents and Brokers Act") grouped them into two classes: registered life insurance brokers, and the rest (broadly, life insurance agents). Life insurance brokers, who are generally independent professional consultants, were required to register under the Agents and Brokers Act. Agents on the other hand act for one or more life companies. The legal relationship for all classes of agent was based on the common law principles of principal and agent, as modified by the Agents and Brokers Act. In addition, the Code (see paragraph 6.49) imposed certain standards of conduct on intermediaries who were natural persons.

6.54 The FSR Act has replaced the Agents and Brokers Act, with effect from March 2004. Under the FSR Act, all financial services providers will have to be licensed and comply with certain conduct and disclosure obligations.

Complaints handling obligations

6.55 All life insurance companies and life insurance brokers have been required to have in place internal and external complaints handling mechanisms, as from September 1995. This was introduced by the Insurance Superannuation Commissioner (who preceded APRA) in the Code. The Code was issued as a circular and intended to be an interim measure until it was included in an amendment to the Life Act (Aust). However, that amendment was never made and the Code continued without a legislative base. ASIC adopted the Code and the Australian Securities Commission policy statements relevant to complaints handling.

6.56 The FSR Act also requires financial services providers to maintain proper complaint handling facilities. Every financial services licensee is required to belong to an independent complaints service. Details of the complaints-handling procedures must be included in the adviser's "financial services guide" as well as the product issuer's "product disclosure statement".

Insurance Contracts Act

6.57 The Insurance Contracts Act 1984 ("Insurance Contracts Act") also includes provisions intended to protect consumers from unfair treatment by insurers. Such provisions include:

- the requirement that both parties act in utmost good faith, and the inability of an insurer to rely on a provision in an insurance contract if to do so would constitute a breach of that duty;
- modifications to the insured's duty of full disclosure, such as:
  - the insurer must inform the insured of the duty of disclosure;
  - when statements made by an insured will constitute "misrepresentations";
  - when an insurer may avoid a contract because of a misrepresentation;
  - the effect of misrepresentations as to age; and
  - the ability of the Court to ignore misrepresentations, even if fraudulent, in certain circumstances;
- the inability of the insurer to rely on unusual terms;
- limits on the effectiveness of clauses attempting to limit liability for pre-existing conditions;
- cooling off periods (although these provisions may have been superseded by the FSR Act);
- obligations on the insurer to give reasons for refusing to provide, or cancelling, insurance, or offering insurance on less advantageous terms;
- imposing personal liability on directors for contraventions of that Act.

6.58 The Australian Government has announced that it intends to review the Insurance Contracts Act to ensure the Act "continues to meet its original consumer protection objectives and does not discourage insurers from writing policies in Australia".[74]

Financial Services Reform Act 2001

6.59 As from March 2002, Australian financial services providers have also been subject to the FSR Act. The FSR Act:

- aims to bring the superannuation, life and general insurance and securities industries under one licensing regime;
- proposes a new disclosure regime for financial products (excluding offers of shares and debentures);
- introduces an amended market regulation regime; and
- imposes standards of conduct for financial services providers dealing with retail clients.

6.60 There is a 2-year transitional period for industry participants to make the transition from their current regulatory structure to the single licensing and product disclosure regimes required under the FSR Act. During the transitional period, industry

[74] Press release from Senator The Hon Helen Coonan, Minister for Revenue and the Assistant Treasurer (Aust), 10 September 2003.

participants can elect to opt into the new regime or continue to operate and be regulated under the existing law.

6.61 The new single licensing regime requires certain persons to obtain an "Australian financial services licence". The following activities will require the provider to obtain this licence:

- providers of financial product advice;
- dealers in financial products;
- persons who make a market in financial products;
- operators of registered managed investments schemes; and
- persons providing custodial or depository services.

6.62 The licences are issued and administered by ASIC. In order to meet the general licensee obligations, all Australian financial services licensees, irrespective of size, will be required to have adequate risk management systems, dispute resolution systems and compliance measures. Entities already licensed or registered by ASIC will be eligible for a streamlining process that involves certifying that the licence meets the requirements of the FSR Act and ASIC policy. New products or services will have to undergo full assessment.

6.63 There is also a new single disclosure regime for all industries offering financial products or services. A document called a "product disclosure statement" will (subject to certain exemptions) be required for an offer of:

- superannuation;
- life insurance;
- general insurance
- managed investment schemes;
- derivatives;
- banking products.

6.64 Product issuers will need to comply with related product disclosure obligations such as significant event disclosure, confirmation of transactions and periodic reporting requirements. Other disclosure obligations that apply when providing advice to retail clients include the need to provide a "financial services guide", explaining the adviser's capacity and background, as well as a written "statement of advice".

Does the Australian regime comply with the IAIS Insurance Core Principles?

6.65 The Australian regime appears to comply substantially with the IAIS Insurance Core Principles 2000. Some of the Principles are incorporated as requirements of the Life Act (Aust), such as the requirement that all life companies be registered. With other Principles, such as the ones requiring standards with respect to assets and liabilities, it is not so easy to determine whether there is full compliance, as these matters are dealt with in technical accounting and actuarial standards, but they seem to be covered. The comparative table annexed as Appendix B shows generally how Australia's regime compares with the IAIS Principles.

Cross border issues

Does the Australian regulatory regime extend to offshore subsidiaries?

6.66 It would seem that parts of the Life Act (Aust) do apply to the New Zealand business of an Australian life company. Under section 31(c), a life company that carries on a life insurance business outside Australia must have a statutory fund in respect of that business. However, there are two exceptions. The first is that a fund for mixed Australian and non-Australian business is allowed, so long as the fund was established before the commencement of the Life Act (Aust) and so far as the fund relates to business carried on outside Australia, the fund relates only to business carried on in a country (or countries) in which the life company was carrying on life insurance business before the commencement of that Act. The second is that APRA can approve otherwise.

6.67 Once there is a statutory fund, all the rules about operation of statutory funds come into play. This would include the duties on the company and its directors, the rules regarding investments, the Solvency and Capital Adequacy Standards, and many other rules mentioned above. There are, however, special rules for overseas funds in relation to allocation of profits and losses and capital payments, distribution of retained profits and shareholders capital, and in relation to the financial records that must be kept.

6.68 Under section 125A, APRA can make specific exemption orders from certain provisions of the Life Act (Aust). One of those provisions is section 76, which requires a life company to keep financial records for overseas funds.

6.69 Certain other provisions of the Life Act (Aust) distinguish between Australian and non-Australian operations, such as section 198(1), which empowers ASIC to require a life company to submit to it any form of proposal or policy ordinarily used in Australia. In addition, section 227 requires registration of life policies. Under section 227(2), policies issued outside Australia must be registered in a register for such policies.

6.70 Some of the Act's provisions do not make it clear whether they apply to non-Australian operations. For example, APRA has the power under section 157 to apply for a Court order that a life company or part of the business of a life company be placed under judicial management. On the face of it, this seems to extend to the non-Australian operations of a life company. Similarly, Division 4, which relates to surrender values, appears to apply to all policies (except policies declared by regulations to be excluded from this Division).

Winding-up provisions: could Australian policyholders get priority if a New Zealand branch or subsidiary of an Australian life business was wound up?

6.71 Sections 180 to 188 of the Life Act (Aust) deal with winding up a life company. The general rule is that a life company can only be wound up by order of the Court on application by a judicial manager (section 175(6)) or by APRA (section 181). The winding up is then conducted in accordance with the Corporations Act. Under section 187 of the Life Act (Aust) the assets of a statutory fund must first be applied in accordance with the Corporations Act in discharging debts and claims referred to in section 556(1) of that Act. (These are things like expenses of the winding up and unpaid wages.) If any assets remain, those assets are applied in a certain order. The first

priority is the discharge of policy liabilities referable to that fund. If any assets remain, other liabilities of the fund are to be discharged.

6.72 An Australian life company carrying out business in New Zealand would be doing so either through a subsidiary incorporated here, or a branch. The nature of the operation in New Zealand could have implications for supervision in New Zealand. Under section 31(c) of the Life Act (Aust), a life company that carries on life insurance business outside Australia must have a statutory fund exclusively in respect of that business. There is an exception under which the life company may have a mixed Australian/non-Australian life business fund if the fund was established before the Life Act (Aust) and satisfies certain other conditions, as explained in paragraph 6.66. Another exception is that APRA can approve otherwise.

6.73 Section 31(c) seems to apply whether the business carried on in New Zealand is through a branch or a subsidiary. In any event, even if the fund was a mixed fund under the exception, the Act appears to provide no justification for giving Australian policyholders priority over New Zealand policyholders. Two sections of the Life Act (Aust) (sections 32 and 48) impose duties to give priority to the interests of owners (and prospective owners) of policies referable to a fund. These sections distinguish between the interests of policyholders and the interests of shareholders, but not between classes of policyholders.

6.74 Section 116(3) of the Insurance Act 1973 (Aust), which relates to a winding up of a general insurance company, is significant. That section states that on the winding up of a general insurer, the insurer's assets in Australia must not be applied in the discharge of its liabilities other than its liabilities in Australia unless it has no liabilities in Australia. There does not, however, appear to be an equivalent provision applying to the winding up of a life insurance company. While, in theory, Australian and non-Australian statutory funds should be separate but equal, there is the potential for a company in difficulty to move its assets into its Australian fund or funds before liquidation. This could be done, for example, by way of repayment of loans. In this context, the rules relating to transactions between related parties become important. In relation to life business conducted in New Zealand through a subsidiary, note section 131(2) of the Companies Act 1993 (NZ), which permits a director of a wholly owned subsidiary to act in a manner that is in the best interests of the holding company, even though it may not be in the best interests of the subsidiary.

Q6 Do you have any comments on chapter 6?

Chapter 7
United Kingdom life insurance law

INTRODUCTION

7.1 The United Kingdom began regulating life insurance companies with the Life Assurance Act 1870. That Act introduced the principle of "freedom with publicity" as the watchword for regulation. This meant the financial condition of the company would be regularly exposed to public scrutiny by revealing an actuary's report. The actuary reported on the valuation of the assets and liabilities of a life insurance company.

7.2 The "supervisor" at that time was the Board of Trade. The Board of Trade required only to receive the accounts and valuation reports and to make them public. It was not envisaged that it would take any action. This historical approach reflected a strong political philosophy that Government intervention in commerce should generally be avoided and that a healthy competitive market was what consumers most needed.[75]

7.3 For the next 100 years there was surprisingly little change in the regulation of life insurance companies, until the Life Insurance Companies Act 1973. This Act introduced the "appointed actuary" system, which meant all life insurance companies had to appoint a named actuary to carry out the actuarial functions for the firm.

7.4 The UK regulatory system continued under the Insurance Companies Act 1982, and was considered a lighter handed approach than the detailed US regulation system. However, from 1997, the UK financial services industry has undergone major reform.

7.5 The Insurance Companies Act 1982 was repealed and replaced by the Financial Services and Markets Act 2000 on 1 December 2001. The Financial Services and Markets Act covers the regulation of long term insurance companies (life insurance, pensions savings business (see paragraph 7.8)) and a wide range of other financial services. The Act established the Financial Services Authority ("FSA") as the single regulator of all financial services. The FSA came into being in June 1998.[76]

7.6 The FSA is the combination of 10 regulatory bodies that operated under the former system. The FSA is an independent, non-governmental body. It is a private company limited by guarantee, and funded by fees paid by those it regulates. A board, which is appointed by the Treasury, governs the FSA.

7.7 The FSA regulates some 12 000 firms across various sectors of the financial market – banking, insurance (life and non-life (that is, fire and general)) securities, exchanges,

---

[75] C Daykin (UK Government Actuary) *The Supervision of Life Insurance Business in the United Kingdom* (1999).

[76] The FSA was formally the Securities and Investment Board until October 1997.

advice – and represents the integration of prudential supervision and the conduct of business regulation. The British Government has announced a substantial widening of the FSA's regulatory responsibilities in that all mortgage lending, administration and advice will be regulated by the FSA from January 2005. A further 30 000 firms conduct mortgage and general (property and casualty) insurance business.[77]

7.8 Over 800 life and non-life insurance companies are authorised, either by the United Kingdom or by another European Economic Area ("EEA") member, to carry on insurance business in the United Kingdom. Of these, 160 are authorised for long term business (such as life insurance, pensions and savings)[78] and 56 are composites (able to do life and fire and general). The 10 largest long term insurance companies account for 68 per cent of the market. The industry pays out £166 million a day in pension and life insurance claims.[79]

CURRENT SITUATION

7.9 The Financial Services and Markets Act and secondary legislation under it create the framework for the regulation of financial services. The Act sets the statutory objectives and principles of good regulation, and provides the FSA with rule-making and statutory powers. The FSA approach is the United Kingdom interpretation of European Union Directives. The FSA has four statutory objectives:

- maintaining confidence in the financial system;
- promoting public understanding of the financial system;
- securing the appropriate degree of protection for consumers; and
- reducing the potential for financial service firms to be used for a purpose connected with financial crime.

7.10 The FSA is a risk-based regulator. This means that for each firm, the FSA makes an assessment of the risks that firm presents to the FSA's four statutory objectives.

7.11 The FSA has used its powers under the Act to set out the details of its regime in a single *Handbook of Rules and Guidance* ("FSA Handbook").

FSA Handbook for financial services

7.12 The FSA Handbook sets out the regulatory processes for all financial services. There are various manuals or sourcebooks within the FSA Handbook for the different areas of regulation. The High Level Standards and other general manuals or sourcebooks apply to all financial services, and the Interim Prudential Sourcebook for Insurers applies directly to insurers.

---

77 J Tiner "The FSA's radical new approach to insurance regulation" (Central and East European Regulators Seminar, Poland, 27 June 2003).

78 "Pensions and savings" refer to personal pension schemes, which are sold by insurance companies, as opposed to occupational pension schemes.

79 Information was obtained from the Association of British Insurers website (www.abi.org.uk).

High Level Standards

7.13 The FSA Handbook requires all regulated firms to meet certain High Level Standards.

Principles for businesses

7.14 The principles for businesses underpin the FSA's regulatory regime, and essentially set standards for the way the FSA expects all financial service firms to operate. The 11 principles are: integrity; skill, care and diligence; management and control; financial prudence; market conduct; customers' interests; communications with clients; conflicts of interest; customers – relationships of trust; clients' assets and relations with regulators. They are "catch all" provisions that bind all firms and may be enforced by the FSA.

7.15 Principle 6 requires firms to treat their customers fairly. This is widely relevant and includes balancing policyholder and shareholder interests in respect of distributions from long term insurance funds.

Senior management responsibility

7.16 The FSA Handbook requires firms to take reasonable care to maintain a clear and appropriate apportionment of significant responsibilities among directors and senior management.

"Threshold conditions"

7.17 "Threshold conditions" are the conditions a firm must meet to obtain authorisation. Once authorised a firm must continue to meet the conditions. (See the authorisation process in paragraphs 7.35 and 7.36).

Statements of Principle and Code of Practice for Approved Persons

7.18 The FSA has prescribed 27 functions ("controlled functions"). These include governing functions, such as those of directors, the chief executive and partners. Personnel carrying out these functions must have prior approval from the FSA. Under section 61 of the Act, the FSA must be satisfied the person is "fit and proper" in accordance with that section before granting approval (see paragraph 7.20).

7.19 Individuals who carry out "controlled functions" for a firm are bound by certain Statements of Principle including: acting with integrity, due skill and diligence; observing proper standards of market conduct; dealing with the FSA and other regulators in an open and co-operative way and disclosing appropriate information.

"Fit and proper" person test

7.20 Before a person obtains approval from the FSA to carry out a "controlled function", the FSA must be satisfied the person is fit and proper. There are three limbs to the FSA test:

- honesty, integrity and reputation;
- competence and capability;
- financial soundness.

Interim Prudential Sourcebook for Insurers

7.21 The FSA Handbook has specific business standards for the different financial services it regulates. The Interim Prudential Sourcebook for Insurers relates to general insurance and life insurance companies.

7.22 The prudential rules applying to insurers in the Interim Prudential Sourcebook for Insurers are intended to largely re-state the provisions of the Insurance Companies Act 1982 and the regulations made under it. The substance of the rules will change when an Integrated Prudential Sourcebook is implemented in early 2004. The Integrated Prudential Sourcebook will enable one prudential regime to operate across the whole financial sector. The FSA believe single regulation will allow them to maintain better and more focused oversight of the financial soundness of firms.[80] The first stage of the reforms is outlined paragraph 7.58.

7.23 All insurers must comply with the rules in the Interim Prudential Sourcebook for Insurers.

Restriction of business to insurance

7.24 The business of an insurer is restricted to insurance and activities directly arising from its insurance business.[81] The purpose of this rule is to protect the assets from being diverted to fund other activities and to ensure to the fullest extent possible that they are available to pay legitimate claims.

Margins of solvency

7.25 Every UK insurer must maintain a required minimum margin of solvency in accordance with the rules. The purpose of the solvency margin is to ensure the insurance company maintains sufficient assets to pay its liabilities to policyholders. Although there is a basic requirement, long term or life companies may need to meet a much higher margin.

7.26 Breach of the required minimum solvency margin triggers a requirement for the firm to provide the FSA with a plan to restore their financial position and may be a cue for further regulatory attention.

Long term insurance business

7.27 Given the duration of long term contracts, the protection of policyholders requires special rules. Therefore, there is a fundamental requirement that a long term insurer maintains a separate account in respect of each kind of business it carries on, and must enter receipts into a separate insurance fund with appropriate names.[82] These rules effectively ring-fence the assets relevant to long term insurance business.[83]

---

80 Clive Briault (Director of Prudential Standards, FSA) press release (30 July 2002).

81 Interim Prudential Sourcebook for Insurers, Rule 1.3.

82 Interim Prudential Sourcebook for Insurers, chapter 3.1.

83 Interim Prudential Sourcebook for Insurers, chapter 3.

7.28 All records must identify the assets and liabilities attributed to that business. The assets representing the long term fund are applicable only for the purpose of that business. There are exceptions when an actuarial investigation shows the value of these assets exceeds the amount of the liabilities attributed to long term insurance business, or where the insurer exchanges, at fair market value, long term insurance business assets for other assets of the insurer.[84]

For long term insurance companies there are restrictions on:

- Transactions with connected persons. This rule prohibits a long term insurer or a subordinate company (that is, a subsidiary whose shares are held by the insurance company as a part of its long term assets) from entering into a transaction[85] with a "connected person"[86] if the total of the assets and liabilities attributable to the existing transactions with connected persons exceeds 5 per cent of the long term funds of the insurance company, or if the proposed transaction would result in the 5 per cent limit being exceeded.
- Arrangements between separate insurance funds. A long term insurer in the United Kingdom must ensure arrangements are in force for securing that transactions affecting assets of the insurer do not operate unfairly between long term insurance funds and the other assets of the insurer, or where there is more than one fund, between those funds.
- Linked long term contracts. These contracts are permissible only when the benefits are determined by reference to property listed in an appendix to the Interim Prudential Sourcebook for Insurers.

Financial reporting

7.29 Insurers must prepare an annual return, comprising a revenue account, balance sheet and profit and loss account for each financial year and must deposit these with the FSA within 2 months and 15 days after the close of the financial year. Such documents deposited with the FSA must be provided to shareholders or policyholders within 30 days of a request. Arrangements are in place to make the returns available to the public.

7.30 Long term insurers are required to procure an annual investigation by the appointed actuary. When the actuary makes an investigation, an abstract of the actuary's report must be sent to the FSA and be made available at the request of shareholders or policyholders. Arrangements are in place to make this document available to the public. Amendments have been made to the rules relating to this abstract for the benefit of the FSA, policyholders and analysts.

---

84 Interim Prudential Sourcebook for Insurers, chapter 3.2.

85 A transaction includes, for example, where a person connected with the insurer will owe it money; or the insurer acquires shares in a company that is a person connected with it; or the insurer undertakes a liability to meet an obligation of a person connected with it or to help such a person meet an obligation.

86 A person is "connected" with an insurance company when the person controls or is a partner of a person who controls an insurance company; or the person is a company controlled by the insurance company; or the person is a director, spouse or minor child of the director of the insurance company.

Transfers of insurance business

7.31 Part VII of and Schedule 12 to the Financial Services and Markets Act deal with the rules to be followed when an insurer seeks to transfer all or part of its portfolio to another insurer. This part of the Act replaced Schedule 2C to the Insurance Companies Act 1982. The most significant change is that general insurance transfers require the sanction of the High Court. The FSA must be notified and it will indicate how closely it wishes to monitor the scheme and will agree on a timetable.

7.32 The regulations under the Act state that the applicant must publicise a notice stating the transfer application has been made in the London, Edinburgh and Belfast gazettes, in two national papers and, when the transfer includes a policy with a commitment in another EEA state, in two national papers in that state. It must also be sent to every policyholder of the parties. Usually, the FSA will want to comment on the statement before it is sent. A statement of the terms of the scheme and a copy of the expert's report must be sent to any person who requests one.

7.33 When the scheme involves long term business, the affidavit evidence to the court would usually include copies of reports on the transfer by appointed actuaries of both firms. This should be shown to the FSA.

Conduct of Business Sourcebook

7.34 The Conduct of Business Sourcebook governs the sale of regulated products. This sourcebook includes provisions relating to communications with clients, financial promotions and advising and selling. At the time of sale a "Key Features Document" must be given to private clients.

Authorisation Manual

7.35 An insurance company must be authorised by the FSA before it may carry on a regulated activity in the United Kingdom. Once authorised, the company will be subject to regulation and supervision by the FSA. These provisions also apply to reinsurance companies.

7.36 There is a single authorisation process covering the whole of the financial services community. Broadly, to become authorised an applicant must satisfy certain *threshold conditions* and the FSA's *risk assessment process*, which involves an assessment of the risks posed by the applicant against probability and impact factors. The obligation to meet the threshold conditions is ongoing. The threshold conditions relate to the applicants: legal status, location of office, close links, adequacy of resources and suitability.

Supervision Manual

7.37 The Supervision Manual sets out the processes by which the FSA supervises regulated firms. It introduces the concept of risk-based supervision that attempts to focus resources on the mitigation of risks to the FSA's objectives.

7.38 The FSA carries out supervision from information it has gathered and places reliance on information provided by auditors, actuaries and other skilled persons. The Supervision Manual also contains the detailed provisions of the "approved persons regime", by

which individuals who hold positions of influence within regulated firms are vetted to ensure they satisfy appropriate "fit and proper" criteria.

7.39 Chapter 4 of the Supervision Manual formalises the role of a company's appointed actuary transacting long term insurance business. Any such firm must appoint an actuary with the necessary skills and experience to provide the firm with appropriate actuarial advice. The firm must ensure that if there is a vacancy in the office of the appointed actuary, it informs the FSA and ensures a replacement is appointed as soon as reasonably practicable. An application must be made to the FSA for approval of the person taking up the appointment.

7.40 Since 1992, the appointed actuary has been required to obtain a practising certificate from the profession before his or her appointment has been renewed each year.[87] The profession has continued this requirement, and the insurer is expected to verify that this certificate is indeed held.

7.41 The main responsibilities of the appointed actuary are to identify and monitor the risks that may have a material impact on the firm's ability to meet its liabilities to policyholders as they fall due. These liabilities include any constructive obligations in respect of future annual or final bonuses to with-profit policyholders. Secondly, the actuary is expected to inform the management (and directors) of any material concerns about the current ongoing ability of the firm to meet these liabilities. Thirdly, the actuary is expected to carry out the actuarial investigation of the firm each year and produce the appropriate abstract to be included in the FSA returns.

Enforcement and Decision Making Manuals

7.42 When making certain decisions relating to authorisation, supervision and enforcement, the FSA is required to give statutory notices, including warnings, notices of further decisions, notices of discontinuance, final and supervisory notices.

Statutory schemes

Financial Services and Markets Act Compensation Scheme

7.43 The FSA must, by rules,[88] establish a scheme for compensating persons in cases where authorised firms are unable, or are unlikely to be able, to satisfy claims against them. Therefore, the FSA set up the Financial Services Compensation Scheme ("FSCS") on 1 December 2001. The FSCS covers investments, deposits and insurance. The FSCS is a separate organisation from the FSA.

7.44 The FSCS can compensate consumers if an authorised company is not able to pay the claims made against it. In general, this is when a company has gone into liquidation or ceased trading. The FSCS manager has the power to take measures for safeguarding policyholders. The FSCS may assist by providing financial assistance to the insurer

87 An actuary must be a member of the Actuarial Profession.

88 The rules are known as the Financial Services Compensation Scheme Rules under s 213(2) of the Financial Services and Markets Act 2000.

concerned, by transferring policies to another authorised insurer, or by paying compensation to eligible policyholders.

7.45 The FSCS manager has the power to impose levies on authorised persons for the purpose of meeting its expenses, including expenses incurred or expected to be incurred in paying compensation, borrowing or insuring risks.[89] For long term policies (for example, pension plans and life assurance) the FSCS covers the first £2000 in full and then 90 per cent of the value of the policy (in a liquidation) thereafter.[90] The money used to pay compensation comes from charges levied on authorised firms.

Financial Services and Markets Act Ombudsman Scheme

7.46 The Financial Ombudsman Service (FOS) is a scheme set up under the Financial Services and Markets Act,[91] under which certain disputes may be resolved quickly and with minimum formality by an independent person. The FOS was established as a result of the merger of eight independent Ombudsmen and complaint handling schemes. Firms authorised by the FSA fund the scheme at an amount calculated by the FSA. The FOS is a separate organisation from the FSA.

7.47 The FSA has developed a set of rules to ensure complaints are handled fairly, effectively and promptly and are resolved at the earliest possible opportunity. The standards imposed by legislation are an extension of the voluntary procedures developed in a self-regulated industry and focus on consumer protection.[92]

7.48 Determinations made by the Ombudsman in favour of the complainant may include an award against the respondent of such amount as the Ombudsman considers fair compensation, or a direction that the respondent take such steps in relation to the complainant as the Ombudsman considers fair and appropriate. A monetary award is enforceable by a complainant, if a county court so orders, by execution issued from the county court as if it were payable as an order of that court. Compliance with a direction is enforceable by an injunction. Only the complainant may bring proceedings for an injunction.

Other bodies within the UK life insurance industry

Association of British Insurers

7.49 The Association of British Insurers ("ABI") represents the collective interests of the UK's insurance industry.[93] The ABI speaks out on issues of common interest, helps to inform and participate in debates on public policy issues and acts as an advocate for high standards of customer service in the insurance industry. The ABI has around 400 member companies. Between them, they provide over 97 per cent of insurance business in the United Kingdom.

---

89 *Halsbury's Laws of England* (4th edn, Butterworths, London, 2003) Vol 25.

90 Information was obtained from the FSA website (www.fsa.gov.uk).

91 Section 225(2) of the Financial Services and Markets Act.

92 New Zealand Insurance and Savings Ombudsman *Annual Report* (Wellington, 2001).

93 Information was obtained from the Association of British Insurers' website (www.abi.org.uk).

7.50 The ABI was formed in 1985 when several existing industry bodies joined together, notably the British Insurance Association, Life Offices' Association, Fire Offices Committee and Accident Offices Association.

7.51 Previously, the UK insurance industry was represented only by specialist associations. The creation of the ABI meant that all sectors of the insurance company market could now speak through a single organisation. The ABI is funded by the subscriptions of member companies.

Government's Actuary Department

7.52 The fundamental aim of the Government's Actuary Department ("GAD") is to provide mainly public sector clients with independent, professional actuarial advice of the highest quality at reasonable cost.[94] Although constituted as a Government department, GAD operates as a consultancy firm within the public sector, offering independent actuarial advice to clients and charging fees for its services. GAD is required to charge to recover its costs, but does not seek to make a profit.[95]

CURRENT ISSUES AND REFORM WITHIN THE UK LIFE INSURANCE INDUSTRY

7.53 In recent years the UK life insurance industry has been affected by falling equity markets and lower long term interest rates. The FSA has seen these events as catalysts to modernise life insurance regulation. The FSA has issued several reports highlighting the deficiencies with the system of insurance regulation it inherited in 1998.

7.54 In September 2001, the FSA appointed John Tiner, the FSA's Managing Director of Consumer, Investment and Insurance, to lead a review into the future regulation of the insurance industry in the United Kingdom. In October 2002, the *Future Regulation of Insurance* ("the Tiner Report"), was published.

7.55 The Tiner Report identified the following weaknesses in the existing regime:

- consumers need to be better informed about the products available to them and be given more information after buying a product so they can monitor its investment performance;
- more explicit responsibility needs to be placed on management to maintain proper systems and controls; and
- improvements need to be made in the way in which solvency requirements are calculated.

7.56 To begin the reform process, the FSA completed risk assessments of the 200 largest life and general insurance companies. The FSA used the assessment process as a way of understanding the extent to which individual firms may pose a risk to market confidence, consumer protections or financial crime, and to establish a continuing relationship with the companies.

---

[94] Information was obtained from the Government's Actuary Department website (www.gad.gov.uk).

[95] The FSA employs its own actuarial staff and is not reliant on the GAD.

7.57 The FSA has recently announced reforms for the governance of life insurance companies.[96] The FSA plans to implement a package of measures to make more transparent how discretion in with-profit funds is exercised by boards and senior management, bringing policyholder liabilities within the scope of the audit and introducing a public actuarial opinion to be published with the annual report.[97] The plans make directors and senior management of life insurers explicitly responsible for all decisions of their business.

7.58 Reforms announced by the FSA on 26 June 2003 include:

- Requiring life insurers to define and make publicly available their Principles and Practices of Financial Management ("PPFM") applied in their management of with-profits funds. There has previously been no specific regulatory requirement imposed on firms to either publicise how they use their discretion or to show how, in doing so, they have managed any conflicts of interest and ensured policy holders are treated fairly.
- Life insurance firms must certify in the annual returns whether these funds have been managed in accordance with the PPFM, and provide an annual report to policyholders on this compliance. The latter report must be submitted to the FSA at the same time as the returns. The FSA will require all firms to publish a PPFM from the end of March 2004.
- The FSA plans to discontinue the existing role of the appointed actuary regime and introduce two new actuarial functions, the "actuarial function" and the "with-profits actuary function", both of which will become controlled functions:
  - The "actuarial function", which will act as an advisor to the board on various actuarial issues. The actuarial function will specifically monitor the financial condition of the firm and advise on the level of capital needed to support the business.
  - The "with-profits actuary function" will directly represent the interests of the policyholders in ensuring they are treated fairly by the firm and that the fund is operated in accordance with the PPFM. The with-profits actuary will not be able to be a member of the board of directors.

7.59 Solvency standards have been the topic of investigation by the FSA for some time. The international accounting standards, the European Union Directives and the new Basel Accord for Banks have been drivers for change in the field of solvency. Work on international accounting standards for insurance contracts and for financial instruments more generally, including progress towards fair value accounting, will have a profound effect, especially for life insurance firms.[98]

---

96 The FSA published a policy statement on feedback from "With-profits governance and the role of actuaries in life insurers" (Consultation paper 167, 2003) in June 2003. The policy statement sets out the timetable for implementing a package of measures following earlier consultation.

97 Tiner, above n 77.

98 Tiner, above n 77.

7.60 The FSA has stated that although the required minimum margin for solvency is an important indicator of the financial health of a life insurer, it is in some respects a very conservative calculation.[99] The FSA has begun to introduce a new approach to measuring the solvency of life insurers based on a "realistic" assessment of assets and liabilities together with a "safety margin" or "capital buffer" to cover adverse market developments.

7.61 The United Kingdom's reforms for solvency should be seen against the background of proposals to introduce a new solvency regime within the European Union. The proposed "Solvency II Directive" is unlikely to be implemented until 2008. Until then, the FSA will operate an amended version of the current statutory calculation alongside the new realistic liabilities plus capital buffer test. The FSA plans to introduce the new approach from the beginning of 2004.

7.62 The FSA's proposed reforms (in paragraph 7.58) have attracted major criticism from the Government Actuary's Department.[100] GAD states that the proposals fail to meet FSA's stated objective of strengthening the governance of insurance firms and improving transparency. Most notably, GAD states the FSA's proposals fail to recognise and build on the strengths of the existing appointed actuary system. GAD believes the case for relying on board responsibilities alone as being more effective than the existing appointed actuary system in delivering protection for customers has not been made.

7.63 GAD suggests that instead of abandoning the appointed actuary regime, a better approach would be to retain the regime and require the actuarial advice given to be disclosed publicly, along with a requirement for the board to have regard to this advice. GAD states the proposals take away the influence of expertise and individual, professional responsibility and do not replace them with anything robust.

7.64 GAD also questions whether the proposed PPFM can be both effective and precise and, at the same time, understandable to the general public. Further, GAD believes the requirement that the with-profits funds have been managed in accordance with the PPFM should be subject to an independent external actuary, and so too should the PPFM themselves.

Q7 Do you have any comments on chapter 7?

---

[99] Tiner, above n 77.

[100] GAD published its comments on the FSA's Consultation Paper 167 on 11 April 2003 (available from www.gad.gov.uk).

Chapter 8
Life insurance in other overseas jurisdictions

REPUBLIC OF SOUTH AFRICA

Overview

8.1 In the Republic of South Africa, insurance legislation is divided between two main statutes, the Long-term Insurance Act (Act 52 of 1998) and the Short-term Insurance Act (Act 53 of 1998). The Insurance Amendment Act (No. 17 of 2003) came into force on 1 August 2003 and amended both Acts.

Long term insurance policy

8.2 A "long term policy" is defined under the Long-term Insurance Act, to mean "an assistance policy, a disability policy, fund policy, health policy, life policy or sinking fund policy, or a contract comprising a combination of any of those policies; and includes a contract whereby any such contract is varied" (section 1).

8.3 A "life policy" is defined under the Long-term Insurance Act, to mean "a contract in terms of which a person, in return for a premium, undertakes to (a) provide policy benefits upon, and exclusively as a result of, a life event, or (b) pay an annuity for a period; and includes a reinsurance policy in respect of such a contract" (section 1). The Insurance Amendment Act has added "linked liabilities" and "linked policies" to the definition.

Short term insurance policy

8.4 A "short term policy" is defined under the Short-term Insurance Act to mean "an engineering policy, guarantee policy, liability policy, miscellaneous policy, motor policy, accident or health policy, property policy or transportation policy or a contract comprising a combination of any of those policies; and includes a contract whereby any such contract is renewed or varied" (section 1).

Regulation of long term insurance

8.5 The Financial Services Board ("FSB") supervises the control over the activities of non-banking financial services in South Africa. It is an independent institution established as a statutory body by the Financial Services Board Act (Act 97 of 1990).

8.6 The FSB's mission is to promote sound and efficient financial institutions and services together with mechanisms for investor protection in the markets it supervises.[101] The FSB also acts in an advisory capacity to the Minister of Finance. The FSB is funded through levies placed on its members.

8.7 The FSB regulates and supervises long term insurance under the Long-term Insurance Act (in this section on South Africa referred to as "the Act"). The FSB has specific duties and powers to act as the Registrar of Long-term Insurance (section 2).

8.8 There is also an Advisory Committee on long term insurance, which may by its own initiative, or at the request of the Minister or Registrar, investigate and report or advise on any matter relating to long term insurance (section 6).

8.9 The South African Government has recently decided to move towards a single, mega-regulatory structure of all financial services, such as that of the United Kingdom.

Specific areas of regulation

Registration

8.10 Anybody who is involved in life insurance must operate as a wholly owned subsidiary company. A company must be registered as a long term insurer in order to carry on long term insurance business (section 7).[102] For registration, an applicant must have the carrying on of long term insurance business as its main objective (section 9(3)(a)).

8.11 Registration may be refused on a number of grounds, including: the applicant not having sufficient financial resources, organisation or management; the director or managing executive not being fit and proper; or the applicant's direct or indirect control is contrary to the interests of policyholders (section 9(3)(b)).

8.12 Conditions of registration may be imposed under section 10. The conditions are detailed and include: the ability to limit the amount of the premiums the long term insurer may contract to receive and minimum capital adequacy requirements.

Solvency

8.13 The statutory requirements in terms of solvency mean a long term insurer must have assets the aggregate value of which, on any day, is not less than the aggregate value, on that day, of its liabilities (section 30(1)).

8.14 A long term insurer must also, at all times, maintain its business in a financially sound position (by having assets, providing for its liabilities, and generally conducting its business), so as to be in a position to meet its liabilities at all times (section 29). Assets and liabilities must be calculated by means of the financial soundness method prescribed in Schedule 3.

---

101 Information obtained from the Financial Services Board website (www.fsb.co.za).

102 Section 7(1) does not apply to friendly societies and pension fund organisations that may carry on long term insurance under the Friendly Societies Act (Act No 25 of 1956) and the Pension Funds Act (Act No 24 of 1956) respectively. There are also other Acts to which section 7(1) does not apply.

8.15 The Actuarial Society of South Africa has issued a guideline ("PGN 104"), which provides guidance for the financial soundness valuation.

Capital adequacy

8.16 The Insurance Amendment Act introduced a minimum capital adequacy requirement. The minimum capital requirement is R10 million, which is the minimum capital adequacy expected from any long term insurer at registration, and an amount representing 13 weeks' operating expenses (section 29).

Financial reporting

8.17 A company is required to comply with the Generally Accepted Accounting Principles ("GAAP") standards, which are in line with international standards.

8.18 Before the Insurance Amendment Act, the statutory requirements applicable to long term insurance companies under the Act were the prescribed methods of calculating the value of assets and liabilities (Schedule 2) and the financial soundness method of calculating the value of assets and liabilities (Schedule 3).

8.19 The Insurance Amendment Act repealed Schedule 2 (the prescribed valuation method) so the financial soundness valuation method (Schedule 3) is now the only valuation method (section 30 and 31).

Statutory actuary regime

8.20 A statutory actuary must be approved by the Registrar (section 20). Appointment of an actuary is subject to the Registrar's approval and includes criteria such as a "fit and proper" test, having sufficient experience and being in good standing with the Actuarial Society of South Africa (of which they must be a member). The Registrar may remove an actuary from office if they are not fit and proper (section 22).

8.21 The actuary must report to the long term insurer any matter relating to the business of the long term insurer of which he or she becomes aware in the performance of actuarial functions that may prejudice the insurer's ability to remain financially sound (section 29(1)). If steps to rectify the matter are not taken to the actuary's satisfaction, he or she must report the matter to the Registrar immediately (section 20).

Directors' duties

8.22 Directors are required to adhere to corporate governance principles. The director's duties are set out in Chapter VIII of the Companies Act of 1973. Directors also have certain fiduciary duties in terms of section 2 of the Financial Institutions (Protection of Funds) Act (No. 28 of 2001).

Whistle blowing

8.23 Directors should report any financial unsoundness (section 29), auditors any material irregularity, and actuaries anything that may cause financial unsoundness to the Registrar (sections 19 and 20).

Segregation of life insurance policy funds

8.24 Non-life business is governed by the Short-term Insurance Act and life business by the Long-term Insurance Act. The FSB requires registration of two separate entities.

Registrar's powers

8.25 The Registrar may prohibit a long term insurer from carrying on long term business in certain situations (section 12), or may impose a prohibition or determine a limitation on business (section 15(3)(a)).

8.26 The Registrar may terminate the appointment of a long term insurer's director, managing executive, public officer, auditor or statutory actuary, if the person or firm concerned is not fit and proper to hold the office concerned (section 22).

Protection of policyholders

8.27 There is a growing trend in regulation to emphasise the consumer's position and ensure their fair treatment. Section 62 of the Act provides for rules governing the protection of policyholders to be established. The Policyholder Protection Rules ("Rules") came into force on 1 July 2001. The purpose of the Rules is to enable the policyholder, or proposed policyholder, to make informed decisions about long term insurance products and to guide insurers and intermediaries to act fairly and with due care and diligence.

8.28 Part II of the Rules deals with principles of disclosure and obligatory disclosures. There are rules surrounding the contact stage, proposal or quotation stage and the acceptance stage.

8.29 Part III of the Rules deals with replacement of policies. Generally, no insurer or intermediary may advise or ask a policyholder to terminate an existing policy and replace it wholly or partially with a replacement policy, without disclosing to the policyholder the potential implications, cost and consequences of such a replacement.

8.30 Part IV of the Rules deals with policy cancellations and cooling-off periods.

8.31 Other rules cover the Registrar's specific duties, additional duties for insurers and intermediaries and penalties for non-compliance.

8.32 Part VII of the Rules covers marketing of long term products directly to the public.

8.33 Part IX of the Rules provides for a statutory notice to long term policyholders. The statutory notice is a checklist of information that the policyholder, or prospective policyholder, has a right to. This statutory notice includes information on replacing an existing policy, rights to cancel the transaction, and the particulars of the Long-term Insurance Ombudsman.

Offences

8.34 A long term insurer may be liable on conviction to a fine not exceeding R100 000 for failing to comply with certain provisions of the Long-term Insurance Act. For failure to furnish the Registrar with a return, information or documentation as provided by that

Act, a person is liable to a penalty not exceeding R1000 for every day during which the failure continues (sections 67 and 68).

8.35 The judicial management provisions in the Act have not been used by the FSB. However, a less intrusive process, curatorship (under the Financial Institutions (Protection of Funds) Act (No. 28 of 2001)) is often used when there are signs of instability. The curatorship powers have been used reasonably successfully.

Licensing of financial advisers

8.36 The Financial Advisory and Intermediary Services Act (No. 37 of 2002) requires financial service providers to be licensed and maintain minimum standards. The Act's subordinate legislation contains enforcement measures and codes of conduct.

Complaints

8.37 The Ombudsman for Long-term Insurance investigates complaints from the public against long term insurers that participate in the Ombudsman's Scheme. The Scheme is a free and independent service for resolving disputes with insurers. Complainants must, however, endeavour to resolve the complaint with the insurer first.

8.38 In the year ending 2001, the Ombudsman identified three major areas of complaints: communication/administration failure, claims disallowed on account of policy terms not being met, and alleged mis-selling. This pattern is said to be similar to previous years.[103]

CANADA

Overview

8.39 Regulation of Canada's life and health insurance is shared between the federal and provincial governments.

8.40 The Office of the Superintendent of Financial Institutions ("OSFI") supervises federally incorporated firms (including foreign firms), which account for over 90 per cent of the industry's premium income.[104] Four provinces have agreements with the federal regulator for it to carry out prudential supervision of provincially incorporated companies on the behalf of the provinces. The OSFI also has Information Sharing Memorandums of Understanding with most provinces, whereby the OSFI shares annual financial return data on all federally regulated insurance companies with the provinces. The provincial regulators use the data for comparative analysis.

8.41 The OSFI is a solvency regulator and is responsible for making sure life insurers are in sound financial condition and in compliance with the provisions of the Insurance Companies Act 1991 (in this section on Canada referred to as the "Act"), which governs federally regulated financial institutions. The OSFI may advise management and require remedial action to be taken. The OSFI has powers under the Act to prescribe enforceable regulations.

---

103 Financial Services Board *Fourth Annual Report of the Registrar of Long-term Insurance* (2001).

104 Information obtained from the Department of Finance, Canada.

8.42 The OSFI conducts prudential reviews of companies to determine their financial soundness. It measures life insurance companies' capital adequacy by applying the Minimum Continuing Capital and Surplus Requirements ("MCCSR") guideline. Companies are required to submit quarterly and annual financial reports to the OSFI detailing assets, liabilities, receipts and disbursements.

8.43 All life insurers are subject to market conduct regulation by the province in which they operate. The Federal Consumer Agency of Canada is charged with administering the market conduct provisions contained in the Act, which are applicable to all federally incorporated insurance companies. This includes the licensing and marketing of insurance company products, standards of competence and behaviour of insurance agents, and consumer protection. The provincial statutes governing insurance contracts and beneficiary rights are modelled on the Uniform Life Insurance Act, which is a model law adopted by the Canadian Council of Insurance Regulators to regulate life insurance policies. Almost all provinces have adopted the model.[105]

8.44 The Canadian Life and Health Insurance Compensation Corporation is a private non-profit corporation created and financed by life insurance companies for policyholder protection. It guarantees life insurance policies up to certain limits. The Corporation provides policyholder protection in the event of loss of policy benefits due to the insolvency of their life and/or health insurance company members.

8.45 In June 2001, the Canadian Government passed legislation reforming the regulatory framework governing the financial services sector. This included legislation and regulations allowing Canada's largest mutual life insurance companies to convert into stock companies, a process known as demutualisation. Four companies have now demutualised.

8.46 The life and health industry continues to consolidate. The new framework maintains the long-standing principle of ensuring regular reviews of the regulatory framework by including an automatic 5-year revisit to the legislation to ensure the legislation keeps pace with the rapidly changing marketplace.[106]

Specific areas of regulation

Solvency and capital adequacy

8.47 The Insurance Companies Act 1991 permits the OSFI to set up guidelines for minimum capital and surplus requirements. Capital requirements are risk based and at no time should the capital be less than CAN$5 million. There is also an annual Dynamic Capital Adequacy Testing investigation.

8.48 The OFSI has the power under the Act to take control of any financial institution in serious financial difficulties and may petition the courts to issue a winding-up order. Under the Bankruptcy and Insolvency Act 1985, and Winding-up Restructuring Act 1985, in the liquidation of an insurance company priority must be given to policyholders over other creditors and shareholders.

---

105 Quebec is the only province that has not adopted the model.

106 Information obtained from the Department of Finance, Canada.

Appointed actuary

8.49 Both life and general insurance companies are required to appoint an actuary, and there is a high degree of involvement by the Canadian Institute of Actuaries. The Insurance Companies Act covers the appointed actuary regime in terms of the actuary's qualifications, appointment, valuations and reports, and revocation of appointment.

8.50 The insurer's actuary co-operates with the OSFI and its inspectors in calculating the company's liabilities and includes this information in the annual financial statements. The actuary must report to the directors any matter that has come to the actuary's attention, which would have adverse effects on the financial condition of the company. If action is not taken, the actuary must send a copy of the report to the OSFI.

Directors' duties

8.51 Directors are subject to normal corporate governance requirements. The standards for directors and officers are the codified common law standard requiring them to "act honestly, in good faith and with the view of the best interests of the company". In addition, directors are officially designated as representing either shareholders or policyholders.

Allocation of profits between policyholders and shareholders

8.52 The OSFI has no specific rules about the allocation of profits. However, life companies are required to maintain a prudent level of capital that in some cases dictates how profits (or a portion of profits) are to be allocated in a particular year.

Segregation of life policy funds

8.53 As a rule, Canada does not allow composite companies. If a life insurance company also sells accident and sickness insurance, its accident and sickness business must be kept in a separate account.

Financial reporting

8.54 The Insurance Companies Act requires financial reporting in accordance with GAAP.[107] The Canadian Institute of Chartered Accountants establishes specific accounting standards ("Canadian GAAP").

8.55 Insurance companies are required to file annual and quarterly returns in a form specified by the OSFI. Annual financial statements must be sent to shareholders and policyholders and an annual return must be sent to the OSFI.

8.56 Provincial securities regulators, for example, the Ontario Securities Commission, govern reporting with respect to the traded securities of insurance companies.

---

[107] In Canada, statutory and generally accepted accounting standards are identical. There is a single general purpose set of financial statements.

Registration/approval

8.57 Federal insurance companies must be approved by the OFSI. The Minister of Finance issues letters patent incorporating a company under the Act. The OSFI is responsible for assessing applicants for incorporation and making recommendations to the Minister of Finance.

8.58 There is a minimum capital requirement of CAN$5 million and an ownership regime based on equity. The OSFI has a detailed Incorporation Guide for incorporating federally regulated insurance companies. The Guide covers business plans, financial structure and ownership, management structure and supervisory frameworks.

8.59 All publicly traded life insurers are also required to have a rating.

Reinsurance

8.60 A company may commence insurance business without assuming any amount of reinsurance, provided it meets the capital requirement of CAN$5 million. The OSFI controls the reinsurance of a primary life insurance company by allowing or not allowing, the deduction of that portion of the reserve of the reinsured part of the policy in the actuary's company valuation.

Licensing

8.61 Provinces have exclusive jurisdiction for regulating insurance intermediaries. Each province licenses its agents and brokers. In many provinces this function and discipline is delegated to a self-governing body that is accountable to the provincial regulator/supervisor.

Taxation

8.62 The corporate taxation of life insurance companies is complex. Product taxation varies according to products and is administered by the Canadian Customs and Revenue Agency.

UNITED STATES

Overview

8.63 Insurance regulation was first introduced in the United States – in New York and Massachusetts – in the 1860s. This was fairly tight regulatory control, in which there was close scrutiny of contracts and prior approval was required for the premium rates charged.

8.64 The primary objectives of insurance regulation in the United States today are to protect the interests of policyholders, assure insurance company solvency and ensure rates are not inadequate, excessive, or unfairly discriminatory. To uphold these objectives, life insurers follow tight and detailed regulations with prescribed rules.

8.65 Individual states are responsible for regulating life insurers within their jurisdiction. Each state maintains its own insurance department and has a commissioner who supervises the department. Each state also has its own legislators who set broad policy

for the regulation of insurance. The legislators establish and oversee insurance departments, regularly review and revise state insurance laws and approve regulatory budgets.

8.66 The most important consumer protection offered by state insurance departments is endeavouring to ensure insurers remain solvent so they can meet their obligations to pay claims. States also supervise insurance sales and marketing practices and policy terms and conditions to protect consumers when they purchase insurance products and file claims.

8.67 The major regulatory support organisation for all states is the National Association of Insurance Commissioners ("NAIC"). The NAIC is an organisation of the chief insurance regulatory officials of the 50 states, the District of Columbia and the four territories. Established in 1871, the NAIC functions as an advisory body and service provider for state insurance departments. Commissioners use the NAIC to pool resources, discuss issues of common concern and align the oversight of the industry. However, each state ultimately determines what actions it will take.

8.68 The NAIC maintains an online database containing 10 years of detailed annual and quarterly financial information, for approximately 5200 insurance companies.[108]

8.69 The Financial Modernization Act 1999 (US) (also called the Gramm-Leach-Bliley Act and referred to in this section on the United States as the "Act") governs the regulation of insurance at a federal level. The Act established a comprehensive framework to permit affiliations among banks, securities firms and insurance companies. The Act re-acknowledges that states should regulate their own insurance business. States have taken action to meet the Act's specific requirements.[109]

Specific areas of regulation[110]

8.70 The NAIC has developed standards for regulation, but some states have significantly tougher requirements than others. States do not have to adopt model laws developed by the NAIC, but may have "substantially similar" laws or a combination of practices that achieves the same objectives as the NAIC standards.

Solvency

8.71 All state departments require a minimum level of capital and surplus. The NAIC has adopted risk-based capital ("RBC") formulas for life companies, and a model law prescribing regulatory action based on the result of those formulas. The valuation of assets must also comply with NAIC standards. The Act states the RBC or substantially similar provisions should be law.

---

108 Information obtained from OECD publications (2002).

109 Information obtained from the NAIC website (www.naic.org).

110 Based on NAIC standards.

Solvency monitoring or surveillance

8.72 States require insurers to file annual and quarterly financial statements and submit themselves to financial examinations. States have expanded financial reporting requirements, for example, statements of actuarial opinion, asset adequacy analyses and independent audit requirements. State insurance departments and the NIAC review the annual and quarterly statements through a variety of systems.

Appointed actuary regime

8.73 All insurers must appoint independent actuaries who must be fit and proper persons. States incorporate, by reference, the American Academy of Actuaries' criteria for independence. Actuaries have to report to the state supervisor and must report any significant deficiencies in the insurer's business.

Financial reporting

8.74 The annual statement is an extensive document containing a balance sheet and an income statement as well as supporting exhibits and schedules. The quarterly reports contain key information about assets and liabilities, income, changes in investment holdings, premiums, written losses and reserves. Quarterly statements are an important regulatory tool for detecting trends in a company's financial condition.

Directors

8.75 Directors are typically required to act in good faith as a person of ordinary prudence in the best interests of the company. They are covered by general corporate governance laws. Publicly listed companies are also subject to the Securities and Exchange Commission.

Separation of life policy funds

8.76 Life and non-life business must be kept separate.

Authorisation

8.77 Each state requires a company to be licensed to undertake insurance business in that state. The NAIC has adopted one application form for all states.

Reinsurers

8.78 Some states require prior approval of reinsurance, others require only disclosure. Reinsured companies are regulated like other insurers.

Licensing

8.79 All states may license company agents and brokers. The National Association of Registered Agents and Brokers was created in 1999 to achieve licensing reciprocity.

Risk management and financial products

8.80 All states may approve insurance rates, surrender values and policy conditions.

Foreign companies

8.81 Policyholders of a foreign company have the same rights as those of a domestic insurer.

Actions against troubled companies

8.82 Actions to prevent a financially troubled insurer from becoming insolvent include hearings or conferences, corrective plans, restrictions on activities, notices of impairment, cease and desist orders, or supervision. If preventative regulatory actions are unsuccessful a state may institute more formal proceedings, such as conservatism levels for statutory reserves, seizure of assets, rehabilitation, liquidation or dissolution.

Q8 Do you have any comments on chapter 8?

Chapter 9
International obligations and guidelines

Introduction

9.1 When reviewing the regulatory regime for any area of activity it is important to take into consideration any international obligations New Zealand has that may impact on that area. In the area of life insurance, New Zealand's commitments under the World Trade Organisation ("WTO") General Agreement on Trade in Services ("GATS"), the Australia New Zealand Closer Economic Relations Trade Agreement ("CER") and the New Zealand Singapore Closer Economic Partnership ("CEP"), must be considered. In addition, the International Association of Insurance Supervisors ("IAIS") considers issues relating to supervision of insurance and develops principles of best practice. New Zealand is a member of that body. However, while the WTO, CER and CEP obligations are legally binding on the New Zealand Government in international law, the principles developed by the IAIS are not.

World Trade Organisation

9.2 New Zealand is a member of the WTO, which is an international body that deals with the rules of international trade. Its main function is to ensure international trade flows as smoothly, freely and predictably as possible.

General Agreement on Trade in Services

General

9.3 New Zealand is a party to GATS, which was negotiated as part of the Uruguay Round of multilateral trade negotiations and entered into force on 1 January 1995. GATS aims to reduce the barriers encountered by services exporters, while reconfirming each state's right to regulate to meet national policy objectives.

9.4 New Zealand has certain general obligations to other WTO members under GATS, such as an obligation to treat foreign service suppliers equally as between each other (the "most favoured nation" or "MFN" treatment). Under Article V of GATS, however, members may be exempted from MFN treatment if a comprehensive free trade agreement exists. In New Zealand's case, this allows for more favourable treatment of Australian service suppliers under CER.

9.5 New Zealand has also agreed to be bound by specific GATS obligations set out in its Schedule of Commitments ("the Schedule"). The Schedule lists the service sectors in which New Zealand grants rights of access to the New Zealand market ("market access") and where New Zealand is obliged to treat foreign service-suppliers the same as local service-suppliers ("national treatment").

Modes of supply

9.6 In scheduling specific commitments, members must also look at the way services are delivered (the "modes of supply") as commitments on market access and national treatment are given in respect of four such modes. The WTO has identified four methods, or "modes", for delivering services:

- *Mode 1: Cross border trade:* the service is supplied by a provider physically located in one territory to a consumer in another (for example, insurance services provided over the internet to a New Zealand resident by a non-resident insurance company).
- *Mode 2: Consumption abroad*: a customer travels to another territory to consume a service (for example, a New Zealand citizen travels abroad and purchases an insurance service in a foreign country).
- *Mode 3: Commercial presence*: a foreign services supplier establishes a presence in another territory, through incorporation, branch office, a joint venture or other form of business entity to provide a service (for example, a New Zealand insurance company establishes a branch in China to provide services to Chinese customers).
- *Mode 4: Movement of natural persons*: the temporary movement of human services suppliers (for example, a New Zealand insurance assessor travels to the United States for several weeks to assess an insurance claim).

Additional documents

9.7 There are three further WTO documents relating to financial services. The first, an annex to GATS entitled the "Annex on financial services", provides certain qualifications to how the general rules are to be applied to financial services. Life insurance is specifically identified as being a "financial service" for the purposes of this annex. In particular, nothing in GATS prevents a member from taking measures for prudential reasons, including for the protection of policyholders, or to ensure the integrity and stability of the financial system. Also, a member may recognise the prudential measures of another WTO member (by implication thereby giving preferential treatment to that member's financial services suppliers), but must give other members the chance to demonstrate that their prudential measures may be equally effective.

9.8 Thirty-one, predominantly OECD, members (including New Zealand) entered into an Understanding on Commitments in Financial Services ("the Understanding"). The Understanding modifies the approach to market access and national treatment for financial services commitments.

9.9 The third document is GATS "Second annex on financial services", which was approved to permit the Uruguay Round negotiations on financial services to continue after the end of the rest of the negotiations because governments believed that broader commitments could be achieved if the negotiations lasted to the end of June 1995. This annex has no further effect.

9.10 As updated by the Understanding, New Zealand's Schedule of Commitments in the area of financial services covers several service sectors relevant to the provision of life

insurance services. In turn, for each of these sectors, specific commitments have been made in respect of the different modes of service supply.

9.11 Specific limitations apply across all financial services commitments made by New Zealand. For example, for all financial services provided via mode 3 (having a commercial presence in New Zealand) compliance with the financial reporting provisions of the Companies Act and the Financial Reporting Act is specifically noted and required. Similarly, for each subsector listed by New Zealand, no commitments are made on mode 4 (the movement of natural persons in and out of New Zealand to provide life insurance services here) except as provided in the horizontal section of the Schedule, which gives specific rights of movement to intra-company transferees and service sellers.

Schedule of specific commitments

9.12 Taking each subsector (as defined by the United Nations CPC classification system) relevant to life insurance in turn, New Zealand's Schedule of Commitments provides as follows.

Life insurance services

9.13 In respect of life insurance services (CPC 8121), subject to the financial reporting conditions noted above, New Zealand maintains no market access or national treatment limitations on the commercial presence of life insurance providers in New Zealand (mode 3). No commitments are made on the movement in and out of New Zealand of foreign nationals (mode 4) to provide life insurance services in New Zealand except as detailed in the horizontal section of the Schedule.

Intermediation

9.14 For insurance intermediation, such as brokerage and agency services (part of CPC 8140), while several market access limitations are noted in the Schedule, none is relevant to the provision of life insurance services. Accordingly, and subject to the financial reporting conditions noted above, New Zealand maintains no relevant market access or national treatment limitations on the commercial presence of providers of insurance intermediation services in New Zealand (mode 3). No commitments are made on the movement in and out of New Zealand of foreign nationals (mode 4) to provide insurance intermediation services in New Zealand except as detailed in the horizontal section of the Schedule.

Auxiliary services

9.15 In respect of services auxiliary to insurance, such as consultancy, actuarial, risk assessment and claim settlement services (part of CPC 8140), New Zealand has obligations on the cross border supply of such services (in modes 1 and 2) in accordance with paragraphs B.3 and B.4 of the Understanding on Commitments in Financial Services. Accordingly, New Zealand permits non-residents to supply services auxiliary to insurance to New Zealand clients as a principal, through or as an intermediary, under terms and conditions that accord national treatment. Likewise, New Zealand permits its residents to purchase services auxiliary to insurance from providers located abroad. Subject to the financial reporting conditions noted above, New Zealand maintains no

market access or national treatment limitations on the commercial presence of providers of services auxiliary to insurance in New Zealand (mode 3). No commitments are made on the movement in and out of New Zealand of foreign nationals (mode 4) to provide services auxiliary to insurance in New Zealand except as detailed in the horizontal section of the Schedule.

New services and products

9.16 Finally, the admission to the market of new life insurance services or products may be subject to the existence of, and consistency with, regulatory frameworks aimed at achieving prudential outcomes, or the integrity or stability of the New Zealand financial system.

Doha Development Agenda

9.17 In March 2003, as part of the WTO Doha Development Agenda negotiations, New Zealand submitted to the WTO an Initial Conditional GATS Offer, but this did not propose any further commitments on life insurance services.

Recognising the licensing regimes of other countries

9.18 Under Article VII of GATS, New Zealand may, for the purposes of fulfilment of its own licensing or other authorisation criteria, recognise the licensing regime of another country. However, if this is done by way of agreement or arrangement, other WTO members must be given the opportunity to negotiate their accession to such agreement or arrangement, or a comparable agreement. If recognition is done autonomously, other members must be given the opportunity to demonstrate that their licensing requirements should be recognised too.

9.19 If New Zealand was proposing to enter into negotiations on any such agreement or arrangement (for example, with Australia, in relation to its regulatory regime for life insurers) it must inform the WTO Council for Trade in Services, so other members have the opportunity to indicate their interest in participating.

9.20 Recognition of another country's licensing regime is to be based on multilaterally agreed criteria. In appropriate cases, members are required (under Article VII, paragraph 5) to work co-operatively with relevant inter-governmental and non-governmental organisations towards the establishment and adoption of common international standards and criteria for recognition and common international standards for the practice of relevant services. This is relevant when considering the significance of the IAIS Insurance Core Principles.

Australia New Zealand Closer Economic Relations

9.21 In 1983, New Zealand and Australia entered into CER. In 1988, the Protocol on Trade in Services to the CER achieved free trade in services between New Zealand and Australia as from January 1989, on all services except those inscribed in annexes. The annexes to the Protocol have gradually been amended to the point where New Zealand retains only two inscriptions, which relate to airway services and coastal shipping.

9.22 As a result, New Zealand is obliged to accord Australian financial services suppliers access rights in the New Zealand market no less favourable than those accorded to New Zealand suppliers. Subject to measures taken for prudential, fiduciary, health and safety or consumer protection reasons, New Zealand is also obliged to accord Australian financial services suppliers treatment no less favourable than that accorded in like circumstances to local financial services suppliers (that is, national treatment).

9.23 New Zealand and Australia have entered into a Memorandum of Understanding ("MOU") on co-ordination of business law dated August 2000. The MOU states that co-ordination does not necessarily mean the adoption of identical laws, but rather finding a way to deal with any differences so that they do not create barriers to trade and investment. "In working towards greater co-ordination, the efforts of both Governments will focus on reducing transaction costs, lessening compliance costs and uncertainty, and increasing competition" (page 1). The MOU recognises that co-ordination and co-operation already exist in a number of areas, including:

- competition laws enforced by the Commerce Commission in New Zealand and the Australian Competition and Consumer Commission;
- consumer protection laws, including fair trading laws;
- cross-investment activity including the offer of securities; and
- mutual recognition of registered occupations.

9.24 The MOU also includes a work programme that identifies areas as possible candidates for co-ordination, including:

- providing for cross-recognition of companies;
- seeking to achieve greater compatibility in disclosure regimes in relation to financial products;
- managing cross border insolvency; and
- facilitating information sharing.

9.25 As well as these specific areas, the MOU also provides that:

- when either Government considers that a difference between their respective business laws or regulatory practices gives rise to an impediment to the development of the trans-Tasman relationship, the two Governments will consult with a view to resolving that impediment; and
- each Government will keep the other informed of proposed reforms in the business law area, and give the other the opportunity to be involved in the other's reform process at an early stage.

9.26 At the Twentieth Anniversary Ministerial Forum held on 28–30 August 2003, Australian and New Zealand Ministers released a joint statement on the business law co-ordination work programme. This document noted that significant progress had been made in a number of areas of the work programme, including:

- competition agency co-operation;
- mutual recognition of securities offerings;
- adoption of international accounting standards and the future establishing of a joint institution governing accounting standards; and
- cross border insolvency and adoption of UNCITRAL Model Law.

New Zealand Singapore Closer Economic Partnership

9.27 The agreement between New Zealand and Singapore on a Closer Economic Partnership entered into force in January 2001. New Zealand and Singapore's services commitments under this agreement are similar to those each has made under GATS. For life insurance, there are no market access or national treatment limitations in the commercial presence mode of supply.

International Association of Insurance Supervisors

Introduction

9.28 The IAIS was established in 1994 and represents insurance supervisory authorities from more than 100 jurisdictions.[111] It was formed to:

- promote co-operation among insurance regulators;
- set international standards for insurance supervision;
- provide training to members;
- co-ordinate work with regulators in other financial sectors and international financial institutions.

9.29 The IAIS issues global insurance principles, standards and guidance papers, provides training and support on issues related to insurance supervision, and organises meetings and seminars for insurance supervisors. It works closely with other financial sector standard-setting bodies and international organisations working to promote financial stability.

9.30 The IAIS also welcomes insurance professionals as observer members and has more than 60 observers, representing industry associations, professional associations, insurance and reinsurance companies, consultants and international financial institutions. The IAIS holds an annual conference where supervisors, industry representatives and other professionals discuss developments in the insurance sector and topics affecting insurance regulation.

9.31 New Zealand is one of the jurisdictions represented on IAIS. The Registrar of Companies attends conferences as New Zealand's representative.

Principles

9.32 The IAIS sets out principles it regards as fundamental to effective insurance supervision. The principles identify areas in which the insurance supervisor should have authority or control and that form the basis on which standards are developed. The following principles have been developed:[112]

---

111 Information in this section was primarily obtained from the IAIS website (www.iaisweb.org).

112 The description of the principles and the standards in paras 9.32 to 9.35 has been taken directly from the IAIS website, prior to the approval of the Revised Principles at the October 2003 conference.

Principles on minimum requirements for supervision of reinsurers (October 2002)

This paper sets out principles on minimum requirements for supervision of pure reinsurers. It identifies elements of the supervisory framework that should be common for primary insurers and reinsurers and those elements that need to be adapted to reflect the unique risks faced by reinsurers. This paper is seen as an essential building block in the development of more detailed standards for the supervision of reinsurers.

Principles on capital adequacy and solvency (January 2002)

Intended as an essential building block in the development of more detailed standards relating to capital adequacy and solvency, this paper elaborates 14 principles for evaluating the solvency of life and non-life insurance undertakings. It is also relevant to reinsurers, depending on the degree of regulation of the reinsurance industry in their jurisdictions.

Insurance core principles (October 2000)

Intended to serve as a basic reference for insurance supervisors in all jurisdictions, the Insurance Core Principles set out the framework for insurance supervision, identify subject areas that should be addressed in legislation or regulation in each jurisdiction and provide a framework for the IAIS to develop more detailed international standards. The Insurance Core Principles were revised to include essential regulatory and supervisory principles on "Organisation of Insurance Supervisory Authorities", "Market Conduct" and "Cross-Border Business Operations" and replaces the Insurance Supervisory Principles issued in September 1997.

Insurance core principles methodology (October 2000)

Developed to present detailed criteria for each core principle; this will facilitate jurisdictions in carrying out comprehensive, precise and consistent assessments of their compliance with the Insurance Core Principles.

Principles on the supervision of insurance activities on the internet (October 2000)

Proposes an environment for the supervision of insurance activities on the internet that is consistent with that of insurance activities through other media. The principles also emphasise the importance of international cooperation between supervisors in this area. Ultimately the protection of the policyholder remains one of the most important tasks of the supervisor, regardless of the medium through which insurance is sold.

Principles for conduct of insurance business (December 1999)

Has the objective of improving insurer, intermediary and consumer relationships, thereby strengthening consumer confidence in the industry.

Principles applicable to the supervision of international insurers and insurance groups and their cross-border business operations (insurance concordat) (December 1999)

First approved in September 1997, these principles were amended in December 1999 to extend to insurance business that is conducted on a services basis without any foreign establishment. These principles aim to improve the supervision of internationally active insurance companies, stating that all insurance establishments should be subject to effective supervision, that authorisation involving cross-border activities should be subject to consultation between the relevant supervisors, and that provision should be made for external audits and for information sharing with other supervisors.

9.33 In October 2003, the IAIS approved what was until then a draft set of revised principles for insurance supervision (the "Revised Insurance Core Principles"). These principles in general terms reiterate and expand on the Insurance Core Principles 2000.

Standards

9.34 Standards focus on particular issues. They describe what IAIS regards as the best or most prudent practices. In some cases, standards set out best practices for a supervisory authority; in others, they describe the practices a well-managed insurer would be expected to follow, thereby assisting supervisors to assess the practices companies in their jurisdictions have in place.

9.35 The following standards have been developed:

Supervisory standard on the evaluation of the reinsurance cover of primary insurers and the security of their reinsurers (January 2002)

This standard covers the indirect supervision of reinsurance. Its main purpose is to ensure that the reinsurance arrangements that primary insurers conclude are fully assessed, and consequently that a judgment can be made on the level of security provided by the reinsurance programme.

Supervisory standard on the exchange of information (January 2002)

This paper sets out a standard for efficient and regular exchange of information between supervisory bodies, both within the insurance sector and between different financial services sectors. Information exchange is crucial for the effective supervision of internationally active insurers, insurance groups and financial conglomerates.

Supervisory standard on group coordination (October 2000)

Based on the Coordinator paper issued by the Joint Forum in 1999, which sets the general principles for the role of a coordinator regarding the supervision of financial conglomerates, this standard presents the principles covering the insurance sector in more concrete form.

Supervisory standard on asset management (December 1999)

This standard describes the essential elements of a sound asset management system and reporting framework across the full range of investment activities. It provides guidelines for good practice for supervisors to use in assessing how insurers control the risks associated with their investment activities.

Supervisory standard on licensing (October 1998)

Licensing plays an important role in ensuring efficiency and stability in the insurance market. This standard deals with the prudential aspects of licensing and contains requirements that should be met by an insurer seeking a licence, and the principles that apply to the licensing procedure itself, including the review of changes in the control of a licensed company.

Supervisory standard on on-site inspections (October 1998)

On-site inspection is an important part of the supervisory process, closely related to the ongoing monitoring process. This standard lays down the objectives of on-site inspection, the on-site inspection procedure and organisation of the on-site inspection process.

Supervisory standard on derivatives (October 1998)

This standard provides guidance to supervisors in assessing how insurers control risks in derivatives. It sets out risk management controls for insurers active in derivatives and a reporting framework, applicable across the full range of potential activities.[113]

Insurance Core Principles: October 2000

9.36 New Zealand has no legal obligation to adopt the IAIS Insurance Core Principles. However, they represent an international opinion of "best practice" in the area of insurance supervision, and as such warrant inclusion in a discussion of regulatory options. As to whether the existing New Zealand regulatory regime for life insurance complies with the IAIS Principles, see the comparative table in Appendix B. In many cases, offshore insurers operating in New Zealand will be subject to rules that comply with the IAIS Principles in their home jurisdictions. However, many questions arise, for example:

- Do the home jurisdiction rules apply to offshore (in particular, New Zealand) operations?
- Does the form of the New Zealand operation make a difference (that is, a branch or subsidiary)?
- Are New Zealand policyholders assured of being treated in all respects on an equal footing with the home jurisdiction's policyholders (for example, on a liquidation or in relation to inter-company transactions made before liquidation)?
- Can an offshore regulator adequately supervise operations in New Zealand?

These issues are discussed in more depth in chapter 16.

Introduction to the IAIS Principles

9.37 The purpose of the IAIS Insurance Core Principles is set out in paragraph 3 of the Principles, which reads:

> The Insurance Core Principles comprise essential principles that need to be in place for a supervisory system to be effective. Insurance supervisors should apply the Insurance Core Principles in the supervision of all insurers within their jurisdictions. The Insurance Core Principles are intended to serve as a basic reference for insurance supervisors in all jurisdictions. They may need to be supplemented by other measures designed to address particular conditions and risks in the insurance systems of individual jurisdictions. The Insurance Core Principles are to be used in assisting individual jurisdictions to strengthen their regulatory and supervisory arrangements.

9.38 The IAIS Principles include the following statements on self-assessment:

> Insurance supervisors should carry out a self-assessment to determine whether the principles are being substantially observed in their jurisdiction. In completing this self-assessment and determining the extent of observance, insurance supervisors should consider whether all the main principles are satisfied and the degree to which each

[113] In October 2003, a further standard was approved, being the supervisory standard on supervision of reinsurers.

principle is met. Insurance supervisors are encouraged to provide information on their self-assessments to the IAIS so that the IAIS may periodically review the extent to which members have adopted the principles. In this regard the IAIS has prepared the Insurance Core Principles Methodology providing comprehensive criteria for each principle that can be used for assessing observance. The Insurance Core Principles are supported by best practices set out in approved IAIS principles and standards. Together with the Insurance Core Principles, these other documents should always be referred to in order to obtain a complete picture.

9.39 The IAIS Principles are introduced with the following statement, which is followed by the text of the Principles:

> An insurance supervisor is expected primarily to protect policyholders and promote a secure and efficient market by ensuring that companies comply with the legislation and regulations governing the business of insurance. The insurance supervisor intervenes as necessary, using powers available under the legislation. The following are key issues for the insurance supervisor.
>
> *Principle 1: Organisation of an Insurance Supervisor*
>
> The insurance supervisor of a jurisdiction must be organised so that it is able to accomplish its primary task, ie to maintain efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders. It should at any time be able to carry out this task efficiently in accordance with the Insurance Core Principles. In particular, the insurance supervisor should:
>
> a. be operationally independent and accountable in the exercising of its functions and powers;
> b. have adequate powers, legal protection and financial resources to perform its functions and exercise its powers;
> c. adopt a clear, transparent and consistent regulatory and supervisory process;
> d. clearly define the responsibility for decision making; and
> e. hire, train and maintain sufficient staff with high professional standards who follow the appropriate standards of confidentiality.
>
> *Principle 2: Licensing*
>
> Companies wishing to underwrite insurance in the domestic insurance market should be licensed. Where the insurance supervisor has authority to grant a license, the insurance supervisor:
>
> a. in granting a license, should assess the suitability of owners, directors, and/or senior management, and the soundness of the business plan, which could include pro forma financial statements, a capital plan and projected solvency margins; and
> b. in permitting access to the domestic market, may choose to rely on the work carried out by an insurance supervisor in another jurisdiction if the prudential rules of the two jurisdictions are broadly equivalent.
>
> *Principle 3: Changes in Control*
>
> The insurance supervisor should review changes in the control of companies that are licensed in the jurisdiction. The insurance supervisor should establish clear requirements to be met when a change in control occurs. These may be the same as, or similar to, the

requirements which apply in granting a license. In particular, the insurance supervisor should:

a. require the purchaser or the licensed insurance company to provide notification of the change in control and/or seek approval of the proposed change; and

b. establish criteria to assess the appropriateness of the change, which could include the assessment of the suitability of the new owners as well as any new directors and senior managers, and the soundness of any new business plan.

Principle 4: Corporate Governance

It is desirable that standards be established in the jurisdictions which deal with corporate governance. Where the insurance supervisor has responsibility for setting requirements for corporate governance, the insurance supervisor should set requirements with respect to:

a. the roles and responsibilities of the board of directors;

b. reliance on other supervisors for companies licensed in another jurisdiction; and

c. the distinction between the standards to be met by companies incorporated in his jurisdiction and branch operations of companies incorporated in another jurisdiction.

Principle 5: Internal Controls

The insurance supervisor should be able to:

a. review the internal controls that the board of directors and management approve and apply, and request strengthening of the controls where necessary; and

b. require the board of directors to provide suitable prudential oversight, such as setting standards for underwriting risks and setting qualitative and quantitative standards for investment and liquidity management.

Introduction to Principles 6 to 10

The following text in the Insurance Core Principles is by way of introduction to Principles 6 to 10, which relate to the setting of prudential standards:

Insurance companies, by the very nature of their business, are exposed to risk. Insurance companies should meet prudential standards established to limit or manage the amount of risk that they retain.

In establishing the requirements the insurance supervisor should consider whether standards that apply to companies that are incorporated in the jurisdiction should differ from those that apply to branches of companies incorporated in another jurisdiction.

Principle 6: Assets

Standards should be established with respect to the assets of companies licensed to operate in the jurisdiction. Where insurance supervisors have the authority to establish the standards, these should apply at least to an amount of assets equal to the total of the technical provisions, and should address:

a. diversification by type;

b. any limits, or restrictions, on the amount that may be held in financial instruments, property, and receivables;

c. the basis for valuing assets which are included in the financial reports;

d. the safekeeping of assets;

e. appropriate matching of assets and liabilities, and

f. liquidity.

Principle 7: Liabilities

Insurance supervisors should establish standards with respect to the liabilities of companies licensed to operate in their jurisdiction. In developing the standards, the insurance supervisor should consider:

a. what is to be included as a liability of the company, for example, claims incurred but not paid, claims incurred but not reported, amounts owed to others, amounts owed that are in dispute, premiums received in advance, as well as the provision for policy liabilities or technical provisions that may be set by an actuary;

b. the standards for establishing policy liabilities or technical provisions; and

c. the amount of credit allowed to reduce liabilities for amounts recoverable under reinsurance arrangements with a given reinsurer, making provision for the ultimate collectability.

Principle 8: Capital Adequacy and Solvency

The requirements regarding the capital to be maintained by companies which are licensed, or seek a licence, in the jurisdiction should be clearly defined and should address the minimum levels of capital or the levels of deposits that should be maintained. Capital adequacy requirements should reflect the size, complexity, and business risks of the company in the jurisdiction.

Principal 9: Derivative and "off-balance sheet" items

The insurance supervisor should be able to set requirements with respect to the use of financial instruments that may not form part of the financial report of a company licensed in the jurisdiction. In setting these requirements, the insurance supervisor should address:

a. restrictions in the use of derivatives and other off-balance sheet items;

b. disclosure requirements for derivatives and other off-balance sheet items; and

c. the establishment of adequate internal controls and monitoring of derivative positions.

Principle 10: Reinsurance

Insurance companies use reinsurance as a means of risk containment. The insurance supervisor must be able to review reinsurance arrangements, to assess the degree of reliance placed on these arrangements and to determine the appropriateness of such reliance. Insurance companies would be expected to assess the financial positions of their reinsurers in determining an appropriate level of exposure to them.

The insurance supervisor should set requirements with respect to reinsurance contracts or reinsurance companies addressing:

a. the amount of the credit taken for reinsurance ceded. The amount of credit taken should reflect an assessment of the ultimate collectability of the reinsurance recoverables and may take into account the supervisory control over the reinsurer; and

b. the amount of reliance placed on the insurance supervisor of the reinsurance business of a company which is incorporated in another jurisdiction.

Principle 11: Market Conduct

Insurance supervisors should ensure that insurers and intermediaries exercise the necessary knowledge, skills and integrity in dealings with their customers.

Insurers and intermediaries should:

a. at all times act honestly and in a straightforward manner;

b. act with due skill, care and diligence in conducting their business activities;

c. conduct their business and organise their affairs with prudence;

d. pay due regard to the information needs of their customers and treat them fairly;

e. seek from their customers information which might reasonably be expected before giving advice or concluding a contract;

f. avoid conflicts of interest;

g. deal with their regulators in an open and cooperative way;

h. support a system of complaints handling where applicable; and

i. organise and control their affairs effectively.

Principle 12: Financial Reporting

It is important that insurance supervisors get the information they need to properly form an opinion on the financial strength of the operations of each insurance company in their jurisdiction. The information needed to carry out this review and analysis is obtained from the financial and statistical reports that are filed on a regular basis, supported by information obtained through special information requests, on-site inspections and communication with actuaries and external auditors.

A process should be established for:

a. setting the scope and frequency of reports requested and received from all companies licensed in the jurisdiction, including financial reports, statistical reports, actuarial reports and other information;

b. setting the accounting requirements for the preparation of financial reports in the jurisdiction;

c. ensuring that external audits of insurance companies operating in the jurisdiction are acceptable; and

d. setting the standards for the establishment of technical provisions or policy and other liabilities to be included in the financial reports in the jurisdiction.

In so doing a distinction may be made:

a. between the standards that apply to reports and calculations prepared for disclosure to policyholders and investors, and those prepared for the insurance supervisor; and

b. between the financial reports and calculations prepared for companies incorporated in the jurisdiction, and branch operations of companies incorporated in another jurisdiction.

Principle 13: On-site Inspections

The insurance supervisor should be able to:

a. carry out on-site inspections to review the business and affairs of the company, including the inspection of books, records, accounts, and other documents. This may be limited to the operation of the company in the jurisdiction or, subject to the agreement of the respective supervisors, include other jurisdictions in which the company operates; and

b. request and receive any information from companies licensed in its jurisdiction, whether this information be specific to a company or be requested of all companies.

Principle 14: Sanctions

Insurance supervisors must have the power to take remedial action where problems involving licensed companies are identified. The insurance supervisor must have a range of actions available in order to apply appropriate sanctions to problems encountered. The legislation should set out the powers available to the insurance supervisor and may include:

a. the power to restrict the business activities of a company, for example, by withholding approval for new activities or acquisitions;

b. the power to direct a company to stop practices that are unsafe or unsound, or to take action to remedy an unsafe or unsound business practice; and

c. the option to invoke other sanctions on a company or its business operation in the jurisdiction, for example, by revoking the licence of a company or imposing remedial measures where a company violates the insurance laws of the jurisdiction.

Principle 15: Cross-border Business Operations

Insurance companies are becoming increasingly international in scope, establishing branches and subsidiaries outside their home jurisdiction and sometimes conducting cross-border business on a services basis only. The insurance supervisor should ensure that:

a. no foreign insurance establishment escapes supervision;

b. all insurance establishments of international insurance groups and international insurers are subject to effective supervision;

c. the creation of a cross-border insurance establishment is subject to consultation between host and home supervisors; and

d. foreign insurers providing insurance cover on a cross-border services basis are subject to effective supervision.

Principle 16: Co-ordination and Co-operation

Increasingly, insurance supervisors liaise with each other to ensure that each is aware of the other's concerns with respect to an insurance company that operates in more than one jurisdiction either directly or through a separate corporate entity.

In order to share relevant information with other insurance supervisors, adequate and effective communications should be developed and maintained.

In developing or implementing a regulatory framework, consideration should be given to whether the insurance supervisor:

a. is able to enter into an agreement or understanding with any other supervisor both in other jurisdictions and in other sectors of the industry (i.e. insurance, banking or securities) to share information or otherwise work together;

b. is permitted to share information, or otherwise work together, with an insurance supervisor in another jurisdiction. This may be limited to insurance supervisors who have agreed, and are legally able, to treat the information as confidential;

c. should be informed of findings of investigations where power to investigate fraud, money laundering, and other such activities rests with a body other than the insurance supervisor; and

d. is permitted to set out the types of information and the basis on which information obtained by the insurance supervisor may be shared.

Principle 17: Confidentiality

All insurance supervisors should be subject to professional secrecy constraints in respect of information obtained in the course of their activities, including during the conduct of on-site inspections.

The insurance supervisor is required to hold confidential any information received from other insurance supervisors, except where constrained by law or in situations where the insurance supervisor who provided the information provides authorisation for its release.

Jurisdictions whose confidentiality requirements continue to constrain or prevent the sharing of information for supervisory purposes with insurance supervisors in other jurisdictions, and jurisdictions where information received from another insurance supervisor cannot be kept confidential, are urged to review their requirements.

Revised Insurance Core Principles and Methodology, October 2003

9.40 We summarise below the Revised Insurance Core Principles, which expand on and in some regards modify the Insurance Core Principles 2000.

ICP1: Conditions for effective insurance supervision

Insurance supervision relies upon:

- a policy, institutional and legal framework for financial sector supervision;
- a well-developed and effective financial market infrastructure;
- efficient financial markets.

ICP2: Supervisory objectives

The principle objectives of insurance supervision must be clearly defined. In particular, objectives should refer to the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.

ICP3: Supervisory authority

The supervisory authority must have adequate powers, legal protection and financial resources to exercise its functions and powers, be operationally independent and accountable, have sufficient staff with high professional standards, and treat confidential information appropriately.

ICP4: Supervisory process

The supervisory authority must conduct its functions in a transparent and accountable manner.

ICP5: Supervisory co-operation and information sharing

The supervisory authority is to co-operate and share information with other supervisors subject to confidentiality requirements. Essential criteria include obligations to inform in relation to material changes in supervision and in advance of taking any action in respect of foreign establishments.

ICP 6: Licensing

An insurer must be licensed before it can operate within a jurisdiction. Requirements for licensing must be clear, objective and public. (Essential criteria for licensing are set out in the Revised Principles.)

ICP7: Suitability of persons

Significant owners, board members, senior management, auditors and actuaries of an insurer must be fit and proper to fulfil their roles. This requires that they possess the appropriate integrity, competency, experience and qualifications.

ICP8: Changes in control and portfolio transfers

The supervisory authority should approve or reject proposals to acquire significant ownership or any other interest in an insurer that results in that person, directly or indirectly, alone or with an associate, exercising control over the insurer. The supervisory authority should also approve portfolio transfers and mergers of insurance businesses.

ICP9: Corporate governance

The corporate governance framework must recognise and protect the rights of all interested parties. The supervisory authority must require compliance with all applicable corporate governance standards.

ICP10: Internal control

The supervisory authority must require insurers to have in place adequate internal controls, and oversight and reporting systems that allow the board and management to

monitor and control operations. This requires, among other things, regular actuarial reporting to the board (where appointment of an actuary is required by law or the nature of the insurer's operations) and an internal audit function.

ICP11: Market analysis

The supervisory authority, making use of all available sources, must monitor and analyse all factors that may impact on insurers and insurance markets (this requires, for example, regular analysis of market conditions, participants, products etc). The supervisory authority draws conclusions and takes action as appropriate.

ICP12: Reporting to supervisors and off-site monitoring

The supervisory authority should receive the information necessary to conduct effective off-site monitoring and to evaluate the condition of each insurer and the insurance market. The supervisor decides what information it needs, its form and its frequency. This includes setting requirements for regular financial information, actuarial reports and so on. Immediate reporting of material changes is required. Different standards are envisaged for reports to policyholders and those to supervisor.

ICP13: On-site inspection

The supervisory authority is to carry out on-site inspections to examine the business of an insurer and its compliance with legislation and supervisory requirements.

ICP14: Preventive and corrective measures

The supervisory authority must be able to take preventive and corrective measures that are timely, suitable and necessary to achieve the objectives of supervision. A progressive escalation of actions is envisaged.

ICP15: Enforcement or sanctions

The supervisory authority must enforce corrective actions and, where needed, impose sanctions based on clear and objective criteria that are publicly disclosed. A range of actions should be available.

ICP16: Winding up and exit from the market

The legal and regulatory framework should define a range of options for orderly exit of insurers from the marketplace. Insolvency must be defined, and criteria and procedure for dealing with insolvency established. The legal framework is to give priority to the protection of policyholders in the event of winding up.

ICP17: Group-wide supervision

The supervisory authority is to supervise insurers on a solo and group-wide basis. The supervisor is to assess the risk profile of the whole group, including oversight on a group basis of capital adequacy, reinsurance and risk concentrations. This includes having policies on and supervision of intra-group transactions.

ICP18: Risk assessment and management

The supervisory authority is to require insurers to recognise the range of risks they face and to assess and manage them effectively. Insurers must have in place comprehensive

risk management policies and systems. The ICP recognises that ultimate responsibility for risk management must rest with the board.

ICP19: Insurance activity

The supervisory authority is to require insurers to evaluate and manage the risks they underwrite, in particular through reinsurance, and to have tools to establish an adequate level of premiums. The board is to approve and monitor underwriting and pricing policies and the reinsurance strategy. The supervisor is to review underwriting and reinsurance policies, and the tools used to set premiums. The insurer must have a risk diversification strategy, including reinsurance or other risk transfer arrangements, monitored by the board, and reinsurance arrangements are to be reviewed by the supervisory authority. The supervisory authority is to ensure reinsurance is appropriate and that reinsurance is secure.

ICP20: Liabilities

The supervisory authority is to require insurers to comply with standards for establishing adequate technical provisions (policy liabilities) and other liabilities, making allowance for reinsurance recoverables. The supervisory authority must have both the authority and the ability to assess the adequacy of the technical provisions and to require the provisions to be increased if necessary.

ICP21: Investments

The supervisory authority is to require insurers to comply with standards on investment activities, including investment policy, asset mix, valuation, diversification, asset–liability matching and risk management. Insurers must also have an overall strategic investment policy approved by the board. Audit procedures must cover investment activities.

ICP22: Derivatives and similar commitments

The supervisory authority is to require insurers to comply with standards on the use of derivatives and similar commitments. The standards must address restrictions on use, disclosure requirements, internal controls and monitoring of related positions. Audit procedures must cover derivative activities.

ICP23: Capital adequacy and solvency

The supervisory authority must require insurers to comply with the prescribed solvency regime, including capital adequacy requirements. Sufficient technical provisions are required to cover expected losses, plus sufficient capital to absorb unexpected losses, and additional capital to absorb losses from risks not explicitly identified. There must be minimum capital adequacy requirements, plus a series of solvency control levels at which the supervisory authority can intervene.

ICP24: Intermediaries

The supervisory authority is to set requirements for the conduct of intermediaries. Intermediaries are to be licensed and make certain disclosures.

ICP25: Consumer protection

The supervisory authority is to set minimum requirements for insurers and intermediaries in dealing with consumers, including the provision of timely, complete and relevant information, before and during a contract. They must also cover foreign insurers selling on a cross-border basis. Different rules for different consumers are envisaged (for example, reinsurance as compared with retail contracts). Insurers and intermediaries are to deal with consumer complaints effectively and fairly through simple, easily accessible and equitable processes.

ICP26: Information, disclosure and transparency towards the market

The supervisory authority is to require insurers to disclose relevant information on a timely basis to give stakeholders a clear view of the insurer's business activities and financial position, and to facilitate understanding of the risks to which insurers are subject. Requiring public disclosure of reliable and timely information to prospective and existing stakeholders is a form of market discipline and an adjunct to supervision.

ICP27: Fraud

The supervisory authority is to require that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.

ICP28: Anti-money laundering, combating the financing of terrorism

The supervisory authority is to require insurers and intermediaries (in particular those offering life insurance or other investment-related insurance) to take effective measures to deter, detect and report money laundering and the financing of terrorism. This includes having effective "know your customer" provisions and obligations to report suspicious transactions, and requires communication between authorities.

Q9 Do you have any comments on chapter 9?

Part 4
The Issues

Chapter 10
Introduction to the issues

10.1 As noted in chapter 2, financial products pose risks for members of the public over and above those that apply to physical goods and services. In the case of life insurance there are special risks for policyholders over and above those that apply to other financial products, and these may vary depending on the nature of a specific life policy.

10.2 The risks that apply to all financial products include:

- There is nothing physical for people to examine; financial products consist of legal rights only. Therefore, a full understanding of a product requires a good knowledge of the relevant law and practice; most people do not have this knowledge.
- Management and control of the money outlaid to purchase financial products is in the hands of managers who are not subject to any practical control by the product owners. It is easy for incompetent and/or dishonest mangers to dissipate or lose control of that money.
- Enforcement of legal rights is very difficult for individual product owners.

10.3 The risks that are special to life insurance include:

- Some life policies (especially savings policies) are complex products, and difficult for members of the public to fully understand.
- Some financial intermediary remuneration and other incentive arrangements are complex and/or are not always explained clearly to policyholders.
- It is difficult for policyholders to assess the financial positions of life insurers, in particular because of the risk nature of the bulk of their liabilities.
- In the case of savings policies, policyholders' savings are often held by life insurers for very long periods (for example, a lifetime in the case of children's life policies), and policyholders depend entirely on the competence and honesty of the life insurers' managers to protect and enhance the real value of these savings.
- In the case of savings policies, conflict of interest between shareholders of a life insurer and policyholders (or, in case of a mutual company, between management and policyholders and/or between different generations of policyholders) may result in policyholders not being allocated a fair proportion of income earned from the policyholders' savings.
- It is sometimes difficult for policyholders to sell or terminate savings policies before maturity at a reasonable price or return. In these cases, policyholders have the choice of receiving inadequate compensation for their savings or being forced to hold their policies until their maturity dates (which often is the policyholder's death).

10.4 New Zealand legislation that applies to all or many markets (general market regulation) assists to reduce some of the risks. In addition, there is legislation that applies specifically to life insurance or financial products including life insurance (see chapters 3 and 5). Furthermore, life insurers may, and to some extent do, take various steps voluntarily that assist to reduce these risks, perhaps because they see a competitive advantage in doing so. For example, life insurers may obtain credit ratings from independent rating agencies voluntarily, or may endeavour to provide information on complex policies in a form that is easy for policyholders to understand.

10.5 The following chapters discuss whether this general market regulation, the existing legislation specific to life insurance, and any steps undertaken voluntarily by life insurers are sufficient to give reasonable protection against the risks for holders of life policies (whether savings or risk only policies and whether long or short term):

- financial market integrity (chapter 11);
- consumer protection (chapter 12);
- financial safety (chapter 13);
- reinsurance (chapter 14);
- actuaries (chapter 15);
- cross border issues (chapter 16).

10.6 In considering whether reasonable protection is given, account needs to be taken of the legislation of other countries (in particular, Australia) described in chapters 6 to 8, the Memorandum of Understanding between Australia and New Zealand on Co-ordination of Business Law (see paragraph 9.23), and the international guidelines and obligations described in chapter 9. A table comparing the existing New Zealand legislation with this overseas legislation and the IAIS Principles is set out in Appendix B.

10.7 Account also needs to be taken of the likely costs of existing and proposed legislation in New Zealand, and whether these are justified by the protection provided. An assessment of the costs of the legislation needs to consider the deadweight losses to society from the legislation,[114] as well as the compliance costs to life insurers and the administrative costs to the Government.

10.8 It should also be considered whether existing or proposed legislation helps or hinders a sustainable and competitive life insurance market in New Zealand. Some may argue that strong Government regulation is a necessary condition for such a market; whereas others may argue the reverse.

---

[114] The *Economist* dictionary (www.econmist.com/research/economics/alphabetic.cfm) describes "deadweight costs/losses" as:

> The extent to which the value and impact of a [Government intervention or regulatory measure] is reduced because of its side-effects. For instance, increasing the amount of tax levied on workers' pay will lead some workers to stop working or work less, so reducing the amount of extra tax to be collected. However, creating a tax relief or subsidy to encourage people to buy life insurance would have a deadweight cost because people who would have bought insurance anyway would benefit.

10.9 Finally, a matter that is often raised in relation to the regulation of the financial sector is whether regulation is needed to protect the stability of the financial system. For the reasons given in paragraph 2.11 it seems that regulation of life insurers is not needed to protect the stability of the financial system.

Q10 Do you agree with the statement of risks set out in paragraphs 10.2 and 10.3? Are there any other risks?

Q11 Do you agree with paragraph 10.9 that regulation of New Zealand life insurers is not needed to protect the stability of New Zealand's financial system?

Q12 Are there any issues relevant to the regulation of the New Zealand life insurance industry that are not addressed in chapters 10 to 18?

Chapter 11
Financial market integrity issues

INTRODUCTION

Definition

11.1 Financial market integrity regulation aims to promote confidence in the efficiency and fairness of markets. It seeks to ensure that markets are sound, orderly and transparent. For life insurers, financial market integrity regulation is primarily concerned with disclosure requirements and conduct rules.

Existing legislation and IAIS Principles

11.2 The comparative table set out in Appendix B (clauses 1 and 2) shows:

- New Zealand has general financial market integrity legislation that applies to life insurance and specific legislation that applies to life insurance market integrity (see also chapter 5).
- Other countries, in particular Australia, have general financial market integrity legislation and specific life insurance market integrity legislation that is similar to, but generally more comprehensive and modern, than New Zealand's (see chapters 6 to 8).
- The IAIS Principles that are relevant to financial market integrity regulation identify areas in which the insurance supervisor should have authority or control (see also chapter 9).

POSSIBLE AREAS FOR REFORM

11.3 The areas where New Zealand's existing law may be regarded as unsatisfactory in relation to life insurance market integrity, and possible solutions, are set out below.

> Q13 Life insurance market integrity – Are there areas other than those set out in paragraphs 11.5 to 11.65, where New Zealand's existing law may be regarded as unsatisfactory in relation to life insurance market integrity?

11.4 In considering these areas, it may be necessary to distinguish between savings policies, renewable risk only policies and non-renewable risk only policies, and between different kinds of policies within those classes (such as short and long term policies), as different considerations may apply to different classes and/or kinds of policies.

Financial reporting

11.5 Financial market integrity requires that up-to-date, accurate and understandable information on the financial position of issuers of financial products is publicly available. A lack of this information distorts the allocation of financial resources, for example, it can result in financial losses being shifted to new investors and/or unnecessarily magnified. There are financial and time costs involved in providing and analysing financial information, and a necessary ability to process that information.

New Zealand

11.6 New Zealand life insurers have financial reporting obligations under the Financial Reporting Act 1993, the Securities Act 1978 and the Life Insurance Act 1908 ("Life Act").[115]

- Under the Financial Reporting Act, issuers and overseas companies must register audited financial statements with the Registrar of Companies within 5 months and 20 days of the insurer's balance date, and must prepare those statements in accordance with Financial Reporting Standard 34 (see paragraphs 5.83 to 5.94).
- Under the Securities Act, life insurers who issue savings policies must register prospectuses that refer to financial statements registered under the Financial Reporting Act (see paragraphs 5.59 to 5.68) and prepare investment statements. Copies of the prospectus distributed on request to members of the public must be accompanied by copies of the financial statements. Risk only policies are excluded from the definition of "life insurance" under section 2 of the Securities Act (see paragraphs 5.57 and 5.58).
- Under the Life Act, New Zealand life insurers must prepare a number of statements and reports that must be lodged with the Ministry of Economic Development within nine months of the close of the insurer's financial year. In particular, under section 18 of the Life Act, life insurers must lodge an abstract of an actuarial financial condition report. This abstract must be prepared in accordance with Schedule 6 to the Act. The actuarial financial condition report itself is generally prepared in accordance with the NZSA Standards.

IAIS Principles and Australian law

11.7 The IAIS Principles state that insurance supervisors should establish a process for generating financial reports, including the scope and frequency of reports, setting accounting requirements, requiring acceptable external audits and setting financial reporting standards.

11.8 The Revised IAIS Principles envisage different standards for reports to policyholders than those for the supervisor. Revised Principle 26 states that insurers must disclose relevant information on a timely basis to give stakeholders a clear view of business activities and the insurer's financial position.

---

[115] Publicly listed life insurers are also subject to the Securities Markets Act 1988 and the Stock Exchange Rules.

11.9 In Australia, financial reporting for life insurers is covered by the Life Insurance Act 1995 ("Life Act (Aust)") and the Financial Sector (Collection of Data) Act 2001. Under Part 6 of the Life Act (Aust), insurers must produce and lodge annual audited financial statements with APRA. Through one set of integrated financial statements, life insurers must show their profitability on a realistic market value basis as well as their solvency position relative to the legislative minimum.

11.10 The Financial Services Reform Act 2001 introduced a new disclosure regime in Australia for financial products (excluding offers of shares and debentures). Product issuers need to comply with product disclosure obligations such as significant event disclosure, confirmation of transactions and periodic reporting requirements (see paragraphs 6.59 to 6.64).

Possible problems

11.11 All reports under the Life Act are to be prepared in accordance with the schedules to that Act. These schedules are clearly out of date (for example, in Schedule 3, investments in "Indian and Colonial Government securities" must be included in the statement of financial position) and provide very little relevant information for the Government Actuary (who in practice receives the reports (see paragraph 5.24)), or for the public (who may request the reports). It is difficult to assess the financial position of an insurer from these reports. In particular, the abstract of the actuarial financial condition report required under the Act gives minimal and unhelpful information. Further, giving insurers nine months to lodge reports means the information may be out of date for practical purposes.

11.12 The NZSA Standards are used to assist in calculating the information on assets, liabilities, revenues, expenses and equity of life insurers required by the Financial Reporting Act (see paragraphs 5.90 to 5.93), and are also used to prepare the actuarial financial condition report required by the Life Act. However, they have no legislative standing.

11.13 Existing New Zealand legislation provides only for disclosure of a life insurer's financial statements to potential holders of savings policies (as distinct from risk only policies) and only on request by those potential holders. Furthermore, there is no obligation on a non-mutual life insurer to disclose its financial position to existing policyholders unless (in the case of savings policies only) a request is made. However, any person may review a life insurer's financial statements registered under the Financial Reporting Act and the reports registered under the Life Act, but they will need the time and expertise to assess this information. There is no obligation in existing legislation for life insurers to have ratings (see paragraphs 13.18 to 13.20) or to provide simplified financial statements and actuarial information to potential and existing policyholders. These practical difficulties in obtaining and assessing financial information in an easily understandable form need to be taken into account when deciding whether policyholders should be regarded as being individually capable of choosing an appropriate life insurer.

Options for addressing possible problems

11.14 With regard to the quality and usefulness of the information supplied under the Life Act and the Financial Reporting Act, the options include:

- Updating the schedules to the Life Act, or providing for this information to be prescribed by regulations.
- Including an updated version of the information required by the Life Act in the Financial Reporting Act information, and removing the Life Act requirements relating to the provision of financial information.
- Requiring life insurers to file a full financial condition report with the Government Actuary or another regulator that may or may not be publicly available. Public availability may mean life insurers would either not include or mask important confidential information.
- Reducing the period of nine months to lodge reports under the Life Act to five months, in line with the Financial Reporting Act.
- Extending the role of the Accounting Standards Review Board to cover standards for the actuarial and/or financial information to be provided under the Life Act. In Australia, the Life Act (Aust) provides that the Life Insurance Actuarial Standards Board makes the actuarial standards required under that Act. Alternatively, the Government Actuary or another regulator could be given the role of setting or approving these standards.

11.15 With regard to the disclosure of financial information to potential and existing policyholders, the options include:

- Extending the Securities Act regime to cover risk only policies, or introducing a similar disclosure regime for these policies.
- Implementing the periodic disclosure regime under section 54A of the Securities Act and including simplified financial and actuarial information in the information to be periodically disclosed to policyholders. This could be simply a requirement to send a simplified annual report to policyholders.
- Requiring life insurers to get and publish a rating each year.

> Q14 Financial reporting – Do you have any comments on the possible problems and options in paragraphs 11.11 to 11.15? Are there any problems or options we have not considered?

Valuation of assets and liabilities

11.16 Accurate information on the financial position of issuers of financial products requires the accurate valuation of assets and liabilities.

New Zealand

11.17 Under the Financial Reporting Act, life insurers are required to give a valuation of their assets and liabilities in accordance with Financial Reporting Standard 34 ("FRS-34"). FRS-34 states assets are to be measured at net market values and liabilities at net present values. The Accounting Standards Review Board reviews and approves the financial reporting standards required under the Financial Reporting Act.

IAIS Principles and Australian law

11.18 IAIS Principles 6 and 7 state that the insurance supervisor should set standards in relation to assets, including the valuation of assets and liabilities respectively. The Revised IAIS Principles state that the supervisory authority should set standards on investment activities, including the basis for valuing assets and liabilities.

11.19 In Australia, accounting standards are made by the Australian Accounting Standards Board. The Life Insurance Actuarial Standards Board makes life insurance actuarial standards under the Life Act (Aust).

> Q15 Valuation of assets and liabilities – Are there any problems with the requirements for valuation of assets and liabilities? If so, what could be done to remedy these problems?

Financial records

11.20 Accurate information on the financial position of issuers of financial products requires accurate financial record keeping.

New Zealand

11.21 Life insurers are required by the Companies Act 1993 and Securities Act to keep accounting records that correctly record and explain their transactions and will enable their financial positions to be determined with reasonable accuracy at any time (see paragraphs 5.100 and 5.70 respectively).

IAIS Principles and Australian law

11.22 IAIS Principle 5 states that the insurance supervisor should review insurers' internal controls and require directors to provide prudential oversight. Principle 9 states that requirements are to be established regarding the use of derivatives and other off-balance sheet items. More specifically, Principle 12 states that the insurance supervisor should establish a process for financial reports, including the scope and frequency of reports, setting accounting requirements, requiring acceptable external audits and setting financial reporting standards. The Revised IAIS Principles contain similar requirements.

11.23 Part 6 of the Life Act (Aust) states that life insurers must keep records of the income and outgoings of each statutory fund, and must record properly the affairs and transactions of the insurer in respect of each statutory fund.

> Q16 Financial records – Are there any problems with the current requirements for financial record keeping by life insurers? If so, what could be done to remedy these problems?

Directors and senior management

11.24 Financial market integrity requires that directors of issuers of financial products act ethically and in accordance with the law and sound business practice. In doing so,

directors should have appropriate regard to the interests of all persons who rely on the successful conduct of the issuer's business.

New Zealand

11.25 There is no restriction in New Zealand on who can be a director of a New Zealand life insurer (although section 382 of the Companies Act prohibits persons who have been judged guilty of specified conduct from acting as directors of any company, and section 383 of that Act authorises the Court to prohibit persons from acting as such directors on specified grounds).

11.26 The only statutory duties placed on directors of life insurers are those contained in the Companies Act (see paragraphs 5.97 and 5.98). Under this Act, directors of life insurers that are companies have statutory duties to, among other things, act in the best interests of the company and not allow the business to be carried on in a manner likely to create a loss to creditors. There are no statutory duties expressly related to policyholders. Creditors may, however, initiate action to have a director removed by the Court for failure to comply with his or her duties, if the director has persistently failed to comply with the Act, or has acted recklessly or incompetently in the performance of his or her duties.[116]

11.27 The Securities Commission is reviewing corporate governance practice in New Zealand. Good corporate governance emphasises ethical conduct, transparency, legal compliance and sound business practice. The Securities Commission is planning to develop an agreed set of corporate governance principles. Key issues include ethical conduct and board composition and performance, including the role and definition of independent directors and the issues of certification/accreditation.

IAIS Principles and Australian and United Kingdom law

11.28 IAIS Principle 5 requires the insurance supervisor to review each insurer's internal controls and requires that directors provide suitable prudential oversight. Principle 4 specifically requires the insurance supervisor to set requirements for corporate governance and set out requirements in respect to the roles and responsibilities of the board of directors. Principle 3 states the insurance supervisor may assess the suitability of new directors in relation to changes in control of an insurer.

11.29 Under the Life Act (Aust), a director owes specific duties to the holders of policies referable to a statutory fund of the insurer. The director's duty is defined as being a duty to take reasonable care and to use due diligence to ensure, in the investment, administration and management of the assets of a statutory fund, the insurer gives priority to the interests of policyholders of the fund. Directors become personally liable for losses to statutory funds if they breach this duty. At the time of registration, APRA assesses an insurer's officers' capacity to act on a "fit and proper" basis (see further paragraph 13.27).

11.30 In the United Kingdom, the Financial Services Authority approves "controlled functions" (that is, directors and senior management) through "fit and proper" tests.

---

[116] Section 383 of the Companies Act 1993.

Individuals who carry out controlled functions are bound by Statements of Principle (see paragraphs 7.18 and 7.19).

Possible problems

11.31 Unethical or incompetent directors (or senior management) of life insurers can significantly prejudice the interests of policyholders, especially those of the holders of long term savings policies.

11.32 If a life insurer is a New Zealand company, the directors may be entitled, under section 131 of the Companies Act, to act in the interests of a holding company of the insurer, rather than in those of the insurer itself, thus weakening the position of policyholders. For example, an insurer could transfer funds to a holding company with inadequate security.

11.33 The duties of directors of life insurers vary depending on whether the insurer is a company or some other form of corporation and whether or not it is incorporated in New Zealand. If the insurer is not a company there are likely to be no directors' duties.[117] If the insurer is not established in New Zealand, there may be no or very limited directors' duties, depending on the laws of the country in which the insurer is incorporated, and any such duties may not be owed to policyholders.

Options for addressing possible problems

11.34 Possible options in relation to directors include the following:

- Requiring directors (and senior management) of life insurers to be approved by a regulator as "fit and proper" persons to act as directors. However, this may be difficult to apply in practice to overseas life insurers operating in New Zealand. In any event, refusing approval of a person as "fit and proper" is likely to be feasible only if the person had demonstrated incompetence or unethical conduct in the past. Another approach is to adopt the Companies Act approach, and prohibit persons who have been judged guilty of specified conduct from acting as directors of a life insurer, and authorise the Court to prohibit persons from acting as a director on specified grounds.[118]
- Amending the Companies Act to provide that section 131 does not apply in the case of a life insurer (although such an amendment may not be necessary if the option of requiring properly ring-fenced statutory funds (referred to in paragraph 13.26 is adopted).
- Imposing additional duties on directors of life insurers, as is done in the Life Act (Aust). It could be argued that additional duties should not be placed on directors of life insurers unless similar duties are imposed in other areas of the financial markets. One justification for treating life insurance directors differently may be that life policyholders are in a more vulnerable position than many other creditors in the financial markets. Life insurers often hold policyholders' money for a very long period and policyholders depend entirely on the competence and

---

117 Trustees of friendly societies have duties under the Trustee Act 1956.

118 Section 382 of the Companies Act 1993.

honesty of insurers to protect their money. (Although, this is also true of superannuation schemes and, to some extent, unit trusts.)

> Q17 Directors (and senior management) – Do you have any comments on the problems and options in paragraphs 11.31 to 11.34? Are there any problems or options we have not considered?

Actuaries

11.35 The proper performance of the actuarial role is critical to maintaining life insurance market integrity.

11.36 As outlined in paragraphs 4.37 to 4.44, actuaries have various statutory responsibilities to produce reports under the Life Act, the Financial Reporting Act and tax legislation. Actuaries commonly have other functions such as product pricing and design and management reporting.

11.37 For a discussion on the possible future role of actuaries and the regulation of their profession, see paragraphs 13.33 to 13.36 and chapter 15.

> Q18 Actuaries – Are there any financial market integrity issues relating to actuaries other than those in paragraphs 13.33 to 13.36 and chapter 15?

Auditors

11.38 The proper performance of the audit role is critical to maintaining life insurance market integrity.

New Zealand

11.39 The financial statements of life insurers are required to be audited under the Life Act, Financial Reporting Act and Securities Act (as outlined in paragraphs 5.19, 5.84 and 5.70 respectively).

11.40 The Securities Commission review on corporate governance (see paragraph 11.27) covers auditors, in particular, whether the rotation of auditors is important, and the oversight of auditors.

IAIS Principles and Australian law

11.41 The IAIS Principles state that an insurance supervisor should be able to require that an insurer has an ongoing audit function of a nature and scope appropriate to the nature and scale of the business. That audit function should include unfettered access, appropriate independence and sufficient resources, training and experience, and use a methodology that identifies the key risks run by the institution. The Revised IAIS Principles require an internal audit function that must cover investment and derivative activities.

11.42 In Australia, auditors must audit financial records and financial statements, and also have a "watchdog" role. Under the Life Act (Aust), all life companies must have an audit committee.

Possible problem

11.43 Sections 50 and 50A of the Securities Act require auditors of issuers of debt securities, participatory securities or units in a unit trust to report any matter that in the auditor's opinion is relevant, to the issuer and the trustee or statutory supervisor. There is no such "whistle blowing" function for auditors of life insurers.

Options for addressing possible problem

11.44 A possible option is to amend the Securities Act to provide a "whistle blowing" role for auditors of life insurers. However, the issue would arise as to whom the auditor would report, as there is presently no trustee or statutory supervisor for life insurers. For further discussion on options for "whistle blowing" see chapter 13.

> Q19 Auditors – Do you have any comments on the possible problem and option in paragraphs 11.43 and 11.44? Are there any problems or options we have not considered?

Transfers and amalgamations

New Zealand

11.45 There is no statutory requirement that policyholders be consulted, or that their consent be obtained, before a transfer or amalgamation of a life insurer's business or a portfolio of life policies can proceed. There is also no specific requirement that the directors of either party to such a transaction obtain independent actuarial advice on the effect of the transaction on the policyholders concerned before the transaction can proceed.

11.46 However:

- Under section 226 of the Companies Act, if the Court is satisfied that giving effect to an amalgamation proposal (being a proposal for two or more companies to amalgamate or join and continue as one company) would unfairly prejudice a shareholder, a creditor or a person to whom an amalgamating company is under an obligation, it may make any order it thinks fit in relation to the proposal, including an order:
  - directing that effect not be given to the proposal;
  - modifying the proposal in such manner as may be specified in the order;
  - directing the company or its board to reconsider the proposal or any part of it.
- Section CM18 of the Income Tax Act 1994 requires the Government Actuary, on the transfer of a life insurance business, to report to the Commissioner of Inland Revenue that the business being transferred comprises all of the transferor's life insurance business, and that no policyholder will be unduly disadvantaged as a result of the transfer.

IAIS Principles and Australian law

11.47 The IAIS Principles state that an insurance supervisor should review changes in the control of life insurers. The Revised IAIS Principles go further and state that the insurance supervisor should approve or reject proposals to acquire significant ownership control, and should approve portfolio transfers or mergers.

11.48 Part 9 of the Life Act (Aust) provides that no part of the life insurance business of a life insurer can be transferred to, or amalgamated with the business of another life insurer, without the approval of the Court. If approved, every affected policyholder must be given a copy of an approved summary of the scheme.

Possible problem

11.49 A transfer or amalgamation of a life insurer's business or a portfolio of life policies could have significant implications for policyholders, including affecting the adequacy of the asset-backing for the policies and (for savings policies) the income earned by the policies. It may be considered unsatisfactory to leave protection for policyholders in these circumstances to the Companies Act (which does not apply to all insurers) and the Income Tax Act (which does not apply to all such transactions).

Options to address possible problem

11.50 One option may be to require life insurers to consult with, or obtain the approval of, policyholders before a transfer or amalgamation takes place. However, consultation is of little value if policyholders do not have the power to prevent the transaction, and policyholders would need expert assistance in assessing any such proposal.

11.51 Another option may be to require the life insurers involved to obtain independent actuarial advice on the effect of the transaction on the policyholders before the transaction is proceeded with.

11.52 A third option would be to require both the independent actuarial advice referred to above and that the transaction obtains the approval of the Court or the Government Actuary or another regulator (which would be given if the Court or Government Actuary or regulator was satisfied the transaction did not prejudice the position of any policyholder).

> Q20 Transfers and amalgamations – Do you have any comments on the possible problem and options in paragraphs 11.49 to 11.52? Are there any problems or options we have not considered?

Surrender values and terms

New Zealand

11.53 There are no New Zealand statutory requirements relating to surrender values and terms. These values and terms are particularly important to holders of traditional whole of life and endowment policies who want to terminate their policies before their maturity dates, either because they need the money or because they are dissatisfied with the returns they are receiving on the policies or with the insurer's financial position.

Australian law

11.54 The Life Act (Aust) gives policyholders certain rights in relation to surrenders of policies, and requires the Life Insurance Actuarial Standards Board to set an actuarial standard for minimum surrender values.

Possible problem

11.55 Some life insurers may impose inequitable surrender values and terms on their policyholders, which will constitute a barrier to those policyholders terminating their policies. Such a barrier will be especially significant for long term savings policies. To the extent that policyholders are not able to surrender their policies for reasonable value and on reasonable terms, they will be locked in until the maturity dates of their policies (often their own death) or will have to accept terms that are unfavourable to them in order to terminate their policies.

Options to address possible problem

11.56 One option would be to follow the Australian law mentioned above, with the Accounting Standards Review Board approving an actuarial standard for minimum surrender values.

11.57 Another option may be to provide an independent review to determine whether the surrender value provisions of a policy are fair before a person takes out a policy. The insurer could be required to pay for the review and it could be available on request.

> Q21 Surrender values and terms – Do you have any comments on the possible problem and options in paragraphs 11.55 to 11.57? Are there any problems or options we have not considered?

Allocation of profits

New Zealand

11.58 There is little regulation in New Zealand relating to the allocation of profits of a life insurer between the shareholders of the life insurer and the holders of its savings policies, or between different classes of policyholder. Generally, the basis on which profits are shared is at the discretion of the life insurer, subject to normal competitive pressures and the long term reputation of the insurer.

11.59 Under the actuarial abstract required by section 18 of the Life Act, the actuary must state the principles used to determine the split of profits between shareholders and policyholders, and the source of those principles.

11.60 The Securities Commission discussion paper 1997 stated that: [119]

> … in effect life insurance companies have the capacity to select after the event which particular profits arising from their business will be for the benefit of policyholders and

[119] Securities Commission *A Discussion Paper on Life Insurance Law and Practices* (Wellington, 1997), 42.

which profits will be attributed to shareholders. This is clearly so when the company has not disclosed the "ownership" attribution of the company's assets.

11.61 Under the Securities Act, life insurers must include a brief description of the key factors that determine the returns to holders of savings policies in the insurer's investment statement. However, as noted in paragraph 11.13, this document is given only to prospective policyholders, although it is available at the request of existing policyholders. Furthermore, it is not binding on the life insurer in respect of policies taken out before the commencement of the investment statement regime.

Australian law

11.62 Under section 32(1)(b) of the Life Act (Aust) a life insurer is required, in the investment, administration and management of the assets of a statutory fund, to give priority to the interests of policyholders of the fund. With respect to the allocation of profit for a statutory fund representing an Australian participating business, at least 80 percent of the profit must be added to policy owners' retained profits. The balance of the operating profit must be treated as, or added to, shareholders' retained profits.

Possible problem

11.63 The basis on which profits are shared is of great importance to holders of traditional whole of life and endowment policies as it determines the returns on their policies. A basis that is unfair to these policyholders could materially adversely affect the amount paid to them on the termination of their policies. There is potential for an unfair basis to be used to distribute the profits between these policyholders and shareholders (or, in mutual companies, between these policyholders and reserves) or between classes of policyholder.

Options to address possible problem

11.64 One option may be to require the life insurer's actuary to state, in the abstract of the financial condition report required under section 18 of the Life Act, that the distribution of profits appears fair and equitable between classes of policyholder and between shareholders and policyholders (or an independent actuary could carry out a review on request).

11.65 Another option may be to create rules surrounding the allocation of profits, as is done in Australia.

> Q22 Allocation of profits – Do you have any comments on the possible problem and options in paragraphs 11.63 to 11.65? Are there any problems or options we have not considered?

Chapter 12
Consumer protection issues

INTRODUCTION

Definition

12.1 For the purposes of this paper, consumer protection regulation of life insurance means ensuring retail policyholders have adequate information, are treated fairly and have adequate avenues for redress (see paragraphs 2.8 to 2.9).

Existing legislation and IAIS Principles

12.2 The comparative table set out in Appendix B (clause 3) shows:

- New Zealand has general consumer protection legislation that applies to life insurance, and has specific legislation relating to life insurance consumer protection (see chapter 5).
- Other countries, in particular Australia, have general consumer protection legislation and specific life insurance consumer protection legislation that is generally more comprehensive and modern than New Zealand's (see chapters 6 to 8).
- The IAIS Principles relevant to consumer protection regulation identify areas in which the insurance supervisor should have authority or control (see chapter 9).

POSSIBLE AREAS FOR REFORM

12.3 Areas where New Zealand's existing law may be regarded as unsatisfactory in relation to life insurance consumer protection, and possible solutions, are set out below.

> Q23 Consumer protection – Are there areas other than those set out in paragraphs 12.5 to 12.70 where New Zealand's existing law may be regarded as unsatisfactory in relation to consumer protection?

12.4 In considering these areas, it may be necessary to distinguish between savings policies, renewable risk only policies and non-renewable risk only policies, and between different kinds of policies within those classes (such as short and long term policies), as different considerations may apply to different classes and/or kinds of policies.

Product disclosure

12.5 Disclosure of the characteristics and terms of life policies to potential policyholders facilitates their understanding and assessment of those policies and assists consumers to make informed choices. It also strengthens the accountability of the life insurer's

directors and senior management, encouraging the prudent and efficient operation of the insurer and the equitable treatment of policyholders.

New Zealand

12.6 Under the Securities Act 1978, life insurers are required to disclose product information on savings policies (but not risk only policies) in the investment statement and prospectus (see paragraphs 5.59 to 5.68).

12.7 The Consumer Guarantees Act 1993 provides that, when the policyholder has disclosed his or her needs under the life policy, the policy must be reasonably fit for that particular purpose and of such a nature and quality that it can reasonably be expected to achieve any particular result (see paragraphs 5.80 to 5.82).

IAIS Principles and Australian law

12.8 The IAIS Principles state that the insurance supervisor should ensure insurers and intermediaries act honestly and pay regard to the information needs of their customers.

12.9 The Australian Financial Services Reform Act 2001 ("FSR Act") requires a financial service guide, a product disclosure statement and a statement of advice to be given to retail customers.

Possible problems

12.10 The Securities Act applies only to savings policies. There are no similar disclosure requirements for risk only policies, even though such policies may extend over a long time period and be of significant importance to the financial protection of policyholders and their dependants. On the other hand, it may be that most potential policyholders have sufficient information about risk only policies to make an informed decision on whether and which policy to purchase.

12.11 The disclosure required under the Securities Act for savings policies is consistent with the disclosure required of issuers of other investment products. However, the complex nature of some savings policies may mean this disclosure is not sufficient to enable potential policyholders to make properly informed investment decisions.

12.12 Section 37 of the Securities Act provides that an allotment of a security is void if there is no registered prospectus relating to the security, although any affected person can apply to the Court to validate an illegal contract under the Illegal Contracts Act 1970. This section could adversely affect the dependants of the holder of a savings policy that was issued during a period when there was no registered prospectus, by requiring them to apply to the Court under the Illegal Contracts Act or forgo the death cover provided by the policy. A similar issue has arisen recently in relation to some overseas managed funds that accept investment funds from New Zealanders. The Government has introduced legislation to provide a new method of validating allotments of securities that would otherwise be void. However, this legislation will not solve the problem referred to above of policyholders, whose policies are void under section 37, having to apply to the Court to validate them.

Options for addressing possible problems

12.13 With regard to disclosure relating to risk only policies possible options include:

- Extending the Securities Act to cover risk only policies as well as savings policies. However, this would extend the coverage of this Act to non-investment products and would raise the question whether other non-investment products, such as fire and general insurance, should similarly be covered.
- Introducing a new disclosure regime for risk only policies that is separate from the Securities Act. Such a regime would presumably also apply to other non-investment products, such as fire and general insurance.

12.14 With regard to the possibility that the disclosure required under the Securities Act for savings policies is insufficient for potential policyholders to make informed decisions, a possible option is to amend the Securities Regulations 1983 requirements relating to investment statements and prospectuses for these policies so as to require additional or more useful information to be disclosed.

12.15 Section 37 of the Securities Act could be amended to provide that, if there is no registered prospectus for a security, the holder of the security may (without going to Court) declare the security void within a specified period of becoming aware that there was no registered prospectus. Until such a declaration was made, the security would be valid.

> Q24 Product disclosure – Do you have any comments on the possible problems and options in paragraphs 12.10 to 12.15? Are there any problems or options we have not considered?

Financial advisers

12.16 One of the most important ways to help potential policyholders obtain information and make appropriate decisions about life policies is by ensuring that those who advise the policyholders are sufficiently well informed and able and have the right incentives to give appropriate advice and information to the policyholders.

New Zealand

12.17 Traditionally, in New Zealand, life policies have been marketed through life insurance agents and brokers. However, in recent years there has been a tendency for some insurers to do direct marketing of risk only policies.

12.18 Under the Investment Advisers (Disclosure) Act 1996, investment advisers and brokers have initial disclosure requirements and request disclosure requirements. Initial disclosure covers previous convictions against the Act and a description of the broker's procedure. Request disclosure covers:

- whether the adviser has or will or may have a direct or indirect pecuniary or other interest in giving investment advice to the investor and, if so, the nature of that interest;
- information about the investment adviser's qualifications and experience;

- the types of securities about which the adviser gives advice; and, if the adviser gives advice only about the securities of a particular issuer or issuers, a statement to this effect and the name of each issuer concerned; and
- the name of any relevant organisation with which the adviser has a relationship and a description of that relationship.

12.19 The Government has decided that changes should be made to the Investment Advisers (Disclosure) Act. The key changes proposed are:

- Removing the distinction between initial and request disclosure so that all aspects of disclosure mentioned in paragraph 12.18 will be required up front.
- Making it an offence to recommend illegal offers of securities.
- Giving the Securities Commission the power to make orders against investment advisers and take civil enforcement action against them. The Commission's powers will include the ability to suspend a person from acting as an adviser or a broker for up to 14 days.

A Bill to implement these proposals is expected to be introduced by mid-2004.

12.20 In addition to the above proposals, the Ministry of Economic Development intends to conduct a broad review of the regulation of financial intermediaries as part of a Securities Act review. The review will be initiated in 2004.

IAIS Principles and Australian law

12.21 The IAIS Principles state that the insurance supervisor should supervise intermediaries. The Revised IAIS Principles envisage that the supervisor will set requirements for the conduct of intermediaries, that intermediaries will be licensed and that intermediaries will be required to make certain disclosures.

12.22 In Australia, the FSR Act requires all financial service providers to be licensed and to comply with certain conduct and disclosure obligations. The Act extends many controls previously applying only to stockbrokers to anyone dealing in any other type of financial product. These include:

- disclosure of any interest which may influence advice;
- a requirement to offer suitable advice, otherwise known as the "know your client, know your product" rule; and
- disclosure of brokerage charges and commissions.

Possible problems

12.23 The Investment Advisers (Disclosure) Act applies only to advice about or dealings in "securities" as defined in the Securities Act. The Securities Act does not apply to risk only policies, and therefore the proposals mentioned above will not apply to those policies.

12.24 A requirement for financial advisers to disclose information to potential policyholders may not, in practice, provide much assistance for policyholders to get satisfactory advice. People who know little about an industry often find it difficult to assess information provided to them accurately, even if they have the time and ability to do so.

12.25 The law governing the relationship between a financial adviser and a person seeking the adviser's advice (that is, principally the laws of contract and negligence) may not provide sufficient incentives for the adviser to make all reasonable efforts to give the best advice to that person. A contract may include provisions limiting the adviser's liability, and an adviser's liability in negligence will depend on many factors including the information provided to the adviser by the person.

12.26 The way financial advisors are remunerated may give advisers an incentive to give advice that may not be in the best interest of the person to whom the advice is given. For example, if life insurance agents are remunerated by means of a commission paid on new policies, agents have an incentive to advise policyholders to cancel existing policies and take out new policies ("churning").

Options for addressing possible problems

12.27 The Investment Advisers (Disclosure) Act could be extended to cover all financial advisers and brokers, or new legislation relating to disclosure by all financial intermediaries could replace that Act.

12.28 New Zealand could adopt the Australian requirement to offer suitable advice, otherwise known as the "know your client, know your product" rule. This would require advisers to ensure that when giving advice to a client, they demonstrate knowledge of the objectives, strategy and products appropriate for that client, and that appropriate and adequate research on the products in carried out.

12.29 New Zealand could follow the Australian FSR Act and require all financial advisers and brokers to be licensed and to comply with certain conduct obligations. Alternatively, New Zealand could require specified initial and ongoing educational qualifications for financial advisers and brokers and require them to abide by a code of conduct. Failure to comply with the educational or code of conduct requirements could be grounds for a Court to suspend or prohibit a person from carrying on business as a financial adviser or broker.

12.30 Instead of the proposal in paragraph 12.29, advisers and brokers could be required to be members of an industry association, such as the Financial Planners and Insurance Advisers Association ("FPIA"), through legislation. The industry association could be a company or an incorporated society or a statutory body. Such a body could be required through legislation to have lay members or Government representatives on its governing board, and to have rules about matters such as educational qualifications, a code of conduct and disciplinary processes. Or the status quo could continue, leaving these matters to one or more voluntary regulatory bodies that would continue to build up their own rules.

12.31 As to remuneration, financial advisers and brokers could be encouraged (whether by way of legal obligations or incentives, or otherwise) to move from commission based remuneration to time or value based methods. Furthermore, life insurers (as well as advisers and brokers) could be required to publicly disclose the methods and rates of remuneration paid by them to advisers and brokers.

Q25 Financial advisers and brokers – Do you have any comments on the possible problems and options in paragraphs 12.23 to 12.31? Are there any problems or options we have not considered?

Terms of policies

12.32 A life policy is a contract of insurance between a life insurer and a policyholder, and is governed by the common law relating to insurance contracts. However, this law has been unable to properly protect policyholders in several respects, and so has been overlaid with specific statutory provisions.

New Zealand

12.33 In New Zealand, these specific statutory provisions are principally in Part II of the Life Insurance Act 1908 ("Life Act"). This Part includes provisions relating to the interest rates applicable to policies, assignments and mortgages of policies, protection of policies, minors' policies, and insurances by married women (see paragraphs 5.36 to 5.46).

Australian law

12.34 In Australia, these specific statutory provisions are principally in the Life Insurance Act 1995 ("Life Act (Aust)"). See clause 3.4 of the comparative table in Appendix B.

Possible problems

12.35 Many of the provisions of Part II of the Life Act are outdated in the way they are expressed.

12.36 Under section 41A of the Life Act, life insurers must pay interest on late paid claims from the ninety-first day after the date of the life insurer's death until the day the claim is paid. The interest payable is to be at the rate specified in the policy or at the rate prescribed by the Judicature Act 1908 (7.5 per cent per annum), whichever is the greater. One effect of this provision is that a person entitled to money under a policy can, by delaying claiming, earn interest at a relatively high rate on that money, in effect at the expense of other policyholders.

12.37 The long periods for which life policies are often in force, and the recent substantial change in the way in which life insurance business is conducted and the life insurers involved, has likely resulted in insurers now holding many old fashioned policies and/or policies of other insurers whose businesses they have acquired. This may give rise to administrative problems for the insurer such as a lack of institutional knowledge about the old policies or outdated computer software required to administer the policies. As the policies are individual contracts between the insurer and each policyholder there is usually no practicable way of amending the policies to update them and/or make administration simpler.

Options for addressing possible problems

12.38 Part II of the Life Act could be replaced by a more modern set of equivalent provisions.

12.39 As part of this replacement process section 41A of the Life Act could be amended to provide that interest is not payable to the extent that the claimant is responsible for the delay in payment.

12.40 A new provision could be in included in the Life Act (or its replacement Act) authorising the Court, on the application of a life insurer, to change the terms of particular life policies in order to simplify their administration, so long as the changes were not detrimental in any material way to policyholders and policyholders had had such opportunity to consider and object to the changes as the Court thought fit.

> Q26 Terms of policies – Do you have any comments on the possible problems and options in paragraphs 12.35 to 12.40? Are there any problems or options we have not considered?

Secondary markets – life policies

12.41 Policyholders have the right to transfer their life policies. Some secondary markets have developed that buy life policies as investments and sometimes offer more than the surrender value as an incentive to sell.

> Q27 Secondary markets – Do you have any comments on the issue referred to in paragraph 12.41? Are there any issues we have not considered?

Human Rights Act 1993

12.42 The Human Rights Act makes it unlawful to refuse to supply goods, facilities or services to the public, or treat any person less favourably in connection with those goods, facilities or services (see paragraph 5.132). However, offering life policies on different terms and conditions for each sex, or for persons with a disability or for persons of different ages is allowed if based on certain data, advice or opinion.

> Q28 Human Rights Act – Do you have any comments on the issue referred to in paragraph 12.42? Are there any issues we have not considered?

Genetic information

12.43 Life insurers may and do collect health information and family medical histories to determine whether, and on what terms, they will accept a risk. Risk factors that become known to the insured after the contract has been entered into need not be disclosed. However, some policies must be renewed periodically and there may be a duty to disclose relevant information at every renewal.

12.44 Insurers may have an interest in obtaining genetic information before deciding whether to underwrite an application for life insurance. This is because certain kinds of genetic information about an individual, or his or her family, may reveal information about present or future health, which may in turn affect the likelihood of the applicant making

a claim under the policy. Insurers may ask applicants to disclose genetic information derived from a genetic test or from a family medical history.[120]

12.45 The Australian life insurance industry has in the past used genetic information disclosed by the applicant for underwriting purposes. This practice prompted an inquiry into the use of human genetic information by the Australian Law Reform Commission.[121]

12.46 The Australian Law Reform Commission recommended:[122]

> The insurance industry should be required to adopt a range of improved consumer protection policies and practices with respect to its use of genetic information (including family history) for underwriting purposes. New laws and practices should ensure that: genetic information is only used in a scientifically reliable and actuarially sound manner; reasons are provided for any unfavourable underwriting decision; industry complaints-handling processes are strengthened and extended to cover underwriting decisions; and industry education and training about genetics are improved.

12.47 The Australia Competition and Consumer Commission has agreed to the life insurance industry's request to extend a ban on linking policy discounts to genetic tests. The ban, which has been in place since November 2000, prevents insurance agents from offering discounts to people who can present a "clean" genetic test. The ban has been requested because of doubts over the validity of some genetic tests available and because of major privacy issues.[123]

Q29 Genetic Information – Do you have any comments on the issue referred to in paragraphs 12.43 to 12.47? Are there any issues we have not considered?

Complaints handling

12.48 An important aspect of consumer protection is the provision of effective and low cost processes for hearing and resolving policyholder complaints.

New Zealand

12.49 The Insurance and Savings Ombudsman ("ISO") and the Banking Ombudsman are the industry based complaint schemes operating in New Zealand (see paragraphs 4.58 to 4.69 and 5.145 to 5.150). Life insurers generally have internal complaints handling processes. Disputes Tribunals and Courts are also available to resolve complaints.

12.50 In Part 5 of the Accord on Retirement Income Policies entered into by the Alliance, Labour and National parties in August 1993, it was stated:

---

120 Australian Law Reform Commission *Essentially Yours – The Protection of Human Genetic Information in Australia ALRC: Report 96* (March 2003).

121 Australian Law Reform Commission, above n 120.

122 Australian Law Reform Commission *Inquiry: Time Now to Regulate the "New Genetics" in the Public Interest* (Media Release, 29 May 2003).

123 *Insurers Win Extra Ban on Gene Testing* (*Sydney Morning Herald*, 10 October 2003).

5.1 There should be a person or persons to whom complaints and disputes about any kind of private savings can be referred by any New Zealander for speedy and low cost resolution.

5.2 The preference of the Parties is that the principle in clause 5.1 be achieved by the appointment of one Savings Ombudsman.

5.3.1 At present various private sector banking and insurance organisations have appointed or propose to appoint ombudsmen to consider complaints and disputes about private savings.

5.3.2 The Retirement Commissioner should review the appointments referred to in clause 5.3.1 and the kinds of private savings that are within the jurisdiction of those ombudsmen, and report by the end of 1994 on the need for a Statutory Savings Ombudsman.

12.51 In 1997, the Retirement Commissioner reviewed the appointments and concluded that an appointment of a Statutory Savings Ombudsman could not be justified. At that time, the Retirement Commissioner pointed out that members of group superannuation schemes did not have access to either of the private sector ombudsman schemes, but concluded that there was "no compelling evidence to support the need for an ombudsman for the sole purpose of handling disputes between members and trustees of group superannuation schemes".[124]

12.52 A further review carried out by the Retirement Commissioner in 2002, confirmed the initial conclusion and stated that the effectiveness of the two ombudsman schemes had been maintained at a satisfactory level. The Retirement Commissioner stated that he would look into complaint handling procedures for superannuation schemes with the 2003 Periodic Report Group appointed under the Retirement Income Act 1993.[125]

IAIS Principles, Australian and United Kingdom law

12.53 The IAIS Principles state that insurers and intermediaries should support a system of complaints handling.

12.54 In Australia, the FSR Act requires financial service providers to maintain proper complaint handling facilities. Every financial services licensee must belong to an independent complaints service. Details of the complaint handling procedures must be included in the adviser's Financial Services Guide as well as the product issuer's Product Disclosure Statement.

12.55 Australia is similar to New Zealand in that it has a Banking Ombudsman and an industry body, the Financial Industry Complaints Service ("FICS"). The FICS is an external complaints resolution scheme approved by the financial services regulator, ASIC. The FICS operates in a manner similar to the Banking Ombudsman, but it has an independent panel to make determinations rather than an ombudsman. The Insurance Enquiries and Complaints Scheme deals with general insurance complaints.

---

124 Retirement Commissioner *Monitoring the Banking Ombudsman and the Insurance and Savings Ombudsman Schemes* (Wellington, 5 February 2003), 2.

125 Retirement Commissioner, above n 124, 4, 6.

12.56 In the United Kingdom, the Financial Ombudsman Service is legislated under the Financial Services and Markets Act 2000. All authorised life insurers belong to the scheme. The standards imposed by legislation are an extension of the voluntary procedures developed by the previously self-regulated industry and focus on consumer protection (see paragraphs 7.46 to 7.48).

Possible problems

12.57 Complaints relating to life policies issued by insurers owned by banks are dealt with by the Banking Ombudsman. Complaints relating to life policies issued by insurers who belong to the ISO Scheme are dealt with by the ISO. While these two ombudsmen co-operate well, there is the possibility that they will act inconsistently in relation to complaints simply because they operate independently under different terms of reference.

12.58 It is not compulsory for life insurers to have an internal complaints process or to belong to the ISO Scheme, although the ISI requires its members to do so (but ISI membership is not compulsory). Not all life insurers operating in New Zealand are ISI members, and not all policyholders have access to the ISO Scheme.

12.59 All retail trading banks (any bank registered under the Reserve Bank of New Zealand Act 1989) that are members of the New Zealand Bankers' Association, are required to participate in the Banking Ombudsman Scheme. However, membership of the Bankers' Association is not compulsory.

12.60 Both Ombudsmen's terms of reference are set by appointed members of the industry concerned and are restricted in some respects. For example, a policyholder is usually unable to make a complaint about a financial adviser to the ISO, because the adviser is not usually an employee of the life insurer. On the other hand, the Banking Ombudsman can deal usually with complaints about financial advisers and the selling process for life policies issued by bank subsidiaries, because the advisers are usually employees of the banks.

12.61 Consumers who obtain life insurance coverage as one of the benefits of membership of a group superannuation scheme do not have access to the ISO Scheme. The ISI has suggested that a suitable solution would require legislative support.[126]

Options for addressing possible problems

12.62 There could be a statutory requirement that every life insurer has an internal complaints process and belongs to an ombudsman scheme. The principal elements of the internal complaints process and the terms of reference for each ombudsman scheme could be prescribed in statute or regulation or could be required to be approved by a regulator. Legislation could require that there be only one ombudsman scheme covering all life policies.

---

[126] Retirement Commissioner, above n 124, 7.

Q30 Complaints handling – Do you have any comments on the possible problems and options in paragraphs 12.57 to 12.62? Are there any problems or options we have not considered?

Insured's duty to disclose

12.63 The insured's duty of disclosure has its origin in the reciprocal duty of utmost good faith owed by and to each party to a contract of insurance. The general duty of disclosure requires an applicant to disclose relevant information up to, but not beyond, the moment the contract is entered into. The information disclosed is used for the purpose of underwriting (or risk rating), in which the insurer assesses whether to accept the insurance application and, if so, on what terms.

New Zealand

12.64 In 1998, the Law Commission produced a report entitled *Some Insurance Law Problems.*[127] The report dealt with the rule of disclosure of relevant facts. The Law Commission sought to address situations where it is not clear what matters the insured must tell the insurer and the consequences of that.

12.65 What the insured must disclose is uncertain and there is much room for genuine misunderstanding. However, ignorance is no excuse for breach of the duty to disclose. The insured's duty is unaffected by the fact that he or she did not know or was not warned by the insurer of the nature or extent of the duty.

12.66 Breach of the duty may have disproportionately harsh results for an insured. An insured's failure to disclose a material circumstance allows an insurer to treat the contract of insurance as void from the start. Instead of being able to claim under the policy, the insured usually receives, at most, only a refund of the premiums paid under it.

12.67 In response to the issues surrounding non-fraudulent non-disclosure, the Law Commission recommended a new section be inserted into the Insurance Law Reform Act 1977 (section 7A). Effectively, the new section would state that any right that an insured's non-fraudulent non-disclosure gives the insurer to cancel the contract from its inception (that is, with retrospective effect) should have a time limit. That time limit would mean the right would be exercisable only within the period that begins with the risk first attaching and ends 10 working days later. Any right that the non-disclosure gives the insurer to cancel a concluded contract prospectively would be unaffected.

12.68 The purpose of the reform is to shift the emphasis from an insured's duty to disclose to an insurer's duty to identify circumstances (by asking the insured appropriate questions) about which the insurer needs to be appropriately informed. The purpose of the time limit is not to enable the insurer to discover the non-disclosure but to allow the insurer time to pose appropriate questions to the insured before agreeing to the contract.

---

[127] New Zealand Law Commission *Some Insurance Law Problems: NZLC R46* (Wellington, 1998).

12.69 The Law Commission's recommendations in this area have not been actioned and the Ministry of Justice has stated that further policy work is expected in 2003 and 2004.

Australian law

12.70 The Insurance Contracts Act 1984 ("Insurance Contracts Act") includes provisions intended to protect consumers from unfair treatment by insurers. For example, both parties are required to act in the utmost good faith, and there are specific modifications to the insured's duty of full disclosure. The Australian law in this regard offers a greater degree of protection to the insured than the New Zealand Insurance Law Reform Act 1977. The Insurance Contracts Act is under review, specifically section 54, which limits when an insurer may refuse to pay a claim (see paragraphs 6.57 and 6.58).

Q31 Insured's duty to disclose – Do you have any comments on the issue referred to in paragraphs 12.63 to 12.70? Are there any issues we have not considered?

Chapter 13
Financial safety issues

INTRODUCTION

Definition

13.1 Financial safety regulation is aimed at reducing the risk of financial failure of certain participants in the financial system. For a fuller definition of financial safety regulation see paragraphs 2.10 to 2.14.

Existing legislation and IAIS Principles

13.2 The financial safety regulation of life insurers in various countries, and the IAIS Principles relating to financial safety, are set out in parts 2 and 3 of this discussion paper, and summarised in the comparative table set out in Appendix B.

New Zealand

13.3 In New Zealand:

- Life companies are not required to be registered or licensed, but must lodge a $500 000 deposit with the Public Trust.
- Annual financial accounts under the Financial Reporting Act 1993 are lodged with the Registrar of Companies and available for public inspection.[128] Financial statements and an abstract of the annual financial condition report required under section 18 of the Life Insurance Act 1908 ("Life Act") are lodged with the Ministry of Economic Development. The statements and abstract are reviewed by the Government Actuary, who reports on them to the Minister. This is the primary form of financial safety supervision of life insurers in New Zealand.
- The actuarial profession has developed standards on assets and liabilities, and a guidance note on solvency ("GN5"), based on the Australian Solvency Standard, and these are incorporated into the actuary's financial condition report. The New Zealand Society of Actuaries Professional Standard No. 1 ("PS1") sets out the matters the actuary should address in the financial condition report. The standards set by the New Zealand Society of Actuaries ("NZSA") are not recognised or required by any law.[129]
- Powers of inspection exist under the Corporations (Investigation and Management) Act 1989 and Part 2 of the Insurance Companies (Ratings and Inspections) Act 1994, and there is a procedure for appointing a judicial manager

[128] This applies only to "issuers" (generally, persons subject to the Securities Act 1978), and to companies of a certain size (including overseas companies).

[129] But note the relationship with FRS-34, see para 4.41.

of a life company under Part 1A of the Life Act, if it appears that there is a likelihood that a company will be unable to meet its liabilities to policyholders.

- Section 15 of the Life Act, which requires a separate fund for receipts in respect of life insurance and annuity contracts, may have been an attempt at having a separate statutory fund, but as discussed in paragraphs 5.16 to 5.18, the provision has proven to be unclear and ambiguous and has not achieved that effect. There is no statutory limit on the types of business a life insurer may carry on in New Zealand.
- Section 79 of the Life Act requires every company established outside New Zealand issuing life policies in New Zealand to keep a separate account of all life insurance business transacted in New Zealand, and assets in New Zealand, and to prepare separate financial statements for the New Zealand business. This section does not go so far as to require a separate statutory fund for New Zealand business (as does the Australian regime, see paragraphs 6.23 to 6.26).
- There are no specific limits on transactions with related parties. However, some transactions are voidable by the liquidator if made when the company was unable to pay its debts and within two years prior to the liquidation. The transaction must have enabled another person to receive more towards satisfaction of a debt than they would otherwise have received on liquidation.[130] In addition, GN5 issued by the New Zealand Society of Actuaries, which is the solvency standard applied by actuaries when preparing the financial condition report, requires an "inadmissible assets reserve", which requires special treatment of related party transactions (and large credit exposures). However, section 131(2) of the Companies Act 1993 permits a director of a subsidiary to act in the best interests of the parent company, even if to do so is not in the best interests of the subsidiary (so long as the subsidiary's constitution permits this).
- Certain other provisions of the Companies Act are aimed at protection of creditors.[131]

Australia

13.4 In Australia:

- APRA administers a registration system for life insurers, including undertaking "fit and proper" assessments of management. Solvency, capital adequacy and management capital standards, required under the Life Insurance Act 1995 ("Life Act (Aust)"), have been set. Information provided by APRA states that off-site monitoring includes reviewing each company's operational risk, including corporate governance and risk management systems. Under the Life Act (Aust), APRA receives regular financial and actuarial reports, and both auditors and actuaries have a "whistle blowing" role (to APRA) in relation to contraventions of that Act. APRA has extensive powers of inspection and a range of remedial actions available to it.
- The Life Act (Aust) requires separate statutory funds, and limits the type of business that may be carried on to life insurance business. There are rules about

130 Companies Act 1993, s 292(2).

131 For example, ss 102, 135(a), 136, 137, 179, 204 and 271(1).

and limitations on transactions with related parties, and the imposition of an additional directors' duty to give priority to the interests of policyholders. APRA requires incorporation in Australia as a condition of registration.

IAIS Principles

13.5 The IAIS Principles are aimed primarily at promoting financial safety in the insurance sector of the financial markets:

- Principle 1 requires the existence of an insurance supervisor. The supervisor's primary task is to maintain efficient, fair and stable insurance markets for the benefit and protection of policyholders. Principle 2 requires the licensing of life insurers, the fit and proper assessment of management and an assessment of business plan soundness. Other principles require corporate governance standards to be set and also standards limiting or managing the amount of risk undertaken. In particular, solvency and capital adequacy standards are required, as well as standards on assets and liabilities, including standards on the technical provisions (reserves) that must be maintained. Financial reporting to the insurance supervisor is important (Principle 12) so the supervisor can form an opinion about the financial strength of each insurance company in the supervisor's jurisdiction, and a process for receiving reports, including financial, statistical and actuarial reports, must be established. Supervisors need powers (under Principles 13 and 14) to carry out on-site inspections and take remedial action.
- The Revised IAIS Principles reiterate the need for an effective supervisor, licensing (including fit and proper assessments), corporate governance standards, off-site monitoring and on-site inspections, a range of effective sanctions, and require supervision on a group-wide basis. Supervisors are required to review the insurer's risk management systems (including reviewing reinsurance), establish standards on reserving and investments, and prescribe a solvency regime.

POSSIBLE AREAS FOR REFORM

Possible problems

13.6 New Zealand's financial safety legislation may be regarded as being too limited in scope, and too outdated, to be of any value.

13.7 Financial safety regulation aims to reduce the risk of financial failure, and is based on the concern that increased disclosure obligations alone are not sufficient to enable consumers to assess this risk. Financial safety regulation may be justified in the case of life insurers on the grounds that it is very difficult for policyholders to assess the creditworthiness of these organisations. Further measures may be needed to increase the likelihood that life insurers will be able to meet their liabilities when they fall due. A 2003 OECD paper, *Assessing the Solvency of Insurance Companies*, stated: [132]

[132] OECD *Assessing the Solvency of Insurance Companies* (Policy Issues in Insurance No. 4, Paris, 2003), Executive Summary. As regards the fourth reason, the judgement says: "It must also be borne in mind … that in certain fields insurance has become a mass phenomenon. Contracts are concluded by such enormous numbers of policyholders that

> The need to give insurance policyholders special protection is now universally acknowledged. In judgements handed down on 4 December 1986, the Court of Justice of the European Communities (CJEC) gave four reasons why such protection is necessary:
>
> 1. Insurance is a highly particular service because it is linked to future events, the occurrence of which is uncertain at the time a contract is concluded.
> 2. An insured person may find himself in a precarious position if he does not obtain payment after filing a claim for compensation.
> 3. It is very difficult for a person seeking insurance to assess the terms of a contract and the outlook for the insurer's future financial position.
> 4. Insofar as insurance has become a mass phenomenon, it is equally essential to protect the interests of third parties.

13.8 However, there have been very few financial failures involving life insurers in New Zealand, and what failures there have been have affected relatively few policyholders. The most recent significant failure was that of ACL Insurance Limited (see paragraphs 5.17 and 5.18). Most life insurers that operate in New Zealand are established or owned and regulated in other countries (principally Australia), which may mean New Zealand policyholders are indirectly benefiting from other countries' regulatory regimes. For example, the Australian regime requires a separate statutory fund for offshore (including New Zealand) business and imposes many of its financial safety rules on to that offshore business. There are issues concerning the extent to which these rules apply and the possible treatment of New Zealand policyholders compared with Australian policyholders, especially on a liquidation (see further chapter 16).

13.9 Another reason for the relatively few failures of New Zealand life insurers may be that mutual life insurers (such as, until recently, AMP and National Mutual) have in the past been able and willing to take over, or otherwise provide support to, ailing competitors "for the good of the industry". This ability and willingness may have ceased with the demutualisation of most of the life insurers operating in New Zealand. A further reason may be that the discretion often given to life insurers under the terms of traditional savings policies in respect of the calculation of bonuses and surrender values may provide a buffer against adverse financial results.

13.10 No system of regulation can or should aim to eliminate risk in any sector of the financial system. At best, a system of supervision can help reduce the risk of financial failure. However, insolvencies can still occur (for example, the collapse of HIH in Australia). It may be that one (possibly the main) goal of financial safety regulation is to establish a system capable of recognising the warning signs in time to allow an insurer to exit from the market without causing widespread damage to policyholders (and other stakeholders).

13.11 In considering financial safety issues, it may be necessary to distinguish between savings policies, renewable risk only policies, and non-renewable risk only policies, and between different kinds of policies within those classes (such as short and long term policies), as

---

the protection of the interests of insured persons and injured third parties affects virtually the whole population". This reason probably does not apply to life insurance in New Zealand, which is not a "mass phenomenon".

different considerations may apply to different classes and/or kinds of policies. For example, the case for financial safety regulation may be weaker in relation to short term non-renewable risk only policies than in relation to long term savings policies, because, while it is just as difficult for a policyholder to assess the creditworthiness of the insurer, there is less risk to the policyholder of the insurer getting into financial difficulties during the (short) term of the policy and the potential adversity caused by the insurer's failure to honour its promise may be less. In this context it is significant to note that the New Zealand life insurance market, in terms of new business, is dominated by renewable risk only insurance.

13.12 It may also be necessary to consider the financial safety regulation that exists, or ought to exist, in New Zealand in relation to financial products other than life insurance. For example, if financial safety regulation is needed for life insurance, is it also needed for other forms of insurance or savings products?

Options for addressing possible problems

Remove all sector-specific financial safety regulation for some or all life policies

13.13 If it is considered that no financial safety regulation of life insurers is needed in New Zealand, all such existing regulation (see paragraph 13.3) should be repealed. Alternatively, financial safety regulation may be regarded as necessary for some kinds of life policies, but not for others.

> Q32 Does New Zealand need financial safety regulation for life insurers or for particular kinds of life policies?

13.14 If financial safety regulation of New Zealand life insurers, or for particular kinds of life policies, is desirable, the following options may be considered.

Continue as at present

13.15 As noted in paragraph 13.3, New Zealand does have some financial safety regulation that applies to life insurers, but this regulation is in many respects piecemeal, out of date or unclear. For example:

- the amount of the bond provided to the public trust ($500 000) is generally recognised as insufficient to provide any real degree of protection for policyholders;
- section 15 does not require a separate statutory fund and it is unclear what is achieved by requiring a separate fund for receipts;
- the information required by the schedules to the Life Act, which is received by the MED 9 months after the end of the financial year, is not comprehensive, in particular the abstract of the financial condition report provides only a brief summary of the full financial condition report;
- the MED and Government Actuary have limited powers of investigation and inspection (and limited resources), and a limited range of remedial actions available.

Q33 Should New Zealand simply "tidy up" its existing financial safety regulation of life insurers or is a higher level of regulation needed in relation to all or some life policies?

13.16 If a greater degree of financial safety regulation of New Zealand life insurers is desirable, the following options may be considered.

Government regulator

13.17 An existing entity (for example, the Registrar of Companies, Government Actuary, Securities Commission, or Reserve Bank) or a new entity could be made responsible for supervising the financial safety aspects of life insurers operating in New Zealand, along similar lines to APRA in Australia. An APRA-type regulator would have the following functions:

- registering and deregistering life insurers, including assessing management and business plan soundness at time of registration;
- ongoing off-site monitoring of registered life insurers, including receiving regular financial reports, and ongoing assessment of solvency and overall functioning of the board and management;
- conducting regular on-site investigations of all life insurers, in particular, where reviews indicate problems;
- ongoing monitoring of the operation of statutory funds;
- receiving notification ("whistle blowing") from auditors and actuaries of serious problems;
- issuing prudential standards and rules on matters such as capital requirements, reinsurance and the operation of statutory funds; and
- having a range of powers in relation to problem life insurers, such as deregistration, freezing assets, directing that no new business be written, and instigating judicial management and winding-up procedures.

Q34 Should New Zealand have a financial safety regulator of life insurers, along the lines of the Australian Prudential Regulation Authority in Australia?

Ratings

13.18 While not required by law, many life companies (all ISI members) voluntarily obtain a credit rating from one of the internationally recognised credit rating agencies such as Standard and Poor's or A.M. Best. Imposing a statutory requirement on life insurers to obtain a credit rating would increase the amount of information in an understandable form available to prospective policyholders and policyholders who were considering increasing cover. However, it may be of limited assistance to existing holders of savings or renewable risk only policies because it may not be feasible to switch from one insurer's policies to another's.

13.19 It is likely ratings would impose a form of discipline on life insurers to "fix the problem" if they wished to avoid a credit downgrade. Rating agencies have been known to assist organisations to work out solutions to problems in order to avoid a credit downgrade.

Depending on the issues concerning the credit rating agency, this can have beneficial consequences for creditors (including policyholders), as the likelihood of the organisation being able to repay debts is increased.

13.20 General insurers are required to obtain a credit rating (from A.M. Best or Standards and Poor's) under the Insurance Companies (Ratings and Inspections) Act 1994. Life insurers are not required to be rated in relation to their life insurance business and, to the extent that they carry on non-life business (such as health and disability insurance), so long as they do not issue disaster or general insurance, they can elect not to be rated. For a discussion of the Insurance Companies (Ratings and Inspections) Act, and the issues associated with credit ratings, see chapter 17.

> Q35 Should life insurers in New Zealand be required to obtain an annual credit rating from one of the internationally recognised credit rating agencies?

Trust deed

13.21 Life companies could be required to put in place an independent trustee and a trust deed for all or some kinds of life policies (for example, insurance bonds and other savings policies), with the trustee acting as a prudential supervisor on behalf of the policyholders. This concept was adopted in the Accident Insurance Act 1998 (repealed) in relation to private insurers offering accident insurance for personal injuries (see paragraph 3.37). This would minimise the risk of implicit Government support, as the prudential supervisor would be a private sector entity.

13.22 Trust deeds are required under the Securities Act 1978 for debt securities (such as debentures) offered to the public. The trust deed must contain those matters required by the Securities Regulations 1983 (which include, for example, a duty on the trustee to ascertain whether the trust deed has been breached). The trust deed must be registered with the Registrar of Companies. In addition, the Securities Act provides that participatory securities (such as group investment funds and property syndicates) cannot be offered to the public unless an independent statutory supervisor has been appointed and a deed of participation has been signed and registered with the Registrar of Companies. The trustee for debt securities and the statutory supervisor must be either a trustee corporation or a person approved for this purpose by the Securities Commission.

13.23 Superannuation schemes and unit trusts, which are other kinds of long term financial products, operate through trust deeds under the requirements of the Superannuation Schemes Act 1989 and the Unit Trusts Act 1960 respectively. In particular, the:

- Superannuation Schemes Act requires certain matters to be covered in the trust deed (such as conditions of entry and when benefits become payable) as well as implying a certain duty of care on the trustee. However, it does not require the involvement of an independent third party, such as the trustee for debt securities and the statutory supervisor.
- Unit Trusts Act requires a unit trust to have a manager and an independent trustee. The trustee must be either a trustee corporation or a company or bank approved by the Minister responsible for that Act.

13.24 It seems inconsistent that unit trusts and group investment funds require the involvement of an independent trustee or a statutory supervisor, but other kinds of managed funds, namely insurance bonds and superannuation schemes, do not. A reason may be that the Government Actuary has a form of prudential supervisory role in relation to life insurance and superannuation schemes, but not in relation to unit trusts and group investment funds.

> Q36 Should life insurers in New Zealand be required to put in place an independent trustee and trust deed in relation to all or some kinds of life policies?

Impose additional protective measures

13.25 One or more of the following additional measures could be imposed independently of or in addition to any of the above options.

Statutory funds

13.26 A separate statutory fund could be required for the life business of a life company or for particular kinds of life policies. As noted in paragraphs 5.16 to 5.18, the existing section 15 of the Life Act has proved to be ineffective. Statutory funds are required under the Life Act (Aust) for the life insurance business of each life insurer operating in Australia. Under that Act, amounts received in respect of the life business must be paid into the statutory fund, all assets and investments related to the life business must be held in that fund, all life business liabilities are liabilities of that fund, only expenses relating to the life business can be paid out of that fund, and profits and losses are contained within that fund. There are also rules surrounding the transfer and amalgamation of statutory funds, and restrictions on borrowing and investment. Further details of the operation of Australian statutory funds are contained in paragraphs 6.23 to 6.26. Requiring statutory funds for all life policies would appear to require life insurers to separate out the life element of bundled policies issued by them, as only the life element of policies issued would be required to be placed into the statutory fund.

> Q37 Should life insurers in New Zealand be required to operate all or some (being particular kinds of policies) of their life business through a statutory fund?

Registration and assessment of management

13.27 Registration or licensing of life insurers (or life insurers who issue particular kinds of policies) with a Government agency could be required, possibly including "fit and proper" assessment of management. Requiring registration or licensing is seen by the IAIS as a fundamental aspect of insurance supervision. The IAIS Principles require that before a licence is granted, the supervisor should assess the suitability of the owners, directors and senior management, as well as soundness of the business plan. The IAIS regards the primary role of an insurance supervisor as being to monitor the business and operations of life insurers on a close, regular and frequent basis to ensure continued solvency. Licensing is, therefore, essential to establish the initial contact and take the necessary supervisory steps. APRA also undertakes "fit and proper" assessment of management at the time of registration.

Q38 Should life insurers (or life insurers who issue particular kinds of policies) in New Zealand be required to register with a Government agency? If so, should a "fit and proper" assessment of management and/or assessment of business plan soundness be undertaken at the time of registration?

Limiting business to life insurance

13.28 The type of business that may be carried on by a life insurer could be limited to life insurance. Australia requires that life insurers carry on only life insurance business (section 234 of the Life Act (Aust)).[133] This is in addition to requiring statutory funds. Imposing a limit of this type is another way of ring-fencing the life business of a life insurer from other businesses it might carry on (and so attempt to limit the exposure of the life business to the risks and potential losses of other businesses). Such a limitation would apply only to the life insurer, and not to any other member of any group of which the insurer was a part.

Q39 Should life insurers in New Zealand be prohibited from carrying on business other than life insurance? If so, how would "life insurance" be defined for the purposes of this prohibition and would the definition include, for example, products such as insurance bonds, and disability insurance?

Bond

13.29 Life insurers in New Zealand are required to deposit $500 000 with the Public Trust. It seems that this bond provides no security (beyond possibly providing the funds to pay for a liquidator). One option may be to increase the required bond to an amount such as $5 million, which would go some way towards providing real security for policyholders. It would also provide a significant "threshold" requirement for smaller insurers. Another option may be to require each life insurer to maintain a specified minimum amount of capital.

Q40 Should the bond requirement be retained; if so, should the bond amount be increased to, say, $5 million (or another amount)?

Q41 Should life insurers be required to maintain a minimum amount of paid-up capital?

Ratings

13.30 Life insurers could be required to have a credit rating. While there are some shortcomings to relying on a requirement to obtain a credit rating as a system of financial safety supervision for life insurers, it can operate as a useful adjunct to a system of supervision (see chapter 17 for further discussion of credit ratings).

[133] The Australian definition of "life policy" is not limited to conventional types of life insurance but includes, for example, disability insurance (see paragraph 17.29).

Q42 Could a system of regulation be supported by a requirement that life insurers in New Zealand obtain an annual credit rating from an international credit rating agency?

Restrictions on related party transactions

13.31 Rules could be imposed in relation to related party transactions. Where life business is conducted as part of a group, the parent company may act in a way that it perceives to be in the interests of the whole group, rather than in the interests of the life insurer. The purpose of imposing rules on related party transactions is to insulate the life business of a group of companies from the risks and losses of other business activities undertaken by that group. Australia imposes rules on related party transactions (see paragraph 6.35).

Q43 Should there be rules limiting the ability of life insurers to enter into transactions with related parties?

Corporate governance standards

13.32 Corporate governance standards could be introduced for all life insurers, including requirements for risk management systems. Corporate governance standards would be a set of principles describing best business practice and that may or may not have legal force. The standards that could be of particular importance to life insurers might relate, for example, to the requirement for boards to regularly review the checks and balances that are operating to ensure decisions are being made on a fully informed basis and with sound and expert (such as professional or actuarial) advice.

Q44 Should corporate governance standards be introduced for life insurers in New Zealand, in particular, setting out principles of best practice in relation to risk management systems? If so, should these standards have a statutory basis?

Role of actuaries

13.33 An "appointed actuary" regime could be introduced. An "appointed actuary" regime exists in Australia. Each life company operating in Australia must appoint an actuary who is "eligible" for such appointment. Persons are "eligible" if they:

- are an Australian resident; and
- are a Fellow of the Institute of Actuaries of Australia and have been a Fellow for at least five years; or
- have been approved by APRA (which can happen only if APRA is satisfied that the person has suitable actuarial qualifications and experience).

The appointed actuary must comply with actuarial standards, has certain powers to access company information, has obligations to report to the board on matters that require action, and in the case of serious breaches of the Life Act (Aust) and certain other breaches or problems must advise APRA.

13.34 In the United Kingdom, where an "appointed actuary" regime also exists, there have been some concerns expressed about the operation of the regime including:

- the regime places too much reliance on one individual who often has not had an external, detailed check of their work, which inevitably poses risks;
- appointed actuaries often face conflicts of interest, because many sit on the boards of the insurers in relation to which they provide advice;
- there are reputational risks for actuaries in "whistle blowing", especially in smaller markets; and
- actuaries often do not have the time and resources to carry out the role adequately.

The FSA is planning to abandon the appointed actuary regime in favour of placing more responsibility on senior management and the board, (see paragraphs 7.58 to 7.64).

13.35 Whether or not there is an appointed actuary regime, one option would be to give actuaries a "whistle blowing" role in relation to serious problems of which they become aware. This is one aspect of the Australian "appointed actuary" regime. However, it could exist independently of that regime, by requiring each life insurer's actuary to report directly to a Government regulator or trustee (see paragraphs 13.21 to 13.24) if the actuary becomes aware of serious problems during the year or when preparing the annual financial condition report. Note that a "whistle blowing" role exists for:

- auditors in relation to banks under the Reserve Bank of New Zealand Act 1989;
- managers, actuaries and auditors in relation to superannuation schemes under the Superannuation Schemes Act; and
- auditors in relation to debt securities, participatory securities and units in a unit trust under the Securities Act.

13.36 There are potential problems with an "appointed actuary" regime or a "whistle blowing" role for actuaries, such as conflicts of interest (actuaries are often employees of the life insurer) and the procedures of the NZSA. An increased role for actuaries relies on there being a strong professional body capable of monitoring actuaries' performance and enforcing compliance by its members with the highest professional and ethical standards. For further discussion of these issues, see chapter 15.

Q45 Should an "appointed actuary" regime be introduced in New Zealand?

Q46 Should life insurer actuaries have "whistle blowing" obligations to a Government regulator or trustee?

Q47 Are there other issues concerning the current role of actuaries in the life insurance regime that need to be considered (for example, rights of access to company information)?

Requiring filing of the financial condition report

13.37 The complete financial condition report prepared annually by each life insurer's actuary could be required to be filed with the Government Actuary or another Government regulator. The complete report, which is currently confidential to the life insurer, could

also be made publicly available. However, it is likely to contain commercially sensitive information and making it publicly available may mean such information will not be included in future.

Q48 Should the whole financial condition report be filed with the Government Actuary or another Government regulator?

Q49 Should the whole financial condition report be made publicly available?

Recognition of actuarial standards

13.38 Statutory recognition could be given to the actuarial standards that have been developed by the NZSA, by requiring compliance with those standards when the actuary prepares the financial condition report. PS1 and GN5 (see paragraph 13.3) do not have any legal recognition. All NZSA members are expected by the NZSA's Code of Conduct to comply with PS1. GN5 is a guidance note that NZSA members should use when advising on solvency (the requirement in the Code is to "pay proper regard to" guidance notes). See chapter 15 for further discussion of the issues relating to the actuarial professional.

Q50 Should the financial condition report required under the Life Act be required to be prepared in accordance with PS1?

Q51 Should GN5 be given statutory recognition by requiring compliance with it when an actuary advises on solvency for the purposes of the Financial Reporting Act and Life Act?

Q52 Are there other ways that solvency and/or capital adequacy standards could be incorporated into New Zealand's life insurance regime? For example, a body such as the Australian Life Insurance Actuarial Standards Board could be established with the power to set standards with which all actuaries must comply, or this role could be given to the (New Zealand) Accounting Standards Review Board.

Actuarial audit of financial condition report

13.39 It could be a requirement that an independent approved actuary (possibly a long-standing member of the NZSA) undertake an actuarial audit of each financial condition report. The audit report could be delivered to the board of the life insurer, or to the board and the Government Actuary or another Government regulator. This would provide a means whereby an independent, experienced actuary could review the financial condition report, providing a safety check on the work of the first actuary.

Q53 Should there be a requirement for an actuarial audit of the financial condition report? If so, who should undertake the audit and who should receive the audit report?

Time for filing actuarial abstract

13.40 The actuarial abstract required under the Life Act has to be filed within nine months after balance date. There could be merit in requiring an earlier filing of the abstract. Reports are required to be filed under the Financial Reporting Act within five months of balance date.

> Q54 Should the actuarial report required under the Life Act (whether it be the existing abstract or an expanded report) have to be filed earlier than nine months after balance date? If so, what is an appropriate time limit?
>
> Q55 Should there be a requirement for more regular (possibly three-monthly) reporting by actuaries to the board and/or to a Government regulator?

Application of Official Information Act 1982

13.41 The Government Actuary has no protection from requests under the Official Information Act 1982 for the release of material received by him or her under the Life Act. If the Government Actuary wishes to view the full financial condition report, there is a risk that he or she could be required to disclose it. By comparison, the Government Actuary has protection from requirements to produce or divulge information in his or her possession under the Superannuation Schemes Act (see section 26 of that Act).

> Q56 Should the Government Actuary be entitled to refuse a request under the Official Information Act for disclosure of a financial condition report or other commercially sensitive information received in the course of his or her review of a life insurer's operations?

Power of Government entity to set prudential standards

13.42 The Government Actuary or another entity (for example, the Accounting Standards Review Board) could be given the power to set or approve prudential standards on matters such as valuation of assets, calculation of technical provisions, use of derivatives and accounting for reinsurance. The IAIS Principles require the supervisor to have the power to set prudential standards with respect to such matters, in particular:

- in relation to assets, on issues such as diversification, valuation, liquidity, limits on types of investment, safekeeping and appropriate matching of assets and liabilities;
- in relation to liabilities, on issues such as how technical provisions are to be calculated, what is to be included as a liability and the amount of credit allowed for reinsurance;
- in relation to the use of derivatives, on issues such as restrictions on the use of derivatives, disclosure requirements and requirements for controls on and monitoring of derivative positions; and
- in relation to reinsurance, on issues such as addressing the amount of credit taken for insurance ceded, (which must reflect an assessment of ultimate collectability of reinsurance recoverables).

Prudential standards could also be set on matters such as solvency, capital adequacy and management capital (that is, capitalisation outside the statutory fund or life insurance business), as has been done in Australia. These standards could, for example, incorporate the standards already set by the NZSA.

> Q57 Should the Government Actuary or another entity be given the power to set standards on any or all of the matters set out in paragraph 13.42 or any other matters relating to the business of life insurance?

Increased powers of inspection

13.43 The Government Actuary has very limited powers to investigate a life insurer with whom there are concerns. The Government Actuary may, via the report made to the Minister, ask the Registrar of Companies to request more information under section 21 of the Life Act. If information is not forthcoming, it is possible for the Registrar to initiate an investigation under the Corporations (Investigation and Management) Act 1989 or the Insurance Companies (Ratings and Inspections) Act 1994, but this requires a reasonably high level of concern about the life insurer. Similarly, judicial management proceedings (under the Life Act) would be initiated only when there were serious concerns about a life insurer's solvency. In respect of some aspects of life insurance, the Securities Commission has an investigative role. The Securities Commission may carry out inspections of any issuer, for the purposes of the Securities Act or any of the Acts mentioned in Schedule 1 to that Act (which includes the Friendly Societies and Credit Unions Act 1982, but not the Life Act).

> Q58 Does the Government Actuary (or another regulator) require a greater degree of investigative power than already exists under the Life Act (and other Acts)?

Require incorporation in New Zealand

13.44 Every life insurer operating in New Zealand could be required to do so through a company incorporated in New Zealand. APRA requires incorporation in Australia as a condition of registration under the Life Act (Aust). This is presumably to enable easier monitoring of the operations of overseas life insurers operating in Australia and, in particular, the maintenance of adequate capital in Australia. In relation to banks, the Reserve Bank has a policy that:

- all systemically important banks must be locally incorporated; and
- non-systemically important banks must be locally incorporated if they have more than $200 million in retail deposits and come from a jurisdiction that has non-pari passu treatment of foreign creditors[134] or a home jurisdiction that does not have an acceptable standard of disclosure.

Only one bank operating in New Zealand is not compliant with this policy, and the Reserve Bank is in discussion with that bank to determine how it will reach compliance.

---

[134] Non-pari passu treatment of foreign creditors means having laws that give priority to creditors in the home jurisdiction, especially on a winding up.

Q59 Should overseas life insurers operating in New Zealand be required to operate through a company incorporated in New Zealand? If so, why?

Policy-only liability insurance

13.45 One idea suggested in Australia as an alternative to Government regulation is to require all insurers (called "direct insurers") to take out insurance against the risk of insolvency. It is proposed that such insurance would have to be obtained from an offshore insurer. Under such insurance, the offshore insurer would undertake to honour whatever policies are in force when the direct insurer collapses. In return for this undertaking the offshore insurer would be paid a premium by the direct insurer. Further details of how this proposal would work and the reasons for proposing it as an alternative to Government regulation, can be found in an article by Andrew Schmulow.[135]

Q60 Does the concept of policy-only liability insurance as an alternative to Government regulation require further consideration and investigation?

Guarantee fund

13.46 A guarantee system could be established, under which all life insurers contribute (either in advance or at the time of the insolvency) a percentage of premiums to a central fund to be used to assist payments to policyholders in the event of an insolvency of one of them (see paragraphs 7.43 to 7.45 for a description of the compensation scheme that operates in the United Kingdom life industry).

Q61 Should a guarantee system be established along the lines set out in paragraph 13.46 (or in another form) to assist payments to policyholders in the event of a life insurer insolvency?

Bring friendly societies under the Life Act

13.47 Friendly societies that offer life policies are excluded from the operation of the Life Act, by virtue of the definition of "company" in that Act. They are regulated by their own Act (the Friendly Societies and Credit Unions Act 1982) which requires such things as a trustee to hold the society's property. The Securities Act and Financial Reporting Act requirements apply if the society issues life policies to the public. There are limits on the dollar amounts that may be paid out on life policies issued by friendly societies.

Q62 Should friendly societies be brought within the ambit of the Life Act?

[135] Adv AD Schmulow "Policy-Only Liability Insurance as alternative to Prudential Regulation". This article will appear in the next edition of the *Australian Journal of Corporate Law* (Vol 16, No 10, due December 2003/January 2004). Adv Andrew D Schmulow can be contacted at andy.schmulow@rmit.edu.au.

Other measures

Q63 Are there any other measures that should be taken to increase the prudential supervision of life insurers in New Zealand?

Q64 Are there any other issues in relation to financial safety that have not been addressed (for example, the possibility of a two-tiered system of regulation that recognises that different financial safety issues may apply to larger insurers (who are likely to be subject to offshore regulation) as compared with smaller insurers)?

Chapter 14
Reinsurance

INTRODUCTION

14.1 Most, if not all, life insurers in New Zealand use reinsurance to some degree as a form of risk management. Traditionally, New Zealand life insurers have used either United Kingdom-based reinsurers, such as Mercantile & General Reinsurance (now owned by Swiss Re), or European-based reinsurers, such as Swiss Re, Cologne Re, Hanover Re and Munich Re. (Cologne Re was recently sold to Gen Re, a subsidiary of Berkshire Hathaway Inc, based in the United States.) See paragraphs 4.45 to 4.49 for a discussion of reinsurance in New Zealand and types of reinsurance arrangements.

Existing legislation and IAIS Principles

14.2 The regulation of life reinsurance in various countries, and the IAIS Principles relating to reinsurance, are set out in parts 2 and 3 of this discussion paper, and summarised in the comparative table in Appendix B.

New Zealand

14.3 In New Zealand:

- Reinsurers are required to comply with certain provisions of the Life Insurance Act 1908 ("Life Act"), including the deposit requirements under section 3, and the requirements to file financial statements and an actuarial report required by that Act (excluding the statement of policies required by section 78). If the reinsurer is not registered under the Companies Act 1993, it must make a register of shareholders available, as well as its constituting documents. Reinsurers established outside New Zealand must, before doing business in New Zealand, appoint a general agent in New Zealand. The judicial management provisions of that Act appear to apply to foreign reinsurers.
- If a reinsurer operates in New Zealand through a subsidiary, the subsidiary is subject to New Zealand financial market integrity legislation, (including the Companies Act, Financial Reporting Act 1993, Crimes Act 1961 and Commerce Act 1986, but excluding the Securities Act 1978 because they are not issuing to the "public").
- If a reinsurer operates in New Zealand but not through a subsidiary, the New Zealand regulation it is subject to (in addition to the Life Act) depends on whether the reinsurer is "carrying on business" in New Zealand. If it is, it must register under the Companies Act, provide annual returns and comply with the Financial Reporting Act. The Companies Act does not define what constitutes "carrying on business" in New Zealand. It states (in section 332) that establishing or using a share transfer office in New Zealand and administering or dealing with property in New Zealand constitutes "carrying on business". Certain activities do

not constitute "carrying on business", such as holding a directors' meeting, being party to legal proceedings, investing funds or conducting an isolated transaction. If a reinsurer has a branch office in New Zealand, it will be carrying on business in New Zealand.

- Financial Reporting Standard No. 34 ("FRS-34") (see paragraphs 5.90 to 5.93) includes provisions on accounting for reinsurance (other than purely financing types of reinsurance). These provisions describe how premiums ceded and claims recoverable are to be treated. FRS-34 requires actuarial input, in particular, in calculating policy liabilities and solvency reserves.
- The New Zealand Society of Actuaries' ("NZSA's") Professional Standard No. 1 (see paragraph 4.75) requires the actuary's report to describe any reinsurance arrangements that are material, and comment on their adequacy and appropriateness.
- NZSA's Guidance Note No. 5 ("GN5") (see paragraph 4.75) states that, in determining the prudential reserving liability, the actuary should make proper allowance for reinsurance. The actuary may reduce the liabilities in respect of policies by taking full account of reinsurance when reinsurance is through companies that maintain prudential reserves in accordance with GN5 or legislative requirements in the United Kingdom, the United States, Australia, Canada or Europe, or that have been assigned a credit rating by certain credit rating agencies.
- A life insurer's actuary, in general terms, examines the insurer's reinsurance arrangements each year and assesses whether they are satisfactory. This involves looking at the nature of the reinsurance arrangements, as well as the substance of the reinsurer. In practice, the actuary considers both financing reinsurance arrangements and risk transfer reinsurance arrangements. The actuary's full financial condition report is provided to the life insurer's board, and any concerns the actuary might have about the reinsurance arrangements are conveyed to the board. Parts of the financial condition report (being a summary prepared in accordance with GN5) are included in the financial statements filed under the Financial Reporting Act (and are publicly available through the Registrar of Companies). Parts of the report (being the abstract prepared for the purposes of the Schedule 6 of the Life Act) are submitted to the Ministry of Economic Development and Government Actuary under that Act.

Australia

14.4 In Australia:

- Life insurers are required under the Life Insurance Act 1995 ("Life Act (Aust)") to provide an annual reinsurance report to APRA. A prudential rule sets out the particulars of such reports, which include the details of the reinsurance company, the types of reinsurance provided, the main features of the contract, the kinds of policies reinsured and the extent of the reinsurance cover. This report must be accompanied by the appointed actuary's opinion on whether the reinsurance arrangements are adequate and effective. In addition, certain classes of reinsurance contract can be entered into only with APRA's approval. Generally, this applies to reinsurance contracts providing for some form of financing between the reinsurer and the life insurer. In addition, under section 116(2), a

life insurer must not enter into a reinsurance arrangement unless the appointed actuary has given the insurer written advice as to the likely consequences of the proposed arrangement.

- Reinsurers must register under the Life Act (Aust) if they undertake liability under a life policy. This requires the reinsurer to have a subsidiary incorporated in Australia, maintain a statutory fund, comply with capital adequacy and solvency standards, and comply with all the other provisions of that Act.

IAIS Principles

14.5 Principle 10 of the IAIS Principles recognises that life insurers use reinsurance as a means of risk containment. The Principle requires that the insurance supervisor be able to review reinsurance arrangements, assess the degree of reliance placed on those arrangements, and determine the appropriateness of such reliance. Insurers are expected to assess their reinsurers' financial positions to determine an appropriate level of exposure to them. In particular, the supervisor should set requirements with respect to reinsurance contracts addressing the amount of credit taken for reinsurance ceded.

14.6 The Revised IAIS Principles go further. They state that the most important tool used by life insurers to transfer risk is reinsurance. ICP19 requires each insurer to have a reinsurance strategy approved by its board that is appropriate to its overall risk profile and capital. The supervisor is to ensure the reinsurance programme is appropriate to the level of capital and risk profile of the insurer, and that the reinsurer's protection is secure. This could be done by supervising reinsurers directly or obtaining collateral from reinsurers.

Lessons from HIH

14.7 Based on the findings of the HIH Royal Commission,[136] it would appear that one of the major reasons why the HIH Insurance Group collapsed in March 2001 leaving a deficiency of liabilities over assets of between A$3.6 billion and A$5.3 billion, was that there was serious underprovisioning for liabilities. HIH used reinsurance, but the reinsurance arrangements it had were described as "alternative risk-transfer" products. These products were somewhere in the spectrum between traditional risk transfer type reinsurance, and a pure funding product such as a debt facility. These types of non-traditional, financial reinsurance products are often tailored to cover the specific requirements of the reinsured. These products can be directed at protecting key balance sheet ratios and stabilising revenue and profit (this was the situation in HIH). In other words, the purpose of the reinsurance is to improve the appearance of the balance sheet. Usually an element of risk transfer is included, so as to give the appearance of being reinsurance and to comply with accounting standards. Both FAI (taken over by HIH in 1998) and HIH used reinsurance in this way, with the effect that the extent of FAI's (and HIH's) underreserving problems were concealed.

14.8 One of the reinsurance arrangements entered into by HIH, accounted for as true reinsurance, was not reinsurance but a complex funding arrangement where much of the risk was borne by HIH. The auditors accepted the arrangement as reinsurance, but

[136] The Royal Commission, led by The Hon Justice Owen, which reported on the reasons for the failure of the HIH Insurance Group.

were not told all of the arrangement's details. In another reinsurance arrangement, risk was transferred from HIH's United Kingdom branch, via a European reinsurer, to a subsidiary of HIH in Australia, allowing the United Kingdom branch to report lower taxable income, and the Australian subsidiary to report higher income. It also allowed the United Kingdom branch to improve its balance sheet.

14.9 The HIH Royal Commission looked at how reinsurance is treated under the relevant Australian accounting standard, and noted the importance of there being a real degree of risk transfer. The Commission also stressed the importance of looking at the economic substance of reinsurance arrangements, rather than their form.

POSSIBLE AREAS FOR REFORM

14.10 Areas where New Zealand's existing law may be unsatisfactory in relation to reinsurers, and possible solutions, are set out below.

> Q65 Reinsurers – Are there areas other than those set out in paragraphs 14.11 to 14.22, where New Zealand's existing law may be unsatisfactory in relation to reinsurers?

14.11 In considering these areas, it may be necessary to distinguish between savings policies, renewable risk only policies and non-renewable risk only policies, and between different kinds of policies within those classes (such as short and long term policies), as different considerations may apply to different classes and/or kinds of policies. For example, the case for supervision of reinsurance, which is part of financial safety regulation, may be strongest in relation to long term savings policies, where insureds are least able to switch easily from one insurer to another, the potential adversity caused by breach of the promise is more intense, and the relationship is a long term one, with the insured relying on the insurer to maintain financial soundness often for many years before the policy matures. In relation to renewable risk only policies, the case may also be strong, because the insured can become locked into a relationship with one insurer by virtue of deteriorating health. The case for increased supervision may be weaker in relation to non-renewable risk only policies.

Reinsurance arrangements

Possible problem

14.12 The HIH experience may indicate that reinsurance arrangements made by life insurers require closer scrutiny from an independent person acting in the interests of policyholders.

Options for addressing possible problem

14.13 Options for addressing the above problem include:

- continue as at present;
- follow the Australian approach;
- require life insurers to obtain credit ratings;

- allow life insurers to enter into reinsurance arrangements only with approved or rated reinsurers.

Continue as at present

14.14 To continue as at present involves relying on each life insurer's actuary to review reinsurance arrangements each year-end and report on them in the financial condition report. The insurer's board would receive the full report. The Government Actuary and MED would receive an abstract of that report, in the form of Schedule 6 of the Life Act, which does not include detailed information about reinsurance arrangements. The Registrar of Companies would receive some of the report via the requirements of the Financial Reporting Act (but again, this is unlikely to include detailed information about reinsurance arrangements) and this material would become publicly available.

Follow Australian approach

14.15 Following the Australian approach involves requiring a regulatory body (either an existing one, such as the Government Actuary, or a new entity) to review the reinsurance arrangements of each life insurer in some detail. Annual reinsurance reports would be required, probably accompanied by an actuarial opinion on the adequacy of those arrangements. The regulatory body could also have the power to require prior approval to certain types of arrangements.

Require life insurers to obtain credit ratings

14.16 If a life insurer was credit rated, the extent and quality of its reinsurance arrangements would be taken into account. Also, if rating agencies rate the reinsurers as well, they may be in a good position to assess the adequacy of reinsurance arrangements.

Allow life insurers to enter into reinsurance arrangements only with approved or rated reinsurers

14.17 Allowing life insurers to enter into reinsurance arrangements only with approved or rated reinsurers would involve allowing life insurers to enter into reinsurance arrangements only with reinsurers that have an acceptable rating or are approved by the Government Actuary or other regulator. (Note that the changes agreed by Cabinet to the Insurance Companies (Ratings and Inspections) Act appear to have the effect of requiring reinsurers who are carrying on business in New Zealand to obtain ratings (see chapter 17)).

Q66 Reinsurance arrangements – Do you have any comments on the problems and options in paragraphs 14.12 to 14.17? Are there any other problems or options we have not considered?

Regulation of reinsurers

Possible problem

14.18 Because all major reinsurers operating in the New Zealand life insurance market are overseas-based companies, it may be difficult for a New Zealand regulator to regulate the New Zealand reinsurance market. On the other hand, leaving this market

unregulated may give rise to a large loophole in any regulation of New Zealand life insurers, because reinsurance can be structured in any way that the life insurer and reinsurer agree.

Options for addressing possible problem

14.19 Options for addressing the above problem include:

- continue as at present;
- follow the Australian approach;
- require reinsurers to obtain credit ratings or otherwise be subject to a system of approval by a Government regulator.

Continue as at present

14.20 Continuing as at present involves continuing the existing requirements for reinsurers to file certain financial information and an abstract of a financial condition report under sections 16 to 28 of the Life Act. The filed statements and abstract would continue to be reviewed by the Government Actuary, and policyholders could continue to request to see them. In addition, reinsurers that are "carrying on business" in New Zealand would continue to file financial statements under the Financial Reporting Act.

Follow Australian approach

14.21 Following the Australian approach involves a system of closer supervision of reinsurers by a Government regulator (such as the Government Actuary). Reinsurers could be required to incorporate in New Zealand, maintain a statutory fund for all reinsurance business relating to New Zealand, and be subjected to ongoing supervision, monitoring and investigations by the regulator.

Require reinsurers to obtain credit ratings or otherwise be subject to a system of approval by a Government regulator

14.22 A further possibility involves requiring all reinsurers to obtain a credit rating from an international credit rating agency, or otherwise to obtain approval from a Government regulator such as the Government Actuary. See chapter 17 for discussion of the issues relating to the use of credit ratings and credit rating agencies.

Q67 Regulation of reinsurers – Do you have any comments on the problems and options in paragraphs 14.18 to 14.22? Are there any other problems or options we have not considered?

Chapter 15
Regulation of actuarial profession

Introduction

15.1 As noted in paragraphs 4.37 to 4.44, actuaries have a very important role in the life insurance industry. In particular, actuaries have statutory roles under various Acts. However, unlike many other professions, the actuarial profession is not regulated in New Zealand.

Actuarial profession in New Zealand

15.2 There are 101 qualified actuaries practising in New Zealand.[137] All of these actuaries belong to the New Zealand Society of Actuaries ("NZSA"), which is a self-regulated professional body.

15.3 Actuaries are not obliged by any law to belong to the NZSA, but the definition of the term "actuary" and the reservation of certain duties to actuaries as so defined in various Acts gives them every incentive to do so. For example:

- the Superannuation Schemes Act 1989 states that an actuary is a person qualified as a Fellow of the New Zealand Society of Actuaries;
- the Friendly Societies and Credit Unions Act 1982 states that an actuary is a person qualified as a Fellow of the Institute of Actuaries of London, the Faculty of Actuaries of Scotland or the Institute of Actuaries of Australia, or a person who has other qualifications as an actuary subject to the approval of the Registrar of Friendly Societies and Credit Unions; and
- the National Provident Fund Restructuring Act 1990 states that an actuary is a person who is a Fellow of the New Zealand Society of Actuaries.[138]

It is worth noting that, in Australia, the Life Insurance Act 1995 ("Life Act (Aust)") states that a person is eligible for appointment as a life insurer's actuary if the person is ordinarily resident in Australia, is a Fellow of the Institute of Actuaries of Australia and has been such a Fellow for at least five years. Alternatively, APRA may approve the appointment of a person as actuary for a life insurer.

15.4 Most New Zealanders who embark on an actuarial career first obtain employment as an actuarial trainee, and study for the examinations while they are working. Employers will usually require an actuarial trainee to have at least a university bursary qualification

---

137 Information obtained from the New Zealand Society of Actuaries.

138 The term "actuary" is not defined in the Life Insurance Act 1908, Financial Reporting Act 1993 or Securities Act 1978.

with grades of at least 70 per cent in maths with calculus or statistics. They will generally also expect a degree, with B-average grades in maths or statistics.[139]

15.5 To begin studying as an actuary, applicants must join the NZSA. Membership of the NZSA requires an actuary to be a Fellow of the Institute of Actuaries (UK), the Institute of Actuaries of Australia or the Canadian or US examining bodies. Student actuaries must pass professional exams that take between 5 and 8 years to complete. All examinations from overseas bodies may be sat in Auckland or Wellington. The NZSA is not an examining body, although it does assist student actuaries in their studies.

15.6 The NZSA issues professional standards and guidance notes in relation to various matters, including life insurance business. These standards are set for use by NZSA members when advising insurers rather than for the insurers themselves. The standards and guidance notes have no legal standing, but the actuarial profession generally complies with them (see paragraph 13.38, where the possibility of giving legal force to these requirements is discussed).

15.7 The NZSA has a Code of Conduct with which all members practising in New Zealand must abide. The Code is a statement of the principles to which the NZSA expects all members to conform in the spirit as well as the letter. The Code deals with actuaries' relationships with clients and other actuaries, independence, formulation of advice and publicity. The Code also deals with procedures in the event of a complaint concerning professional ethics or conduct. The Code provides that the Professional Conduct Committee may set in motion disciplinary procedures for alleged breaches of the Code (see paragraph 4.74).

15.8 The NZSA also provides a source of reference on actuarial matters for Government and various official and interested bodies, provides a formal link with other actuarial bodies elsewhere in the world and promotes fellowship among the actuarial profession.

15.9 The NZSA is a very small organisation with a small membership, and as a result is not as well resourced as other self-regulatory bodies, such as the New Zealand Law Society and the Institute of Chartered Accountants.

15.10 The NZSA is not an examining body and potential actuaries must obtain their qualifications from overseas faculties.

15.11 Disciplinary procedures within the NZSA have no external oversight.

Regulation of actuarial profession in other jurisdictions

Australia

15.12 The Institute of Actuaries Australia ("IAA") is the sole professional body representing the actuarial profession in Australia. Under the Life Act (Aust), the appointed actuary must be a member of the IAA, or APRA may approve the appointment (see paragraph 15.3).

---

[139] Information obtained from the New Zealand Society of Actuaries website (www.actuaries.org.nz)

15.13 The IAA represents the interests of its members within Government, the business community and the general public. This is achieved through the activities of members in their roles as IAA councillors or members of council-appointed special professional committees. Working within this structure, the IAA is able to directly influence Government legislation that relates to the Life Act (Aust), superannuation and other areas of actuarial interest.

15.14 The IAA is committed to maintaining the quality, integrity and high professional standard of practising actuaries, and has established a Code of Conduct requiring the development and review of professional standards. A disciplinary process has been established to enforce adherence to the Code and the standards.

15.15 The IAA also provides pre-qualification and continuing professional education, creates forums for discussion about contemporary issues, promotes research and the development of actuarial science, and contributes to and informs the debate on public policy.

United Kingdom

15.16 The Institute of Actuaries in England and the Faculty of Actuaries in Scotland work closely together as the Actuarial Profession, the sole professional body representing the actuarial profession in the United Kingdom. Appointed actuaries must be Fellows of either the Institute or the Faculty. The Actuarial Profession is a self-regulated organisation and, except as mentioned in paragraph 15.17, the Government has no oversight role in relation to the Profession's conduct of its business.

15.17 A Royal Charter underlies the existence of the Institute, and any changes the Institute may wish to promote to the Charter have to be approved by the Privy Council Office (which is part of the UK Government).

15.18 The Institute and the Faculty are each governed by a council but almost all the work for the profession is managed jointly through an executive management committee, executive boards and supporting committees, each of which is concerned with one broad area of professional interest. The permanent staff help to formulate policy and work to implement the decisions reached by the councils, boards and committees.

15.19 The Life Board (which is one of eleven boards and Faculty/Institute committees) oversees the profession's concern with all actuarial matters related to life insurance business. Because of the wide range of these matters, the board is supported by committees dealing with supervision, regulation, accounting issues, education and continuing professional development, research and the Continuous Mortality Investigation Bureau.

15.20 The councils of the Faculty of Actuaries and Institute of Actuaries issue a Manual of Actuarial Practice, which contains advice on professional conduct and guidance notes on technical aspects. Actuaries must also comply with professional requirements in the Faculty or Institute by-laws, guidance notes and professional conduct standards that require them to maintain high standards of professional practice, ethics and conduct.

15.21 The profession has developed disciplinary procedures in order to enforce its professional requirements. The disciplinary procedures include:

- investigating inquiries and complaints about the professional work of actuaries who are members of the Faculty or Institute;
- deciding whether there has been professional misconduct as defined in the disciplinary schemes of either the Faculty or the Institute and, if so, applying an appropriate sanction, which may include admonishment, suspension or expulsion from membership, withdrawal or suspension of the actuary's practising certificate or payment of a fine.

POSSIBLE AREAS FOR REFORM

Possible problems

15.22 It is unusual for a New Zealand profession to be completely unregulated. Other professions, such as law, medicine and, to a lesser extent, accounting, are heavily regulated by statute. Matters such as standards for entry to the profession, the form and governance of the professional body, practice rules and ethical standards and disciplinary processes are prescribed by or subject to the approval of the Government or Parliament.

15.23 Regulation of the professions can be justified on the basis that the awarding by Parliament of a privilege to a section of society (such as the grant of a monopoly over certain kinds of work, as is often the case with professions) should be accompanied by Government or Parliamentary control over the activities of the profession and its members. At the very least, if certain functions or duties are to be reserved by legislation for members of a profession, the Government or Parliament should have some say in the setting of standards for performance of the functions or duties and in the establishment of a disciplinary process for members who fail to meet those standards.

15.24 It is suggested in paragraphs 13.33 to 13.36 that legislation could be enacted to require that certain functions and duties be performed by actuaries. If this suggestion is accepted, it will raise two questions:

- What should the definition of "actuary" be?
- Should the actuarial profession whose members are within this definition be regulated by legislation or the Government?

15.25 Regulation of actuaries must be in accordance with New Zealand's international obligations under the General Agreement of Trade in Services ("GATS") (see chapter 9). Under GATS New Zealand has made commitments to treat foreign service suppliers of actuarial services on terms no less favourable than New Zealand service providers ("national treatment") and to allow them access to the New Zealand market ("market access") (see paragraph 9.15). An example of a national treatment limitation could be a requirement that actuaries are New Zealand citizens or residents. Examples of market access limitations could be limits on the total number of actuaries (New Zealanders or foreigners) that can provide actuarial services, or a requirement that actuarial firms must have 50 per cent New Zealand ownership. The Australia New Zealand Closer Economic Relations Trade Agreement (CER) may also be relevant (see further paragraphs 9.21 to 9.26).

Options for addressing possible problems

15.26 With regard to the first question, the most obvious answer is to define an "actuary" as a Fellow of the New Zealand Society of Actuaries. In addition, or as another option, an "actuary" could be defined as a person approved for this purpose by the Government Actuary or another Government regulator (this would allow overseas actuaries to practise in New Zealand), and this regulator could be empowered to revoke approval of any person on specified grounds.

15.27 For the reasons given in paragraphs 15.22 to 15.25, if the term "actuary" is defined by reference to membership of the NZSA, it would seem desirable for the NZSA to be regulated. Possible models for regulation include:

- Establishing a statutory body similar to the New Zealand Law Society or the Institute of Chartered Accountants. The statutory body would have a governing board consisting mainly of actuaries, but also possibly with lay members and/or Government representatives. The statutory body would set rules about the qualifications of actuaries, actuarial standards, and disciplinary processes, etc. Some or all of the rules may require Government approval, or be subject to disallowance by Parliament under the Regulations (Disallowance) Act 1989.
- Retaining the existing incorporated society structure of the NZSA, but introducing legislation to require it to have lay members or Government representatives on its governing board, and also to have rules about matters such as the qualifications of actuaries, actuarial standards and disciplinary processes. Some or all of the rules may require Government approval, or be subject to disallowance by Parliament under the Regulations (Disallowance) Act.
- Retaining the existing self-regulatory structure of the NZSA, perhaps with the Government having an opportunity to comment on or suggest proposed standards and rules in the future and/or Parliament being authorised by legislation to disallow NZSA standards or rules under the Regulations (Disallowance) Act.

Q68 Regulation of actuarial profession – Do you have any comments on the problems and options in paragraphs 15.22 to 15.27? Are there any other problems or options we have not considered?

Chapter 16
Cross border issues

INTRODUCTION

16.1 As noted in chapter 4, much of the life insurance provided in New Zealand is provided by insurers incorporated or owned overseas. Furthermore, some New Zealand incorporated or owned insurers provide life insurance outside New Zealand.

16.2 This gives rise to the following issues:[140]

- What is the intended scope of the New Zealand life insurance regime?
- Are special rules required for civil claims and criminal offences with cross border elements?
- Will any New Zealand life insurance regulator be able to perform its role effectively in cross border cases?
- Should the regime provide for recognition or enforcement of overseas regulatory decisions in New Zealand or vice versa?
- Should the regime provide for recognition of overseas regulatory regimes, and to what extent should overseas regulation mitigate the need to comply with a system of New Zealand regulation?

16.3 In discussing these cross border issues, the following objectives are likely to be relevant:

- Ensuring that no foreign law discriminates unfairly against the New Zealand policyholders of an overseas insurer.
- Ensuring that overseas insurers operating in New Zealand are subject to any New Zealand regulatory regime.
- Not discouraging overseas insurers from operating in New Zealand. This may require that the New Zealand regime is not onerous compared with other, offshore, supervisory regimes (particularly the Australian regime), and raises the possibility of offering a streamlined procedure for offshore life insurers whose New Zealand operations are already supervised effectively (to standards at least as high as New Zealand's) in their home jurisdiction (such as Australia).
- Ensuring a New Zealand regulator has responsibility for "guarding the gate" in New Zealand to ensure assets are not flowing out in order to protect the interests of offshore policyholders.
- Ensuring New Zealand-owned life insurers, to the extent that they operate offshore, have to comply with only offshore regulation.

---

140 See the Legislation Advisory Committee *Guidelines on Process and Content of Legislation* (2001 edn and 2003 Supplement), chapter 16.

- Ensuring New Zealand policyholders of overseas life insurers are able to enforce their legal rights against those overseas life insurers.

16.4 Further issues that arise out of these objectives include:

- how to treat overseas life insurers who provide services via the internet and do not have any other operations here;
- whether there should be requirements on life insurers to maintain day-to-day records in New Zealand to facilitate monitoring and investigation by a New Zealand regulator;
- the need for good co-operation between regulators of different countries, to facilitate information sharing, access to offshore records and so on.

Existing law and IAIS Principles

16.5 The comparative table set out in Appendix B (clause 5) shows that:

- existing New Zealand legislation already addresses some cross border issues;
- other countries, in particular Australia, have legislation that addresses some cross border issues;
- there are various IAIS Principles that relate to cross border issues.

16.6 Various treaties and international agreements also deal with aspects of the cross border issues (see paragraphs 9.1 to 9.27). In addition, the common law includes many rules dealing with these issues.

16.7 An interesting development has been Part 5 of the Securities Act 1978, which came into force on 1 December 2002. The purpose of this Part is to enable recognition and application regimes to be implemented:

- providing for exemptions from requirements of the Securities Act, so issuers may offer securities in New Zealand in accordance with the securities laws of designated countries;
- extending the territorial scope of various provisions of the Securities Act so that issuers may offer securities in designated countries in accordance with New Zealand securities laws, and investors in those countries may rely on and enforce those laws;
- providing for enforcement in New Zealand of fines and pecuniary penalties imposed for breaches of securities laws of designated countries.

It should be noted that international law issues arise here (see paragraphs 9.1 to 9.27) – in particular, whether such a regime for one or more (but not all) countries would amount to preferential treatment and, if so, whether that is permitted.

POSSIBLE AREAS FOR REFORM

16.8 Areas where New Zealand's existing law may perhaps be unsatisfactory in relation to life insurance cross border issues, and possible options for addressing these possible problems are set out below.

16.9 In considering these areas, it may be necessary to distinguish between savings policies, renewable risk only policies and non-renewable risk only policies, and between different

kinds of policy within those classes (such as short and long term policies), as different considerations may apply to different classes and/or kinds of policy.

> Q69 Are there areas of possible reform in relation to cross border issues that are not mentioned in paragraphs 16.10 to 16.32?

Differences in treatment of foreign versus domestic policyholders by overseas law and regulators

16.10 It is possible that foreign law relating to an overseas incorporated life insurer could discriminate between the domestic and New Zealand policyholders of that insurer. For example, as noted in the comparative table in Appendix B, Australia requires a separate statutory fund for offshore business, and non-UK policyholders are unlikely to have access to the UK financial services compensation scheme.

Possible problems

16.11 The possibility of New Zealand policyholders being discriminated against by overseas law is real. An extreme example, which is the case with Australian banking law (but not Australian life insurance law), would be for the overseas law to rank New Zealand policyholders behind the overseas domestic policyholders in the winding up of an overseas life insurer. Other examples of discrimination could be overseas law as to the allocation of profits or determination of surrender values that applied only to the domestic policyholders' policies, and not those of overseas policyholders.

16.12 If there is discrimination in overseas law against New Zealand policyholders, New Zealand policyholders should at the least know about this discrimination. In the case of savings policies, the investment statements issued to New Zealand policyholders under the Securities Act should identify the discriminatory laws, but this disclosure will not have been made to policyholders who took out their policies before the commencement of the investment statement regime (1997). Apart from the investment statement and prospectus requirements under the Securities Act (which do not apply to risk-only policies), there do not appear to be any legal requirements obliging overseas life insurers to advise New Zealand policyholders of discriminatory provisions in overseas law (although the Fair Trading Act 1986 prevents misleading statements by life insurers).

16.13 Another issue is that overseas regulators may be more concerned about the level of solvency of life insurers in their own jurisdiction, than of those in offshore jurisdictions. For example, there is no adequate New Zealand regulatory supervision of the transfer of assets from New Zealand in order to meet the solvency requirements of offshore regulators.

Options for addressing possible problems

16.14 One option would be to require all overseas life insurers operating in New Zealand to disclose to New Zealand policyholders any overseas laws that would discriminate against those policyholders.

16.15 Another option would be to require all overseas life insurers to operate in New Zealand only through a company incorporated in New Zealand (see paragraph 13.44). Such a

requirement would mean that the life insurer operating in New Zealand was subject to New Zealand law rather than to overseas law. As noted in paragraph 13.44, Australia has such a requirement in relation to overseas life insurers.

16.16 Neither of these options would fully address the issue identified in paragraph 16.13. One way to supervise such transfers would be to have a New Zealand regulator who monitors the solvency of all insurers who operate in New Zealand, and to require solvency levels in New Zealand that are no less adequate than those required by offshore regulators.

> Q70 Differences in treatment of foreign versus domestic policyholders by overseas law and regulators – Do you have any comments on the problems and options referred to in paragraphs 16.10 to 16.16? Are there are any problems or options we have not considered?

Taking action against overseas insurers who operate in New Zealand

16.17 Sections 34 to 38 and 79 of the Life Insurance Act 1908 ("Life Act") provide that overseas life insurers must appoint a general agent in New Zealand (on whom lawful process may be served), state in their policies that they will abide by decisions of the New Zealand courts, keep a separate account of New Zealand life business and of assets in New Zealand, and prepare and file separate statements of New Zealand business. In Australia, section 31(c) of the Life Insurance Act 1995 ("Life Act (Aust)") provides that a life company carrying on life business outside Australia must maintain a separate statutory fund for that business (see paragraph 6.66 for the exceptions to this rule).

Possible problems

16.18 It may be more difficult for New Zealand policyholders, creditors and a regulator to take and enforce action against an overseas incorporated life insurer than against a New Zealand incorporated insurer. For example, directors and management may not live or work in New Zealand.

16.19 On the other hand, overseas life insurers should not be discouraged from operating in the New Zealand market. As noted in chapter 4, the majority of life policies issued in New Zealand are issued by overseas incorporated or owned insurers.

Options for addressing possible problems

16.20 The most obvious option is to follow the Australian regime and require every overseas life insurer operating in New Zealand to operate through a New Zealand incorporated subsidiary. In addition, a majority of directors of the subsidiary could be required to be persons who live and work in New Zealand.

16.21 Another option is to adopt the Canadian model under which branches have parallel legislation to companies or local subsidiaries, and there is a requirement for a separate chief agent to be appointed for branches. Branches are also subject to additional restrictions on assets to be deposited with the regulator and restrictions on capital movements.

Q71 Taking action against overseas insurers who operate in New Zealand – Do you have any comments on the problems and options in paragraphs 16.18 to 16.21? Are there any problems or options we have not considered?

Maintenance of operations and records in New Zealand

16.22 New Zealand does not have any specific legal requirements relating to the maintenance of day-to-day operations and records of life insurers in New Zealand. Companies incorporated in New Zealand have certain obligations to keep records in New Zealand. Full accounting records need not be kept in New Zealand, so long as accounts and returns that disclose "with reasonable accuracy" the company's financial position, and which enable preparation of financial statements required under that Act and the Financial Reporting Act, are kept in New Zealand. The Registrar must be notified of the place where the full accounting recording are kept.[141] As noted in clause 5.4 of the comparative table in Appendix B, Australia requires that certain particulars be kept in Australia and records must be produced within 28 days. The Reserve Bank has been looking at this issue in relation to overseas banks that operate in New Zealand but do not maintain day-to-day records in New Zealand.

Possible problem

16.23 There is an increasing trend for companies to carry out day-to-day processing of transactions and to hold records outside New Zealand. For example, many of the computer processing operations of New Zealand companies are being shifted overseas and call centres for New Zealanders are located outside New Zealand. If this is happening with New Zealand life insurers, practical problems may arise if legal action is taken against the New Zealand life insurer, or an insurer is placed under judicial management or wound up. The records of a financial organisation such as a life insurer are vital in determining the rights and obligations of third parties to and against the organisation.

Options for addressing possible problem

16.24 One option would be to prohibit the carrying on of day-to-day operations or the holding of records outside New Zealand. However, such a requirement may be objected to by life insurers on the grounds that it would reduce their efficiency and/or increase their costs.

16.25 Another option would be to require that copies of all records be kept in New Zealand, and new records be copied to New Zealand within a specified period after their creation.

16.26 Any such legal requirement could also deal with the period for which records must be maintained.

[141] Companies Act 1993, ss 189 and 195.

Q72 Maintenance of operations and records in New Zealand – Do you have any comments on the problem and options referred to in paragraphs 16.23 to 16.26? Are there any problems or options we have not considered?

Offshore branches and subsidiaries of New Zealand life insurers

16.27 Some New Zealand incorporated or owned life insurers operate outside New Zealand. The Life Act applies to New Zealand incorporated life insurers wherever they operate, and section 79 of that Act requires a separate account to be maintained of New Zealand business, as explained in paragraph 5.48. Australian law requires Australian life insurers to have a separate statutory fund for life policies issued to overseas policyholders.

Possible problem

16.28 The question arises whether, in the absence of a reciprocal agreement between New Zealand and another country, New Zealand incorporated life insurers should have to abide by New Zealand law in relation to life policies issued to overseas policyholders. Usually, New Zealand incorporated insurers will have to abide by the law of the country in which the overseas policyholders reside. New Zealand law relating to the incorporation and winding up of a New Zealand incorporated entity would, of course, apply to the New Zealand incorporated life insurer. It would be important to ensure, as far as possible, that a different regulatory regime for policies issued to overseas policyholders did not adversely affect New Zealand policyholders (for example, by allowing adverse effects on solvency of life insurers).

Options for addressing possible problem

16.29 New Zealand could follow the Australian regime and provide that all overseas held life policies are to be kept in a separate statutory fund (see paragraphs 6.66 and 6.67), and consider whether every other requirement of New Zealand law relating to life insurers needs to apply to policies held by overseas persons. The intention would be that, with the exception of the law relating to the incorporation and winding up of the life insurer, generally New Zealand law would not apply to policies held by overseas persons.

16.30 To cover the case where a New Zealand insurer was offering insurance to persons in other jurisdictions via the internet, and without having a business presence in that other jurisdiction, it might be necessary to include in New Zealand law that the insurer must comply with the law of the jurisdiction in which the insurer offers insurance policies.

Q73 Offshore branches and subsidiaries of New Zealand insurers – Do you have any comments on the problem and options referred to in paragraphs 16.28 to 16.30? Are there any problems or options we have not considered?

Foreign insurers acting through brokers in New Zealand

16.31 Under the Insurance Companies' Deposits Act 1953, persons (whether agents or brokers) who negotiate contracts of (non-life) insurance between offshore insurers and New Zealanders, are required to deposit a bond with the Public Trust. There are

proposals to drop the bond requirement for non-life insurers (see paragraphs 17.12 to 17.14). However, the bond requirement is likely to be retained for such agents and brokers. The reasons for this are:[142]

38 Under existing law fly-by-night insurers are free to incorporate overseas, conduct unreliable businesses and sell unreliable policies to New Zealanders, for example through brokers or over the internet, so long as they do not conduct their business in New Zealand.

The government can not control the operations of insurers outside New Zealand. The current requirement that brokers placing business off-shore must lodge a deposit is some slight check on such activities. There is increased potential for abuse if deposits are no longer required from brokers. An unreliable overseas insurer could target vulnerable New Zealand consumers by operating through a broker in New Zealand, thus avoiding the checks imposed on New Zealand insurers by the Ratings Act and imposed on brokers at present by the Deposits Act.

39 Two possible ways to exercise some control over the activities of brokers placing business offshore would be by retaining the requirement for them to lodge deposits or by requiring them to be members of a reputable industry organisation approved by the Registrar of Companies. Membership of a reputable industry organisation is no doubt desirable, but imposing it as a condition of doing business would involve much wider considerations and create the problems associated with protected industry groups. The sanction of losing a deposit is a more direct incentive to brokers to ensure they only deal with reputable insurers overseas.

40 Retaining the requirement for a deposit for brokers would not prevent an unreliable overseas insurer selling insurance direct to New Zealanders, say over the internet, but would discourage such an insurer from targeting New Zealanders through a broker or brokers in New Zealand. It is anomalous, in terms of the scheme of the Ratings Act, but would help to address the potential for abuse that would flow from repealing the Deposits Act entirely.

41 In order to retain the incentive for brokers to deal only with reputable insurers overseas, I recommend that brokers and other agents negotiating or placing insurance offshore should continue to be required to lodge deposits.

16.32 The question arises whether there should be similar requirements for intermediaries placing business with offshore life insurers. Under the Life Act, offshore life insurers are required to deposit a bond with the Public Trust only if they are carrying on business in New Zealand.

> Q74 Foreign insurers acting through brokers in New Zealand – Do you have any comments on this issue, which is discussed in paragraphs 16.31 and 16.32?

---

[142] Report of The Hon Paul Swain, Minister of Commerce, to Cabinet Finance, Infrastructure and Environment Committee, June 2002.

Chapter 17
Other insurance and long term financial products

INTRODUCTION

17.1 In the Terms of Reference, the Law Commission has been asked to consider whether the approach taken to the regulation of life insurers and life insurance products has implications for the regulation of other insurers and insurance products. As noted in paragraph 1.11, life insurance is a financial product that has many similarities with other financial products. In particular, there are similarities with fire and general insurance, health insurance, health-related insurances (such as trauma, disability and income protection) and other non-health related insurance products (such as liability insurance). Some of these insurances are long term and/or renewable and others are short term and non-renewable (as those terms are described in chapter 1), and the appropriate regulatory response may differ as between these two broad classes. In addition, there are other non-insurance long term financial products such as superannuation that, while not specifically within the Terms of Reference, have sufficient similarities with life insurance to make it appropriate for this discussion paper to comment on them.

17.2 It is also important to note that many life insurers provide a range of financial products. It is not unusual for a life insurer to offer, in addition to traditional life insurance, superannuation products (through a trust, the trustee and manager of which may be subsidiaries of the life insurer), unit trust products (again through a trust with a trustee corporation or other approved person as trustee, possibly managed by a subsidiary of the life insurer), and other types of insurance such as disability, trauma and income protection. This raises the question of whether it is sensible to look at the regulation of life insurance in isolation, or whether any regulatory regime should encompass the whole range of financial products offered.

FIRE AND GENERAL INSURANCE

17.3 Fire and general insurance ("general insurance") is a generally short term non-renewable risk only insurance product. Insurance is usually taken out and issued for a year (or less) and at the end of the term neither the insurer nor the insured has any obligation to renew the insurance. Property, like the human body, deteriorates and may become more expensive to insure over time but, unlike life insurance, there is generally no downside for an insured to switch his or her property insurance from one insurer to another (other, perhaps, than the risk of losing a no claims bonus).

17.4 The general insurance market in New Zealand is very lightly regulated. The general insurance industry has developed its own self-regulatory framework. The industry body is the Insurance Council of New Zealand ("ICNZ"), and the self-regulatory framework

includes the Fair Insurance Code, the ICNZ's Solvency Test, and the Insurance and Savings Ombudsman Scheme. The ICNZ comprises 20 members who write approximately 95 per cent of New Zealand's general insurance business. ICNZ members protect approximately half a trillion dollars of New Zealanders' assets. Last year, ICNZ members paid claims of $1.5 billion to New Zealanders.[143]

Financial market integrity regulation

17.5 General insurers operating in New Zealand are required to comply with the Fair Trading Act 1986 and the Consumer Guarantees Act 1993, and are subject to the provisions of the Commerce Act 1986. In addition, companies incorporated in New Zealand and overseas companies carrying on business in New Zealand are required to comply with the Financial Reporting Act 1993 and the Companies Act 1993 (although many important provisions of the latter Act, such as directors' duties, apply only to companies incorporated in New Zealand). General insurers are not subject to the Securities Act 1978 because there is no investment element in a general insurance policy.

Consumer protection issues

17.6 ICNZ members are required to comply with the ICNZ Fair Insurance Code. This Code requires members to act fairly and openly in all their dealings with customers. It requires the provision of suitable information to customers and a certain procedure to be followed in relation to complaints.

17.7 ICNZ members are required to belong to the Insurance and Savings Ombudsman Scheme. The Insurance and Savings Ombudsman is an independent authority. It considers complaints regarding all types of personal and domestic insurance and savings services, provided the amount claimed does not exceed $100 000. This scheme is free for insured people, and the Ombudsman's decision is binding on the insurer involved in the dispute.

17.8 There are some issues concerning the duty of disclosure by the insured. These are discussed in paragraphs 12.63 to 12.70. Note that the Australian legislation in this area goes further in providing protection for consumers.

Financial safety regulation

17.9 The Insurance Companies (Ratings and Inspections) Act 1994 requires all insurers selling general or disaster insurance to:

- obtain a rating from an approved rating agency;
- register that rating with the Registrar of Companies; and
- disclose the rating before entering into or renewing a contract of insurance.

17.10 Insurers who are required to obtain a rating must have a current rating at all times and must renew their ratings annually. New annual ratings must be registered with the Registrar of Companies. A rating is an assessment of an insurer's ability to pay present

[143] Information obtained from the ICNZ website (www.icnz.org).

and future claims,[144] and is represented by letter, number and/or symbol and forms part of a scale. There are two approved rating agencies, Standard and Poor's and A.M. Best. Insurers' ratings are updated quarterly. In addition, the ICNZ requires its members to comply with the Council's Solvency Test. To be an ICNZ member, insurers must maintain a minimum solvency of 20 per cent (that is, a ratio of free reserves/shareholder funds to net written premiums). This solvency ratio is a test of the insurer's ability to pay claims.

17.11 General insurers are also required to make a deposit of $500 000 with the Public Trust under the Insurance Companies' Deposits Act 1953. The obligation rests with all local companies, commonwealth companies and foreign companies carrying on in New Zealand any class of insurance business, excluding marine or life insurance business or insurance against earthquakes. (The Earthquake Commission is the primary provider of earthquake insurance for residential properties up to a specified value.) Mutuals are exempted from this requirement (unless offering employers' liability insurance). A smaller deposit is permitted in certain cases, and special provisions apply to insurers offering mortgage guarantee insurance, professional indemnity insurance and fidelity guarantee insurance. Under section 16, persons required to make the deposit must each year prepare a statement in relation to their business containing the matters prescribed in Schedule 2, which must be audited and deposited within 9 months after the end of the financial year with the Ministry of Economic Development. Schedule 2 requires an underwriting account, which sets out the net underwriting profit or loss for the year; an investment account, which sets out the net investment profit or loss; a profit and loss account; an appropriation account; and a balance sheet.

17.12 In 2001, the Ministry of Economic Development commenced a review of the Insurance Companies' Deposits Act and the Insurance Companies (Ratings and Inspections) Act. In November 2001, the MED issued a consultation paper proposing that:

- the financial reporting requirements in the Insurance Companies' Deposits Act be replaced by an obligation on all insurers (other than life insurers, captive insurers,[145] and reinsurers) to comply with the relevant financial reporting standard (usually Financial Reporting Standard No. 35 ("FRS-35"));
- all insurers (other than life insurers and captive insurers) be governed by the Insurance Companies (Ratings and Inspections) Act and be obliged to obtain ratings;
- the Insurance Companies' Deposits Act be repealed and existing deposits refunded to insurers; and
- some relatively minor modifications be made to the operation of the Insurance Companies (Ratings and Inspections) Act.

---

144 Standard and Poor's rating system has recently changed its terminology. The assessment was previously described as an assessment of "claims paying ability". It is now described as an assessment of an insurer's "financial strength". As advised by Standard and Poor's, this is a more accurate description of what the rating criteria look at (and have always looked at).

145 Captive insurers are insurers which are controlled by a single company or group of companies and which provide insurance only to that single company or group.

17.13 On 17 June 2002, Cabinet agreed to the following:[146]

> The following changes will be made to the Insurance Companies (Ratings and Inspections) Act 1994. These will take effect after a two-year transition period:
>
> - all insurers (other than captive and life insurers) must be rated, whether or not they carry on general insurance business;
> - ratings will be required to show "financial strength" rather than "claims paying ability";[147]
> - brokers need to give details of overseas insurers unless more than four insurers are insuring one risk;
> - the Registrar of Companies will select rating agencies and enter into deeds of agreement with them;
> - an insurer must give the meaning of the rating when the rating is disclosed; and
> - an insurer is required to deliver an actual certificate of rating or credit watch warning for registration in New Zealand within 10 working days of receiving it.
>
> Further amendments to the law, which will also take effect after a two-year transition period, include:
>
> - only brokers and other agents negotiating, or placing insurance offshore, will remain obliged to lodge deposits;
> - all insurers carrying on business in New Zealand except captive insurers, life insurers and reinsurers, will be required to file annual audited returns that comply with FRS-35 and be subject to a maximum financial penalty of $100 000 (reinforced by the power to prevent the insurer from accepting new business) for failure to comply;
> - a register of insurers will be maintained by the Registrar of Companies; and
> - the Registrar of Companies will be responsible for enforcing the new regime for which there will be financial penalties for non-compliance.

17.14 These changes apply not just to general insurers, but to all insurers other than life insurers and captive insurers. Reinsurers carrying on business in New Zealand would appear to be covered by the requirement to obtain a rating, but exempted from the requirement to file annual audited financial returns that comply with FRS-35.

17.15 General insurers are also subject to the provisions of the Corporations (Investigation and Management) Act 1989, which confer power on the Registrar of Companies to obtain information concerning, and investigate the affairs of, companies operating in New Zealand, and take action in the case of companies found to be operating fraudulently or recklessly, or where it is desirable to act for the purpose of protecting the interests of members, creditors or the public interest. The Registrar also has powers of

---

146 Information obtained from the MED website (www.med.govt.nz).

147 The (then) Minister of Commerce, in the report referred to footnote 149, said, in relation to altering the statutory description to "financial strength": "This is a wider concept which provides a more holistic approach in determining whether an insurance company is in the position to meet its claims in the future as the whole financial strength of the insurer is assessed" (p 5).

inspection under Part II of the Insurance Companies (Ratings and Inspections) Act, which may be used for the purpose of determining whether an insurance company is unable to pay its debts.

Cross border issues

17.16 As with life insurers, many of the general insurers operating in New Zealand are overseas owned and based in Australia. Note the provision in the Insurance Act 1973 (Australia) (section 116(3)) that provides that on a winding up of a general insurer, the insurer's assets in Australia must not be applied in discharge of its liabilities other than its liabilities in Australia, unless it has no liabilities in Australia. This could operate to prejudice a New Zealand policyholder of an Australian general insurer, especially if the operations were conducted through a branch in New Zealand. This issue is discussed more fully in chapter 16.

> Q75 Are there any problems with the financial market integrity regulation, consumer protection regulation or financial safety regulation of general insurers in New Zealand? If so, give details.

HEALTH AND OTHER INSURANCE

Health insurance

17.17 In 1999, approximately 1 339 000 people had health insurance in New Zealand, which represented around 34.39 per cent of all New Zealanders. The number of people with health insurance increased in 2000 to approximately 1 363 000, representing around 34.76 per cent coverage. During that period, earned premiums collectively declined by around $4.5 million indicating that, while the market is growing in terms of the number of insureds, new business and existing policyholders are moving towards major medical type policies that tend to be less expensive than comprehensive policies.[148]

17.18 Health insurance is a renewable risk only insurance (in terms of the description of this term in chapter 1). While premiums are paid annually and from the insured's point of view the contract is renewed annually, the insurer generally has an obligation to continue to renew the insurance year after year without reconsidering the individual insured's state of health. This does not preclude premium increases across the board or for certain age groups. The health insurance industry in New Zealand is largely unregulated in comparison to its international counterparts. Health insurers are required to comply with various laws such as the Fair Trading Act and the Consumer Guarantees Act. However, unlike general insurers, the health industry has no specific requirements for minimum solvency standards. The health insurance industry also has no compulsory complaints mechanism, but the Health Funds Association of New Zealand Incorporated ("HFANZ") requires its members to belong to the Insurance and Savings Ombudsman Scheme.

---

148 Information obtained from *The New Zealand Health Insurance Industry: The Need for Self Regulation* (a discussion document, February 2001) Health Funds Association of New Zealand Incorporated.

17.19 As discussed in paragraph 17.12, as a result of its review of the Insurance Companies (Ratings and Inspections) Act, the MED recommended that health insurers be required to obtain ratings after a two-year transitional period ending in June 2004, and this has been agreed by Cabinet. However, legislation effecting this change has not been passed.

17.20 The HFANZ is opposed to the imposition of compulsory ratings for health insurers. In February 2001, the HFANZ issued a discussion document, *The New Zealand Health Insurance Industry: The Need for Self-Regulation*. The aim of this document was to discuss the need for industry self-regulation and the development of New Zealand health insurance solvency standards. An HFANZ working party has been developing draft New Zealand health insurance solvency standards, largely based on the equivalent Australian standards. These draft standards are under consideration by the industry.

17.21 In particular, the HFANZ discussion paper proposed that the Insurance Companies (Ratings and Inspections) Act not be amended to require New Zealand health insurers to obtain external credit ratings, the Insurance Companies' Deposits Act be repealed, the New Zealand Society of Actuaries be asked to develop New Zealand health insurance solvency standards in consultation with the HFANZ, and the HFANZ Code of Conduct be revised to include:

- that insurers must comply with the New Zealand health fund solvency standards;
- guidelines for compliance with, and the consequences of breach of, the solvency standards; and
- that insurers must be members of the ISO Scheme.

17.22 The HFANZ (which is a voluntary organisation) represents approximately 99 per cent of the health insurance industry of New Zealand. According to the HFANZ, there is only one provider of health insurance services who is not a member of the HFANZ, namely Farmers Mutual Insurance Association (Health Insurance). The Code of Conduct focuses on issues surrounding sales and does not include rules pertaining to solvency, specific consumer protection issues or compulsory complaints processes. The main reasons why the HFANZ is opposed to requiring health insurers to obtain a credit rating are:

- cost, especially for small insurers;
- the perception as to what rating is adequate;
- that actuaries question the accuracy of external credit ratings and whether they are appropriate to the health insurance industry; and
- whether ratings work to reduce the risk of insolvency.

17.23 The HFANZ holds the view that credit rating agencies discriminate against rated organisations on the basis of market size, market share and organisation structure. Because many health insurers are niche players and not for profit, they are likely, in the HFANZ's view, to be adversely affected by a financial rating. The HFANZ points out that most New Zealand health insurers have been in operation for many years with no notable market failures. The HFANZ believes that imposing an additional cost and potentially unfair comparison of health insurer financial strength will not necessarily assist consumers to make an informed choice, nor will it increase competition in the health insurance market.

17.24 The largest provider of health insurance (Southern Cross Healthcare) is a friendly society. This means it is outside the ambit of the Companies Act and is governed instead by the Friendly Societies and Credit Unions Act 1982 (see paragraphs 5.122 to 5.126). In addition, Southern Cross Healthcare, like many other health providers, does not offer any other financial products. This may be relevant when considering the appropriate regulatory regime.

Other insurance

17.25 There are many other types of insurance, including disability, income protection, accident, trauma, credit, mortgage and liability insurance. All of these are "risk" products that contain no investment element (and are not therefore covered by the Securities Act). Many of these are available from life insurers. Credit and mortgage insurance (which are forms of life insurance, and so are covered by the Life Insurance Act 1908 ("Life Act")) are often available from banks (usually through a life company subsidiary). It is possible there are specialist insurance companies offering one or more of these types of insurance that are not caught by the life insurance regime or the general insurance regime. In particular, mutual companies (such as the Farmers Mutual Group), friendly societies (such as the Manchester Unity Friendly Society) and credit unions, which are not generally regulated otherwise than by the terms of their own Act (see paragraphs 5.122 to 5.128), offer some of these products. To the extent that the insurer belongs to an industry body, such as the HFANZ or ICNZ, they might be subject to a system of self-regulation. All of these insurers, to the extent that they are not already covered by the life or general insurance regimes, will be covered by the proposed changes to the Insurance Companies (Ratings and Inspections) Act, discussed above, which will require them to obtain a credit rating.

Reasons for extension of ratings regime to health and other insurers

17.26 The report of the Minister of Commerce to Cabinet that preceded Cabinet's decision to amend the law, stated in relation to health (and other unrated) insurers:[149]

> 29 Greater regulation of the 33 unrated insurers offering health, liability, income, mortgage and consumer credit insurance is needed for the following reasons:
>
> 29.1 they offer a diverse range of products, some of which involve considerably greater financial risk than those currently covered by the Ratings Act;
>
> 29.2 they are not subject to the barrier to entry and the discipline imposed by the rating process;
>
> 29.3 they include those insurers that, because of their size or weakness in their accounting procedures, are most vulnerable to insolvency; and
>
> 29.4 there is a real risk that some unrated insurers will default, leaving policyholders as unsecured creditors.
>
> 30 At the same time, the unrated insurers also include some niche insurers that have been conducting sound insurance businesses for many years, provide a useful service and, because of reinsurance arrangements or sound business practice, are

[149] Report of The Hon Paul Swain, Minister of Commerce, to Cabinet Finance, Infrastructure and Environment Committee, June 2002.

not exposing their customers to significant risk. Any reform should balance the need for policyholder protection against the needs of sound niche insurers and their customers and the need to avoid unnecessary compliance costs, facilitate the efficient operation of business and allow incentives for efficiency and innovation to operate.

Five options to protect consumers

31 The following options were considered:

31.1 The level of deposits required for unrated insurers could be increased;

31.2 The Deposits Act could be repealed and no new requirements imposed on unrated insurers;

31.3 A rating could be required from all insurers and deposits should be refunded;

31.4 A rating could be required from any insurers that have not yet lodged a deposit; and

31.5 The existing deposit requirements for unrated insurers could be continued.

32 The preferred option is the third, that all insurers should be required to have ratings and deposits should be refunded. Deposits, at the current low level, do not achieve their consumer protection objectives. If deposits were increased to an adequate level (e.g. tens of millions of dollars to provide sufficient protection to the policyholders of the largest insurer in the market) they would represent an insuperable barrier to entry for many viable and well managed insurance companies. The preferred option promotes good business practice, discourages unsound insurers from entering the market, removes some at-risk insurers from the market and provides a logically consistent system for rating non-life insurers. It would not prevent insurers from becoming insolvent, but would give consumers the benefit of an external, independent and professional assessment of an insurer's financial status.

33 The benefits include:

33.1 increased protection afforded to policyholders, both by giving them more information about their insurer's financial position and by the increased rigour that ratings and the financial reporting requirements would impose on insurers' financial systems;

33.2 all insurers who have lodged deposits would get their money back, allowing them to put the money to better use and offsetting the increased compliance costs;

33.3 costs for insurers who already have ratings would be reduced since they would no longer be required to lodge a deposit; and

33.4 any insurer unable to meet the increased costs and comply with the new regime is likely to be a high-risk business and, therefore, one whose removal from the market will reduce risks to policyholders.

34 Removing the deposit requirement will remove a (slight) constraint on incompetent or unscrupulous brokers placing business offshore. The annual costs of obtaining a rating, combined with the low rating that a small company may get

because of its size and the initial costs of setting up systems to satisfy the ratings authority's requirements, could well drive some small insurers out of business. On balance, the benefits outweigh the costs.

35 A variation of this option was mooted whereby the Registrar of Companies could exempt an insurer from obtaining a rating where it is a member of an industry organisation and the Registrar has approved that organisation and its code of practice. The code could be required to contain provisions dealing with such matters as reinsurance, solvency standards and capital adequacy, so it would give some protection to policyholders. This approach would effectively devolve the duty of policing the code to the organisation.

36 I do not recommend this variation because:

36.1 the government would be more likely to be held responsible for an insurer's failure, on the grounds that it should not have approved the industry organisation or the code.

36.2 the Registrar would have an ongoing involvement and responsibility to continually assess both the industry codes and the industry organisations that enforce those codes. This could be a complex and onerous task.

36.3 it would give consumers less information about insurers than ratings; they would know only that the insurer is in or out, not how strong it is.

36.4 it would make it harder for consumers to understand and compare different insurers, since some would be rated and some would be members of an industry organisation.

36.5 it would detract from the aim of having one robust, credible and comprehensive national (ratings) regime, giving piecemeal regulation.

37 I recommend that existing unrated insurers should be given time, say two years from the date of amending legislation, to continue under the existing regime before the new requirements are imposed on them. This would allow them to evaluate their position and put in place any new arrangements required to bring them within the ratings regime.

Shortcomings of ratings regimes

17.27 Many of the above insurances, like health insurance, are renewable policies, where the insured has a right of renewal on standard terms. This can be a significant benefit, for example, where an insured's health deteriorates and he or she would be unable to obtain comparable insurance at similar rates from an alternative provider. One shortcoming of the ratings regime is that an insured can become locked into one insurer's product, and in the event of a credit downgrade, be unable to switch insurers, except on unfavourable terms. This is a major distinction between these types of insurance as compared with general insurance. Accordingly, requiring a credit rating may be regarded as only a partial answer to the financial safety issues that exist with these types of insurance.

17.28 There are also issues relating more directly to the use of credit rating agencies. A United States Securities and Exchange Commission report dated January 2003 on the Role and Function of Credit Rating Agencies in the Operation of the (US) Securities Markets

identified the following issues relating to the use of credit rating agencies that warranted further investigation:[150]

- issues concerning information flows (such as whether agencies should be required to disclose more information about their decisions, and whether there should be improved disclosure by issuers including disclosures relating to ratings triggers);
- issues concerning potential conflicts of interest (such as whether agencies should have procedures to manage potential conflicts that arise when issuers pay for ratings, whether contact between subscribers and analysts should be restricted, and whether procedures should be required to deal with potential conflicts between main business and ancillary business carried on by agencies);
- issues relating to anti-competitive and unfair practices by large rating agencies;
- issues relating to potential regulatory barriers to entry; and
- issues relating to whether more direct, ongoing oversight of rating agencies is warranted, and whether agencies should incorporate standards of diligence in performing ratings analyses and with respect to the training and qualifications of analysts.

Australian regime

17.29 It is interesting to note that for the purposes of the Australian Life Insurance Act ("Life Act (Aust)"), "life policy" is defined to include a "continuous disability policy", which means a contract of insurance that is of more than 3 years' duration and provides for a benefit to be payable in the event of:

- death by accident or some other cause stated in the contract; or
- injury or disability as the result of accident or sickness; or
- the insured being found to have a stated condition or disease.

In effect, disability insurance, income protection insurance and trauma insurance have been included in the life insurance regime. There are certain qualifications included in the relevant section (section 9A of the Life Act (Aust)), such as the terms of the contract must not permit alteration by the insurer of the benefits provided or the premiums payable, except in certain circumstances (such as across-the-board premium increases).

17.30 General and health insurers are both subject to financial safety regulation in Australia. The Insurance Act 1973 was amended in 2001 by the General Insurance Reform Act 2001, with the effect that there is now a three-tiered regulatory system for general insurers. The new regime includes licensing, fit and proper testing for key personnel, requirements to appoint actuaries and auditors approved by APRA, standards on risk management, capital adequacy requirements and so on. Pricewaterhouse Coopers, in its report *Insurance Facts and Figures 2003*, said:[151]

---

150 Report prepared by the United States Securities and Exchange Commission in response to a Congressional directive in the Sarbanes-Oxley Act of 2002, United States Securities and Exchange Commission (January, 2003).

151 Pricewaterhouse Coopers *Insurance Facts and Figures 2003*, 28 (www.pwcglobal.com).

The general insurance sector has recently been the focus of a significant reform program commencing with discussion papers in 1999. As a result of this reform and the issue of general insurance prudential standards in 2001, a new regulatory regime for general insurers commenced effective 1 July 2002. This new regime has been established with the overall aims of:

- more consistent, rigorous and reliable valuation of insurance liabilities, supported by expert actuarial advice
- capital adequacy requirements that are more sensitive to each general insurer's risk profile
- reinsurance arrangements that are suitable to the scale, complexity and business mix of each company
- increased focus on corporate governance, ensuring that company Boards are well equipped to fulfil their responsibilities to policyholders and other parties.

As regards health insurers, the regulator for health insurers in Australia is the Private Health Insurance Administration Council ("PHIAC"). The role of PHIAC is the administration and prudential control of the health insurance industry. Health insurers must be registered, and PHIAC establishes prudential standards and monitors the financial performance of registered organisations to ensure that statutory reserve requirements are met. Solvency and capital adequacy tests (in the form of standards that came into effect in January 2001), established under the National Health Act 1953, must be met at all times.

Q76 Do you support the extension of the Insurance Companies (Ratings and Inspections) Act, which requires credit ratings to be obtained, to health insurers?

Q77 Do you support the extension of the Insurance Companies (Ratings and Inspections) Act to other unrated (non-life) insurers?

Q78 Do you have other suggestions for the financial safety regulation of health and other unrated (non-life) insurers? In particular, do you support including certain products, which might not include a life element, such as disability, income protection and trauma insurance, within the life insurance regime?

Q79 Do you consider there are other issues (such as in relation to financial market integrity or consumer protection) concerning health and other unrated (non-life) insurers? If so, give details.

SUPERANNUATION

17.31 A superannuation scheme is a trust that is established principally for the purpose of providing retirement benefits to beneficiaries who are natural persons (or paying benefits to the trustees of another registered superannuation scheme).[152] There are two main types of superannuation scheme. The first type is the defined benefit scheme. While there are still a large number of New Zealand schemes operating on defined benefit principles, these are increasingly unavailable to new members. This type of

[152] Superannuation Schemes Act 1989, s 2.

scheme has generally in the past been offered by large employers, but it is unattractive because it imposes unpredictable liabilities on employers. This is because the benefits are guaranteed, and in the event of an actuarial deficit the employer may be required to contribute extra contributions to meet the liabilities. The other type of scheme is the defined contribution scheme. Defined contribution schemes are really investment products where the contributor can generally select the amount of contribution they wish to make (which may or may not be matched by an employer) and the resulting benefit is the accumulation of contributions plus earnings on those contributions (less expenses).

17.32 Both types of scheme are governed by the Superannuation Schemes Act. Schemes must be prepared in the form of a trust deed and may be registered by the Government Actuary. Trust deeds of registered schemes are required to specify certain matters. The main advantages of registration include:[153]

- registration may provide credibility, in that prospective members may know of the regulation, supervision and disclosure requirements that provide some security;
- employer contributions to a registered scheme receive some tax advantages;
- an unregistered scheme is treated as a unit trust for tax purposes and taxed like a company, whereas in a registered scheme contributions and earnings are taxable, but distributions are tax free.

17.33 The Superannuation Schemes Act incorporates the requirements of the Trustee Act 1956 in relation to the investment powers of the trustee, and in particular requires that the trustees exercise the care, diligence and skill of a prudent person engaged in a business of investing money. Accounts must be prepared in accordance with "generally accepted accounting practice" as defined in section 3 of the Financial Reporting Act, and generally those accounts must be audited. In addition, an annual report that includes the accounts and the auditor's report, certain statements by the trustees, details of changes to the trust deed and so on, must be filed with the Government Actuary each year. Actuaries are required to examine defined benefit type schemes. The Superannuation Schemes Act also requires certain information to be provided to potential members before they become members and provides their rights to information while they are members. These disclosure obligations are additional to the disclosure obligations under the Securities Act. There are obligations on managers, actuaries and auditors to disclose information to the Government Actuary when they are of the opinion that there is a serious problem with the scheme.

17.34 The Government Actuary is the regulator of superannuation schemes. The Government Actuary receives the financial and other information required by the Superannuation Schemes Act, as well as "serious problem" disclosures. The Government Actuary has certain powers in relation to schemes that are operating in contravention of the Act, including powers to cancel registration, direct the trustee or manager to operate the scheme in a certain way, or order that the scheme be wound up.

---

153 *Laws of New Zealand*, above n 49, "Superannuation", para 30.

17.35 There is an industry organisation called the Association of Superannuation Funds of New Zealand ("ASFONZ"). This is a voluntary, non-profit organisation whose members include major employer-employee superannuation and pension schemes, as well as professional advisers and service providers. According to information provided by ASFONZ, as at October 2002 the employment-related superannuation sector consisted of 567 registered schemes with total assets of over $10 billion and total membership of 262 000. The mission of ASFONZ is to promote employment-related superannuation in New Zealand. As such ASFONZ does not represent superannuation funds that are not linked with an employer.

17.36 Complaints from members of superannuation schemes may be made to the Insurance and Savings Ombudsman, if the superannuation scheme is a member of the ISO Scheme. The Ombudsman is precluded by his or her terms of reference from dealing with complaints relating to employment-based superannuation schemes (see paragraphs 12.49 to 12.52).

> Q80 Are there any problems with the regulation of superannuation schemes that are similar to the problems with the regulation of life insurance? If so, give details.

Chapter 18
Regulators

INTRODUCTION

18.1 New Zealand has three regulators in relation to life insurance, namely the Ministry of Economic Development (including the Government Actuary), the Commerce Commission and the Securities Commission. If new roles for a regulator are to be created in relation to life insurance, the question will arise as to the appropriate person to undertake these new roles.

18.2 Part 2 of chapter 8 of the LAC Guidelines provides guidance on the question of the appropriate person to have a regulatory power. This Part provides the following guidelines:

> When deciding who should have a [regulatory] power, the following matters should be considered:
>
> - the importance of the individual rights and interests involved (compare, for example, serious criminal or disciplinary processes with the power to confer benefits to which there is no entitlement);
> - the importance of the public or state interest involved;
> - the character of the issues to be decided (for instance, fact, policy, discretion, law);
> - the expertise to be expected of the decision-maker;
> - the context, including the administrative one, in which the issue is to be resolved;
> - the existence of other safeguards over the exercise of the power;
> - the procedure commonly used by the proposed decision-maker;
> - the advantage or disadvantage of having a body independent of the Government and other public controls making the decision or carrying out the function.

Existing law and IAIS Principles

18.3 The comparative table in Appendix B shows that (clause 6):

- New Zealand has three regulators for life insurance;
- other countries have one or more regulators for life insurance;
- there are some IAIS Principles that relate to regulators.

POSSIBLE AREAS FOR REFORM

Who should be the regulator?

18.4 If it is decided to add new roles for a regulator in relation to New Zealand life insurance, for example in relation to financial safety issues (see chapter 13), the question will arise as to who should undertake these new roles.

18.5 If the new roles are primarily related to financial safety, one option would be to give them to the MED (including the Government Actuary) as the MED (acting largely through the Government Actuary) carries out the financial safety roles under existing legislation. If this were to be done, the role of the Government Actuary and the powers and duties of that office would probably need clarification and expansion, and the Government Actuary's office would probably need additional resources.

18.6 Another option would be to give the new roles to the Securities Commission, because it is already responsible for many of the financial integrity and consumer protection regulatory roles in relation to life insurance. The Securities Commission would probably need additional resources to undertake the new roles. In addition, the existing roles of the Commerce Commission that overlap those of the Securities Commission (for example, the prosecution of misleading conduct in relation to life insurance and other securities) could be given to the Securities Commission.[154]

18.7 Alternatively, New Zealand could follow the Australian model and establish a new regulatory agency similar to APRA. This agency could be responsible for all financial safety regulatory matters across the financial market (except perhaps for registered banks). The Securities Commission could continue to be responsible for financial market integrity and consumer protection issues.

18.8 Another option would be to give the Reserve Bank of New Zealand any new financial safety regulatory roles in relation to life insurance.

18.9 There may be an advantage in giving any new regulatory roles to a body that is governed by a board that includes persons with relevant market experience.

- A group of people is less likely than a single person to make errors of judgement or be susceptible to interest group pressure. Sole individual responsibility for an important decision can be a difficult and lonely role, and the absence of suitable people with whom the issues can be fully discussed can make it worse.
- Knowledge and experience of the relevant market is a valuable attribute for a regulator. The Securities Commission model of appointing persons with knowledge and experience of the securities markets as members of the Commission seems to have worked well. On the other hand, such people often

[154] It has been proposed by the Minister of Commerce (media statement 24 July 2003) that there should be a prohibition on misleading or deceptive conduct relating to securities in the Securities Markets Act 1988. This would apply to conduct by any person in relation to the securities of a public issuer, and also to conduct in trade in relation to securities. This would be enforceable by the Securities Commission by way of injunction and civil penalties. This is intended to give the Securities Commission a "fair trading" type enforcement role in relation to securities generally.

have conflicts of interest due to their involvement in the market, so it is necessary to appoint sufficient members to enable a quorum to be obtained in any particular case.

18.10 Another matter to bear in mind is the need to avoid as far as possible the potential for "regulatory capture", where the regulator is subject to influence by the industry it is regulating. Such "capture" is more likely where the regulator consists of persons drawn from the regulated industry, or where the regulator's role relates only to one industry or a few related industries.

> Q81 Who should be the regulator – Do you have any comments on the options in paragraphs 18.4 to 18.10? Are there other options that we have not considered?

Liability of a regulator

18.11 If new regulatory roles and a new regulator are to be established, the question will arise as to the liability of the regulator and the Crown, in the event that the regulator fails in any particular case to perform a regulatory role properly.

18.12 There is a strong argument for saying that the Crown should not be liable for any regulatory failure, in particular because this will effectively transfer to taxpayers the policyholders', financial intermediaries' and life insurers' responsibility for risk management.

18.13 Another approach is to provide penalties for the regulator (and, possibly, its officers and employees) if it fails to perform its role properly. It could be argued that these penalties should be similar to the significant penalties imposed on companies and company directors for failure by companies to comply with financial market laws. Making the regulator, but not the Crown, liable for penalties may require the regulator to be a separate legal entity from the Crown, in other words the regulator could not be a Government department or official.

18.14 Unlike the penalties imposed on companies and company directors referred to above, it is not usual to provide for criminal penalties for failure by a regulator, or its officers and employees, to perform a regulatory role properly (as distinct from crimes such as bribery and corruption).

18.15 However, it is not unusual to allow civil claims against a regulator who has acted in bad faith or not exercised reasonable care in carrying out its role, but claims against an individual officer or employee are often limited to circumstances where the individual acted in bad faith.[155] Despite this, the New Zealand courts have been reluctant on policy grounds to hold that a financial market regulator owes investors a duty of care that would support a claim in negligence.[156]

18.16 If civil penalties are to be provided for a regulatory failure, they should not be such as to enable all of the financial loss involved to be recovered from the regulator or individual

---

155 See, for example, s 28 of the Securities Act 1978 and s 11 of the Takeovers Act 1993.

156 See *Fleming v Securities Commission* [1995] 3 NZLR 514 (Court of Appeal).

– the loss should be shared among all those responsible according to their share of the blame. Furthermore, any such penalties should not apply to an individual officer or employee unless the individual is personally at fault, and should be set at a level reflecting the gains to the individual from performing the role (in other words, the penalties should not be such as to make it difficult to recruit people to undertake the regulatory role).

18.17 It needs to be borne in mind that in practice, because there is no other source of funds, damages awarded in successful civil claims against a regulator (or its officers or employees) will be paid by the Crown/taxpayers, either directly or indirectly through insurance premiums.

Q82 Liability of a regulator – Do you have any comments on the options in paragraphs 18.11 to 18.17? Are there any other options that we have not considered?

APPENDIX A
Life insurers operating in New Zealand

Name of company[157]	Incorporated or registered under the New Zealand Companies Act	Ultimate owners
American Bankers Life Assurance Co of Florida (Not writing new business, few existing policies)	Yes	American Bankers Insurance Group
American Income Life Insurance Company	Yes	Torchmark Corporation
American International Assurance*	Yes	American International Group
AMP Life Limited*	Yes	AMP Group
ANZ Life Assurance Co Ltd	Yes	ANZ Bank
Asteron (previously Royal & SunAlliance)*	Yes	Promina Group
AXA New Zealand (owned by National Mutual Holdings in Australia)*	Yes	AXA Ltd (France)
BNZ Investments & Insurance*	Yes	National Australia Bank
CIGNA Life Insurance NZ Ltd*	Yes	CIGNA (US)
Club Life Ltd and Club Life Holdings Ltd*	Yes	Hellaby Holdings (private New Zealand-owned company)
Combined Insurance Company of New Zealand (no longer issues life insurance, but has some existing life policies)	Yes	Combined Insurance Company of America
Equitable Life Insurance Co Ltd*	Yes	Private New Zealand-owned company
Farmers Mutual Life Limited	Yes	Farmers Mutual Group
Fidelity Life Assurance Co Ltd*	Yes	Private New Zealand-owned company
Hallmark Life Insurance (trading as GE Insurance Services)	Yes	General Electric Company (US)
Lumley Life Limited	Yes	Preafsure (South Africa)
Medical Assurance Society NZ Ltd	Yes	Private New Zealand-owned company
National Bank of New Zealand Ltd*	Yes	ANZ (recently purchased from Lloyds)
New Zealand Association of Credit Unions	Yes	Credit union members

[157] Given the changing environment and available information, some of the information may not be accurate at the time of publication.

Name of company	Incorporated or registered under the New Zealand Companies Act	Ultimate owners
Pacific Life Limited	Yes	Private New Zealand-owned company
Pinnacle Life	No	Partnership
S.A.I Life Limited*	Yes	Dorchester
Southsure Assurance Limited	Yes	Southland Building Society
Sovereign Assurance Company Limited[158]*	Yes	Commonwealth Bank of Australia
TOWER New Zealand[159]*	Yes	Tower Group
Westpac Life (NZ) Ltd *	Yes	Westpac Banking Group
Reinsurers:[160]		
Gen Re*	Yes	Berkshire Hathaway Inc
Hannover Life Re of Australasia Ltd*	Yes	Hannover Re
Munich Reinsurance Co of Australasia Ltd*	Yes	Munich Re
RGA Reinsurance Company of Australia*	Yes	Reinsurance Group of America Incorporated
Swiss Re Life & Health Australia Ltd*	Yes	Swiss Re

* Members of the Investment Savings and Insurance Association.

---

158 As a result of recent amalgamations, Sovereign Assurance Company Limited has assumed the business of Metropolitan Life Assurance Company of N.Z. Limited and Sovereign Life (NZ) Limited (formally Colonial Life (NZ) Limited).

159 The Tower group also makes returns for Tower Funds Management and Tower Health (source: Melville Jessup Weaver).

160 It is difficult to form a comprehensive list, as reinsurance arrangements are often considered commercially confidential.

APPENDIX B
Comparative table of regulatory requirements for life insurance in different jurisdictions

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
1	**General market regulation**	Commerce Act 1986, Companies Act 1993, Consumer Guarantees Act 1993, Corporations (Investigation and Management) Act 1989, Credit Contracts and Consumer Finance Act 2003, Crimes Act 1961, Fair Trading Act 1986, Financial Reporting Act 1993, Securities Act 1978, Securities Markets Act 1988.	Australian Securities and Investments Commission Act 2001, Corporations Act 2001, Financial Services Reform Act 2001 (which inserted a new Chapter 7 into the Corporations Act). Various insurance acts: Insurance (Agents and Brokers) Act 1984, Insurance Act 1973, Insurance Contracts Act 1984, Life Insurance Act 1995 ("Life Act (Aust)"). Trade Practices Act 1974.	Financial Services Authority Handbook, Financial Services and Markets Act 2000.	Insurance Companies Act 1991. Federal government regulates solvency. Provincial governments regulate the fair treatment of consumers and the licensing of insurance intermediaries.	Financial Services Board Act 1990, Insurance Amendment Act 2003, Long-term Insurance Act 1998, Short-term Insurance Act 1998.	*ICP1: Insurance supervision relies upon:* • *a policy, institutional and legal framework for financial sector supervision* • *a well developed and effective financial market infrastructure* • *efficient financial markets.*
2	**Financial market integrity**						
2.1	Financial reporting	Securities Act and Securities Regulations, for offers to the public (prospectus and investment statement requirements),	Life Act (Aust), Part 6, and Financial Sector (Collection of Data) Act 2001. (Reports go to APRA.) Corporations Act, Part 7.8.	Financial Services and Markets Act, ss 84–87, prospectus requirements, FSA Handbook – specific reports and abstract	Insurance Companies Act ss 330–335, financial statement provisions, includes quarterly financial returns.	Reporting must comply with GAAP. Long-term Insurance Act, Schedule 3.	Principle 12: Insurance supervisor to establish a process for financial reports, including scope and frequency of reports, setting accounting requirements,

	Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
	Financial Reporting Act, Life Act, ss16–23 and 78.		of the actuaries report required annually. The Insurance Companies (Accounts and Statements) Regulations 1996 set out the information and the format required.	Financial reporting required to be in accordance with generally accepted accounting principles. Provincial securities regulators govern reporting with respect to the traded securities of insurance companies.		requiring acceptable external audits and setting financial reporting standards. (Principle 7 requires standards relating to liabilities.) Principle 5: Insurance supervisor should review each insurer's internal controls and require directors to provide prudential oversight. Principle 9: Requirements to be set regarding use of derivatives and other off-balance sheet items. *ICP10: (below, clause 2.5).* *ICP12: Supervisory authority to receive necessary information to conduct effective off-site monitoring and to evaluate condition of the insurer as well as the insurance market. Supervisor decides what information it needs, form and frequency. Immediate reporting of material changes. Envisages different standards for reports to policyholders (and investors) and those to supervisor.* *ICP26: Supervisory authority to require insurers to disclose*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
							relevant information on a timely basis to give stakeholders a clear view of business activities and financial position and to facilitate the understanding of the risks to which they are exposed. *Requiring public disclosure of reliable and timely information to prospective and existing stakeholders is a form of market discipline and an adjunct to supervision.*
2.2	Valuation of assets and liabilities	Financial Reporting Act, FRS-34 (Accounting Standards Review Board reviews and approves financial reporting standards).	Accounting standards made by Australian Accounting Standards Board, Corporations Law, prudential rules on financial statements. Generally: market values. Note proposed introduction of International Accounting Standards on 1 January 2005.	Financial Services and Markets Act, FSA Handbook – detailed valuation of assets regulations.	Canadian Institute of Chartered Accountants defines accounting for assets (Canadian GAAP). (Note: in Canada statutory and generally accepted accounting principles are identical. There is a single general purpose set of financial statements.)	Long-term Insurance Act, Schedule 3, calculated by means of the financial soundness method.	Principle 6: Insurance supervisor to set standards in relation to assets, including valuation of assets (and liabilities, Principle 7). *ICP21: Supervisory authority to ensure standards on investment activities are established and complied with, including basis for valuing assets.*
2.3	Financial records	Companies and Securities Acts – proper records to be kept.	Life Act (Aust), Part 6, records to be kept in respect of each statutory fund. Corporations Act, Part 7.8.	Financial Services and Markets Act, FSA Handbook – Systems and Controls, chapter 3: fundamental requirement that reporting should be	Insurance Companies Act, s 261, sets out how records are to be prepared and maintained.	Long-term Insurance Act, s 36, returns must be set out in the form prescribed by the Registrar.	Principles 5, 9 and 12 (above, clause 2.1).

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
				clear and appropriate having regard to the nature, scale and complexity of its business (para 3.2.2).			
2.4	Sanctions for on-compliance with financial reporting requirements	Life Act, s 28 ($100 per day). Financial Reporting Act, ss 36, 38, 41.	Financial Sector (Collection of Data) Act 2001, administrative penalties and prosecutions. Corporations Act, civil and criminal penalties.	FSA Handbook – statutory notices for non-compliance, ie, warnings.	Insurance Companies Act, Part XIX sets out sanctions for non-compliance.	Long-term Insurance Act, s 68, penalties for failure to furnish Registrar with returns (R1000 for every day during which the failure continues).	
2.5	Directors	Companies Act, duty to act in best interests of company, but no specific duty to policyholders.	General duties under Corporations Law and specific extra duties under Life Act (Aust), s 48 (priority to policyholders). Also, liability for losses to statutory funds in limited circumstances. APRA assesses an insurer's directors on a "fit and proper" basis at the time of registration.	Financial Services and Markets Act, FSA Handbook – Statements of Principle and Code of Practice: FSA must approve as "fit and proper". *Each firm must report annually to policyholders that funds have been managed in compliance with its Principles and Practices of Financial Management ("PPFM").*	Insurance Companies Act, sets out the role and responsibilities of directors and officers. Directors are subject to normal corporate governance requirements. In addition, insurance company directors are officially designated as representing either shareholders or policyholders. OSFI has ability to veto the appointment of directors for problem companies.	Companies Act 1973, corporate governance principles. Financial Institutions (Protection of Funds) Act 2001, fiduciary duties. Long-term Insurance Act, s 29, directors should report any financial unsoundness.	Principle 4: Standards to be set for corporate governance. Responsibilities of directors required to be set out. Principle 5: (above, clause 2.1). *ICP9: Corporate governance framework must recognise and protect rights of all interested parties. Supervisory authority to require compliance with applicable corporate governance standards. (Corporate governance standards also relate to "financial safety" especially in relation to risk management systems.)* *ICP10: Insurers must have adequate internal controls, and oversight and reporting systems*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
							that allow monitoring by board and management.
2.6	Actuaries	Life Act, statements and specifically s 18 actuarial abstract of financial condition report. Financial Reporting Act and tax legislation. Compliance with NZSA standards (if NZSA member).	Life Act (Aust), Part 6, appointed actuary regime. Annual investigations, and watchdog role. Compliance with Life Insurance Actuarial Standards Board ("LIASB") standards, for example, on valuation of liabilities, solvency and capital adequacy. Advice about apportionment of in-come and expenditure between funds, and advice regarding policies under s 116 Life Act (Aust).	Financial Services and Markets Act, FSA Handbook – Appointed Actuary: identify and monitor risks, inform management/directors, report to FSA matters of concern, annual actuarial investigation and report (abstract for FSA). *Appointed actuary role to be abandoned and two new actuarial functions will be introduced.*	Insurance Companies Act, ss 357 to 370, requires opinion on liabilities. Also requires annual investigation and report to board. Watchdog duties, including "whistle blowing" combined with legal protection if done in good faith pursuant to duties.	Long-term Insurance Act, s 20, governs the appointment of a statutory actuary. Must be approved by the registrar of long term insurers. Must report anything that may cause financial insolvencies.	Principle 5: (above, clause 2.1). *ICP10: (above, clause 2.5). (Actuary to report regularly to board.)*
2.7	Auditors	Life Act, s 17A, statements to be audited. Financial Reporting Act, s 16, financial statements must be audited. Securities Act and Securities Regulations (prospectus requirements).	Life Act (Aust), Part 6. Approved auditor audits financial records, reports on financial statements and has watchdog role. Also life companies to have audit committees. Corporations Act, Part 7.8 and Chapter 9, registration and banning of auditors. Note proposed reform in relation to auditors in CLERP9.	Financial Services and Markets Act ss 342 to 343, FSA Handbook: auditor's report required, obligation on auditor to report on certain matters to FSA.	Insurance Companies Act, ss 336 to 356, approve income statements and balance sheet of companies. Reliance on actuary for value of actuarial liabilities and increase from year to year.	Long-term Insurance Act, s 19, must report any material irregularity. Must have at least one auditor at all times, who is not a director.	Principle 5: (above, clause 2.1). *ICP10: (above, clause 2.5). (Internal audit function required.)* *ICP21: (below, clause 4.8). (Audit procedures must cover investment activities.)* *ICP22: (below, clause 4.8). (Audit to cover derivative activities.)*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
2.8	Transfers and amalgamations of life businesses	None – but note the Income Tax Act 1994 s CM18, Government Actuary reports to Commissioner of Inland Revenue on transfer, and the Companies Act s 226, Court may make order if proposed amalgamation would unfairly prejudice creditors.	Life Act (Aust), ss 45, 46, and Part 9, transfer of assets between statutory funds and transfer of business between life companies. Transfers of business between life companies to be sanctioned by Court. Financial Sector (Transfers of Business) Act 1999 for friendly societies.	Financial Services and Markets Act, FSA Handbook/ Treasury regulations: transfers require the sanction of the High Court, notification to FSA, publicity statement and actuary reports on the transfer.	Transfers and amalgamations subject to approval by OSFI supported by an opinion by an independent actuary that transaction is in best interest of the companies and their policyholders.	Long-term Insurance Act, Part V, Court approval required for compromise, arrangement, amalgamation, demutualisation or transfer.	Principle 3: Insurance supervisor to review changes in control of licensed life companies. *ICP8: Supervisory authority to approve or reject proposals to acquire significant ownership control, and supervisory authority to approve portfolio transfers or mergers.*
2.9	Rules about surrender values	None.	Life Act (Aust), Part 10, Division 4, and LIASB standard on minimum surrender values. Actuarial advice under s 116.	Financial Services and Markets Act, FSA Handbook – Principles for Business, Principle 6: firms must pay due regard to the interests of their customers and treat them fairly. *Current proposals for how with profits companies should exercise discretion.*	No mandated surrender values except in the case of segregated funds, which must offer a minimum of 75 per cent return of deposits on death or maturity.	Long-term Insurance Act, Policy Holder Protection Rules – Rules on cancellations of policies.	

	Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
2.10 Rules about allocation of profits	None – but note the Life Act, s 18, actuarial abstract requires actuary to state the principles used to determine the split of profits between shareholders and policyholders, and the source of those principles.	Life Act (Aust), Part 4, Division 5 (allocation of profits and losses to statutory funds) and Part 4, Division 6 (distribution of retained profits and shareholders' capital).	FSA Handbook – Principles for Business, Principle 6: firms must pay due regard to the interests of their customers and treat them fairly.	No specific rules.	None.	
2.11 Rules about fraud and money laundering	Crimes Act, Financial Transactions Reporting Act 1996, Corporations (Investigation and Management) Act, Proceeds of Crime Act 1991.	Corporations Act, Part 7.8, prescribes handling of client money. Proceeds of Crime Act 1987, offences in relation to money laundering. Various state criminal legislation.	HM Government regulations. Financial Services and Markets Act, FSA Handbook, money laundering component. Fraud is covered by general provisions in the general law.	OSFI Guidelines on money laundering. Canadian Criminal Code deals with fraud.	Prevention of Organised Crime Act 1998, Financial Intelligence Centre Act 2001.	*ICP27: Insurers must have in place systems and take the necessary measures to prevent, detect and remedy insurance fraud.* *ICP28: Insurers must take effective measures to deter, detect and report money laundering and financing of terrorism. Includes "know your customer" provisions and obligations to report suspicious transactions.*
3 Consumer protection						
3.1 Product disclosure	Securities Act and Securities Regulations – prospectus and investment statement required, restrictions on advertisements (for offers to the public).	Australia Securities and Investment Commission Act, (Code of Practice and Circular GI1), FSR Act (Chapter 7 of the Corporations Act) requires financial services guide, product disclosure statement and statement of advice. Commission disclosure for investment	Financial Services and Markets Act, ss 84–87 prospectus requirements, FSA Handbook – documents deposited with FSA available on request, that is, annual statement, also at the time of sale a Key Features	Insurance Companies Act, ss 296–306 prospectus provisions. Very limited provincial product disclosure requirements beyond formal requirements for segregated fund products.	Long-term Insurance Act, Policyholder Protection Rules, rules on disclosure: includes a checklist of information that must be given to policyholders and prospective policyholders.	Principle 11: Insurance supervisor to ensure insurers and intermediaries act honestly, etc, and pay regard to the information needs of their customers. *ICP25: Supervisory authority to set minimum requirements for insurers and intermediaries in dealing with consumers, including provision of timely,*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
			products (planned for risk products).	Document must be produced to private clients.	Product illustrations have evolved in response to competition rather than legislation.		*complete and relevant information, before and during a contract. Must also cover foreign insurers selling on cross border basis. Envisages different rules for different consumers (for example reinsurance as compared with retail contracts).*
3.2	Regulation of advisers and brokers	Investment Advisers (Disclosure) Act 1996, initial and request disclosure requirements, Secret Commissions Act 1910, Insurance Intermediaries Act 1994.	FSR Act (Chapter 7 of the Corporations Act) and Insurance (Agents and Brokers) Act. Licensing regime for all sales and advice.	*FSA is introducing a regulatory regime for insurance brokers as required under the EC Insurance Mediation Directive.*	Provinces have exclusive jurisdiction for regulating insurance intermediaries.	Financial Advisory and Intermediary Services Act 2002, requires all financial services provided to be licensed and maintain minimum standards. Long-term Insurance Act, Policyholder Protection Rules, include rules for intermediaries.	Principle 11: Insurance supervisor to supervise intermediaries. *ICP24: Supervisory authority to set requirements for conduct of intermediaries. Intermediaries to be licensed, to make certain disclosures, etc.* *ICP27: Intermediaries must have in place systems and take necessary measures to prevent, detect and remedy insurance fraud.* *ICP28: Intermediaries must take effective measures to deter, detect and report money laundering and financing of terrorism. Includes effective "know your customer" provisions and reporting of suspicious transactions.*
3.3	Approval of premium rates	None.	Life Act (Aust), s 116, company must not issue policies unless appointed	None. European Directives prevent the setting up of	None.	Long-term Insurance Act, s 10(e) a condition	

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
			actuary has provided written advice.	systems to systematically approve policy terms or rates.		of registration is that the amount of the companies premiums may be limited.	
3.4	Terms of life policies: • transfer of policy by life company • transfer of policy by policyholder • minors' policies • forfeiture	Life Act, Part II, includes provisions relating to interest rates applicable to policies, assignments and mortgages of policies, protection of policies, minors' policies, and insurances by married women.	Life Act (Aust), Part 10, assignment by policy-holder, forfeiture of policies, minors' policies. Life Act (Aust), Part 9, transfers of policies by life companies. Prudential rules. Life Insurance Circulars and FSR Act requiring disclosure. Some provisions of the Life Act (Aust) impact on content of policy document (ss 15, 35(1), 116, 201, 222, 228, 229).	Financial Services and Markets Act – FSA Handbook.	Policy provisions and wording in most provinces (other than Quebec) are fairly uniform.	Long-term Insurance Act, Part VII. Policy-holder Protection Rules, rules on cancellations of policies.	
3.5	Complaints handling procedures	Insurance and Savings Ombudsman and the Banking Ombudsman, both independent voluntary industry schemes. Insurers and banks must have internal complaints procedures as part of membership to the schemes.	FSR Act and Code of Practice. Life companies must have internal complaints procedures and offer access to independent complaints organisations. Banking Ombudsman and Financial Industry Complaints Service.	Financial Services and Markets Act, ss 225–234: statutory Financial Ombudsman Service is the single ombudsman for all financial services.	Centre for the Financial Services OmbudsNetwork, and the Canadian Life and Health Insurance OmbudService are voluntary industry associations.	Long-term Insurance Ombudsman, voluntary industry scheme.	Principle 11: Insurers and intermediaries should support a system of complaints handling. *ICP25: (above, clause 3.1): Insurers and intermediaries to deal with consumer complaints effectively and fairly through simple, easily accessible and equitable processes.*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
					In addition, provincial ombudsman regimes have evolved to various degrees.		
4	**Financial safety**						
4.1	Registration or approval of life companies	None.	Life Act (Aust) requires registration. APRA assesses suitability.	Financial Services and Markets Act, FSA Handbook requires authorisation. To authorise, must satisfy threshold conditions and risk assessment process.	Insurance Companies Act, company wishing to incorporate under Act must apply for letters patent. Federal insurance companies must be approved by OSFI. New provincial insurance companies (rare) could be approved by provincial insurance regulator.	Long-term Insurance Act, ss 7 and 9: Companies must be registered with the FSB in order to conduct long term business.	Principle 2: Life companies should be licensed. Suitability of management and soundness of business plan to be assessed. *ICP6: Insurer must be licensed. Requirements for licensing must be clear, objective and public. (Essential criteria for licensing are set out in the Principles.)* *ICP7: Significant owners, board, senior management, auditor and actuary of insurer must be fit and proper.*
4.2	Bonds and deposits	Life Act, ss 3–14, deposit of $500 000 with Public Trust.	None, but there is a management capital standard to ensure adequate capitalisation outside statutory funds. Corporations Act, requirement to have financial competency.	None, but insurers do have to meet solvency requirements (FSA Handbook, Authorisation Manual).	Branches need to vest a portion of their assets in trust with federal government. Otherwise, no obligation to post deposits but companies, including branches, need to satisfy minimum capital requirements (MCCSR).	No deposit or bond. *FSB discussions for the creation of a bond requirement.*	Principle 8: Contemplates deposits as an alternative to minimum levels of capital.

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
4.3	Ratings	Required for general insurance companies. Many life companies voluntarily obtain ratings.	Not required under Life Act (Aust).		Insurance Companies Act, all publicly traded life insurers are required to have a rating.	No ratings required.	
4.4	Limits on kind of business that may carry on	None.	Life Act (Aust), s 234. Only life insurance business (as defined).	Financial Services and Markets Act, FSA Handbook: business is restricted to insurance business. EU Directives: business of authorised life companies limited to insurance and closely related business.	If incorporated as an insurance holding company may transact almost any kinds of financial services (life, property, credit cards, banking).	Long-term Insurance Act, s 10, conditions of registration determine the business that may be carried on. Section 15, may carry on business only if authorised to by registration.	
4.5	Statutory funds: • investment of assets • expenditure • distribution of capital and profits	Life Act s 15, requires life insurers to keep a separate fund for receipts in respect of life insurance and annuity contracts.	Life Act (Aust), Part 4. Separate statutory fund required for life business. Containment of assets, liabilities, profits etc within statutory funds. Only policy benefits and expenses related to the business paid out. Restrictions on and reporting about investments in related parties.	Financial Services and Markets Act, FSA Handbook: fundamental requirement that long term insurer maintains a separate account for each type of business it carries on. Must make arrangements to avoid unfairness between separate accounts. These rules effectively ring-fence the assets relevant to long term insurance.	Insurance Companies Act, s 450, life insurers must keep segregated funds as distinct funds, and separate accounts for participating and non-participating life products.	Short and long term business must be registered as separate legal entities.	

	Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
4.6 Solvency	None. (Note: Some actuarial standards relate to solvency.)	Life Act (Aust), Part 5 and solvency standard for statutory funds.	Financial Services and Markets Act, FSA Handbook: regulatory minimum margin over solvency must be maintained. *Moving towards "realistic" assessment with a "safety margin".*	MCCSR risk-based capital formulas, plus annual investigation known as Dynamic Capital Adequacy Testing (DCAT).	Long-term Insurance Act, s 30, Schedule 3, financial soundness method.	Principle 8: (below). *ICP20: (below, clause 4.8): Standards required in respect of technical provisions, that is, amounts set aside to meet liabilities.* *ICP23: Supervisory authority must require insurers to comply with prescribed solvency regime, including capital adequacy requirements. Requires sufficient technical provisions to cover expected losses, plus sufficient capital to absorb unexpected losses, and additional capital to absorb losses from risks not explicitly identified. Requires minimum capital adequacy plus series of solvency control levels, at which supervisory authority intervenes.*
4.7 Capital adequacy	None.	Life Act (Aust), Part 5, and capital adequacy standard for statutory funds.	*Implementation of the Basel Committee and EU capital adequacy requirements.*	Insurance Companies Act – minimum capital required for licensing ($10 million). MCCSR risk-based capital formulas, plus annual investigation known as Dynamic Capital Adequacy Testing.	Insurance Amendment Act, Schedule 3, a minimum capital adequacy requirement of R10 million and an amount representing 13 weeks' operating expenses.	Principle 8: Capital adequacy requirements should be set by insurance supervisor. *ICP23: (above, clause 4.6).*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
4.8	Prudential standards	None.	Life Act (Aust), Part 10A. APRA can make prudential standards.	FSA Handbook and Interim Prudential Sourcebook. *Integrated Prudential Sourcebook to be introduced in 2004.*	Both the Insurance Companies Act and OSFI Guidelines deal with prudential standards.	Long-term insurance Act, Prudential standards, requirements for insurers.	Principles 6–10: Insurance supervisor to set standards with respect to assets, liabilities, capital adequacy, off-balance sheet items and reinsurance. *ICP20: Supervisory authority to require insurers to comply with standards for establishing adequate technical provisions (that is, reserves to meet policy liabilities), and other liabilities, making allowance for reinsurance recoverables. Supervisory authority to assess adequacy of technical provisions and can require provisions to be increased.* *ICP21: Supervisory authority to require insurers to comply with standards on investment activities, including investment policy, asset mix, valuation, diversification, asset–liability matching and risk management. Insurers must also have overall strategic investment policy approved by board.* *ICP22: Supervisory authority to require insurers to comply with standards on use of derivatives and similar commitments. Includes restrictions on use, disclosure requirements and internal controls.*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
4.9	Transactions with related parties	Companies Act (on liquidation).	Life Act (Aust) and regulations. Restrictions in relation to investments in subsidiaries and other related companies. Corporations Act, Chapter 2E, related party transactions.	Financial Services and Markets Act, FSA Handbook: prohibited in specific situations.	Insurance Companies Act and regulations, when transactions are permitted, they are generally subject to certain disclosures.	None (but the FSB has issued a notice on the valuation of assets of related parties (ie, investments in subsidiaries or where the shareholding is more than 20 per cent).	*ICP17: Supervisory authority to supervise insurers on a group-wide basis, and assess risk profile of whole group. This includes having policies on and supervision of intra-group transactions.*
4.10	Monitoring and inspection of life companies	Life Act, ss 22 and 79A, Government Actuary to examine statements and MED may require further information. Securities Act, Part 3, Commission's powers of inspection. Corporations (Investigation and Management) Act. Registrar of Companies has power to investigate companies, give directions and initiate statutory management.	Life Act (Aust), Part 7. APRA monitors compliance with that Act, and can give directions and investigate. Corporations Act, general licensing and disclosure surveillance. Australian Securities and Investments Commission Act, general surveillance and investigative powers.	FSA is regulator and supervisor under the Financial Services and Markets Act. Supervision is set out in the FSA Handbook.	Supervised by OSFI. Powers include on-site inspections and access to information to ensure compliance with the Act.	FSB has powers of monitoring and inspection. Frequent on-site visits.	Principle 13: Insurance supervisor to be able to carry out on-site inspections and request information. *ICP11: Supervisory authority to monitor and analyse all factors that may impact on insurers and insurance markets (requires regular analysis of market conditions, participants, products etc).* *ICP12: Supervisory authority to receive necessary information to conduct effective off-site monitoring, includes setting requirements for regular financial information, actuarial reports etc.* *ICP13: Supervisory authority to carry out on-site inspections.*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
4.11	Directors' duties (Directors duties can have "financial safety" implications, especially where they relate to risk management systems)	See clause 2.5.	See clause 2.5.	See clause 2.5.	See clause 2.5.	See clause 2.5.	*ICP18: Supervisory authority to require insurers to recognise range of risks they face, and to assess and manage them effectively. Insurers must have in place comprehensive risk management policies and systems. Recognises that ultimate responsibility for risk management rests with board.* *ICP19: Supervisory authority to require insurers to (1) evaluate and manage underwriting risks, in particular, through reinsurance; and (2) have tools to establish an adequate level of premiums. Board to approve and monitor underwriting policy, and reinsurance strategy. Supervisor to review underwriting and reinsurance policies. Supervisor also reviews tools used to set premiums.* *ICP22: Board to monitor use of derivatives.*
4.12	Actuarial duties, auditors duties (Actuaries and auditors have roles in monitoring the financial condition of a life company.)	See clauses 2.6 and 2.7.	See clauses 2.6 and 2.7. In particular, actuaries and auditors have "whistle blowing" role (duty to inform APRA).	See clauses 2.6 and 2.7. In particular, actuaries and auditors have "whistle blowing" role (duty to report to FSA).	See clauses 2.6 and 2.7. Actuaries have "whistle blowing" role.	See clauses 2.6 and 2.7. In particular, actuaries and auditors have "whistle blowing" role (duty to inform FSB).	*ICP10: (above, clause 2.5).*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
4.13	Financial reporting (financial reports provide the information that facilitate monitoring of solvency)	See clause 2.1. In particular, Life Act, ss 16–23.	See clause 2.1.	See clause 2.1.	See clause 2.1.	See clause 2.1.	See clause 2.1.
4.14	Reinsurance	Life Act, Parts 1 and 1A (general provisions apply, but no specific monitoring of reinsurance arrangements).	Life Act (Aust), ss 39, 123, 125. Reinsurance arrangements to be reported, some must be approved. Prohibition on reinsurance between statutory funds. Life Act (Aust), s 116(2), appointed actuary advises on reinsurance arrangements. Reinsurers generally subject to the Life Act (Aust) as well.	Financial Services and Markets Act, FSA Handbook provisions apply to reinsurers.	Insurance Companies Act, reinsurers regulated like other life companies. Dealings with unregulated reinsurers permitted, but additional capital requirements need to be satisfied.	Insurance Amendment Act, s 15A. Long-term Insurance Act, s 11, reinsurers must be registered.	Principle 7: Standards required relating to effect of reinsurance arrangements on liabilities. Principle 10: Insurance supervisor must be able to review reinsurance arrangements. *ICP19: Insurer required to have risk diversification strategy, including reinsurance or other risk transfer arrangements, monitored by board, and reinsurance arrangements to be reviewed by supervisory authority. Supervisory authority to ensure reinsurance is appropriate and that reinsurance is secure.*
4.15	Judicial management/ winding up	Life Act, ss 30–31 and Part 1A, judicial management provisions. Companies Act, Corporations (Investigation and Management) Act.	Life Act (Aust), Part 8. APRA can place companies under judicial management and wind up companies.	Financial Services and Markets Act, FSA Handbook – FSA has enforcement and decision making powers. Insurance	OSFI has ability to intervene and take over before or at point of insolvency.	Long-term Insurance Act, Part VI, judicial management and winding up. Financial	Principle 14: Insurance supervisor must have power to take remedial action, and a range of types of action is suggested.

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
				companies may be put under judicial management to the same extent as any other company under UK law.		Institutions Protection of Funds Act, curatorship provisions.	*ICP14: Supervisory authority to take preventative and corrective measures that are timely, suitable and necessary to achieve objectives of supervision. Envisages progressive escalation of actions.* *ICP15: Supervisory authority to enforce corrective action and impose sanctions (based on clear and objective criteria that are publicly disclosed). Range of actions should be available.* *ICP16: Legal framework should define a range of options for orderly exit of insurers from the market place. "Insolvency" to be defined, and criteria and procedure for dealing with insolvency to be established. Policyholders given priority in event of a wind up.*
4.16	Requirement to have guarantee or other compensation fund	None.	Corporations Act, Part 7.6 (compensation for breaches of obligations of financial services licensees).	Financial Services and Markets Act, s 213: Financial Services Compensation Scheme covers £2000 in full and then 90 per cent of the value of the policy (in a liquidation) thereafter.	Membership to ComCorp (Canadian Life and Health Insurance Compensation Corporation) required by OSFI for all licensed life insurers, covers the sum insured up to $200 000.	None.	

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
5.	**Cross border issues**						
5.1	Differences in treatment of foreign versus domestic policyholders while business ongoing	None. (Note: Life Act, s 79 requires every company established outside of NZ and carrying on life business in NZ, to keep a separate account of all life business transacted in NZ.)	Life Act (Aust), s 31(c), separate statutory fund generally required for offshore business. Certain provisions distinguish between Australian and offshore business. APRA has power to alter the rules.	FSA Handbook, Principles of Business: policyholder protection objective extends to all policyholders of UK authorised insurers, wherever the policyholders are located.	No specific rules.	No discrimination between domestic and foreign policyholders.	Principle 15: No foreign insurer to escape supervision. Consultation between home and host supervisors required.
5.2	Differences in treatment of foreign versus domestic policyholders on winding up	None.	Life Act (Aust), Part 8, Division 2, and Corporations Act, s 556(1). All policyholders rank equally. (But note NZ Companies Act 1993, s 131(2)).	FSA Handbook, Compensation module: non-UK policyholders are unlikely to have access to the Financial Services Compensation Scheme.	Winding-up and Restructuring Act 1985, no distinction between foreign and domestic policyholders.	No discrimination between domestic and foreign policyholders.	
5.3	Branches and subsidiaries of foreign companies in NZ	Life Act, ss 34, 38, 79, general agent to be appointed for branches or subsidiaries of foreign companies in order to carry on business in NZ.	Life Act (Aust), s 31(c).		Insurance Companies Act, branches have parallel legislation to companies or local subsidiaries. Separate chief agent must be appointed and branches are subject to additional restrictions on assets to be deposited with regulator and restrictions on capital movements.	Long-term Insurance Act, branch must comply with prudential requirements of Act.	Principle 15: (above, clause 5.1). Principle 16: Good communication with offshore supervisors to be developed. Also, in developing a regulatory framework, consideration to be given to the possibility of entering into agreements or understandings with offshore supervisors (and other industry supervisors) and sharing of information.

Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	**IAIS Insurance Core Principles/*Revised IAIS Principles***
					Principle 17: Insurance supervisors to be subject to professional secrecy constraints in respect of information obtained during inspections and from other supervisors. Also, many of the IAIS Principles seek to accommodate the possibility that an overseas insurer is already regulated in its home jurisdiction, (for example, Principle 2). *ICP5: The supervisory authority is to co-operate and share information with other relevant supervisors subject to confidentiality requirements. Essential criteria include obligations to inform in relation to material changes in supervision, and in advance of taking action against foreign establishments.* *ICP28: (anti-money laundering) requires communication between authorities.*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
5.4	Requirements for maintenance of day-to-day operations and records in operating jurisdiction	None. Reserve Bank working on requirements for registered banks.	Corporations Act, s 988D. Certain particulars must be kept in jurisdiction and records to be producible within 28 days.	FSA Handbook, Conduct of Business Sourcebook, retention of records provisions.	OSFI Guidelines – retention and destruction of records.	Long-term Insurance Act, Policyholder Protection Rules, rule 15.2 (a), records of all disclosures made and advice given must be kept until 3 years after the maturity or termination of the policy.	
5.5	Offshore branches and subsidiaries of NZ companies	Life Act, s 79, separate account of NZ business must be kept.	Life Act (Aust) would apply to NZ life company in business in Australia.	FSA Handbook, Authorisation Manual: branches or subsidiaries may operate provided they meet the authorisation requirements.	Insurance Companies Act, Part XIII, provisions for foreign companies.	All insurers must operate as subsidiaries and must be registered with the FSB.	Principles 15, 16, 17 (see clauses 5.1 and 5.3.) *ICP17: (insurers to be supervised on group-wide basis) (above, clause 4.9).*

		Existing New Zealand	Existing Australia	Existing/*Proposed* United Kingdom	Canada	South Africa	IAIS Insurance Core Principles/*Revised IAIS Principles*
6	**Regulators**	MED and Government Actuary (Life Act), Commerce Commission (Fair Trading Act and Commerce Act), Securities Commission (Securities Act and Securities Regulations).	Australian Prudential Regulatory Authority (APRA) (prudential regulation of life companies). Australian Securities and Investments Commission (ASIC) (regulates market integrity, conduct and disclosure, etc). Australian Competition and Consumer Commission (competition regulation). Reserve Bank of Australia (system stability and payments system).	Financial Services Authority.	Office of the Superintendent of Financial Institutions (OSFI) Financial Consumer Agency of Canada. Ontario Securities Commission (and other provincial equivalents). Various provincial superintendents of insurance.	Registrar of Long-term Insurance, situated in the Offices of the Financial Services Board. Financial Services Board.	Principle 1: Organisation of insurance supervisor. Must be independent, accountable, resourced, etc. *ICP2: The principle objectives of insurance supervision must be clearly defined, in particular objectives should refer to the maintenance of efficient, fair, safe and stable insurance markets for the benefit and protection of policyholders.* *ICP3: The supervisory authority must have adequate powers, legal protection, financial resources, etc and be operationally independent and accountable, have sufficient staff and treat confidential information appropriately.* *ICP4: The supervisory authority must act in a transparent and accountable manner. Accountability requires legislative and executive oversight, strict procedural requirements, and disclosure. Decisions to be subject to judicial review.* International Association of Insurance Supervisors (IAIS).

APPENDIX C
Comparative table of financial products in New Zealand and their regulation

Financial product	Who generally issues?	Subject to Securities Act 1978?	Issuer subject to Financial Reporting Act 1993?	Rating of issuer required?	Independent trustee/statutory supervisor and trust deed/deed of participation required?	Entry requirement for issuer?	Government or legislative supervision?
1. Bank deposits	Registered banks.	Yes, except for prospectus and trustee requirements.	Yes.	Yes.	No.	Reserve Bank has "authorisation process" for banks seeking registration, including minimum capital requirements. Experience and reputation of management is taken into account.	– Reserve Bank of New Zealand and its Act.
2. Shares	Companies (listed and unlisted).	Yes, if issued to the public.	Yes.	No.	No.	None (although companies listed on the New Zealand Stock Exchange must comply with Stock Exchange Listing Rules).	– Companies Act 1993 – Securities Act (and Securities Commission) – Exchange Rules (if listed) – Securities Markets Act 1988 (if listed).

Financial product	Who generally issues?	Subject to Securities Act 1978?	Issuer subject to Financial Reporting Act 1993?	Rating of issuer required?	Independent trustee/statutory supervisor and trust deed/deed of participation required?	Entry requirement for issuer?	Government or legislative supervision?
3. Debt securities, other than bank deposits	Finance companies, credit unions, other borrowers.	Yes, if issued to the public.	Yes, if issued by (most) companies, or if issued to the public (whether or not by a company).	No.	Yes, if issued to the public, under the Securities Act 1978.	None.	– Securities Act (and Securities Commission) – Friendly Societies and Credit Unions Act 1982.
4. Participatory arrangements, other than group investment funds	Partnerships, joint ventures, property syndicates.	Yes, if issued to the public.	Yes, if issued to the public.	No.	Yes, if issued to the public, under the Securities Act.	None.	– Securities Act (and Securities Commission).
5. Group investment funds	Trustee companies.	Yes, if issued to the public.	Yes, if issued to the public.	No.	Yes, if issued to the public, under the Securities Act.	Only companies named in the Trustee Companies Act 1967 can be trustee companies.	– Trustee Companies Act – Securities Act (and Securities Commission).
6. Life insurance, including insurance bonds and other savings policies and risk only policies	Life insurance companies, friendly societies.	Yes, except for risk only insurance.	Yes.	No.	No.	Bond payable under Life Insurance Act 1908 to Public Trust.	– Life Act – Government Actuary – Securities Act (and Securities Commission), except for risk only insurance.
7. General insurance	General insurers.	No.	Yes, if issued by a company (other than an "exempt" company).	Yes.	No.	Bond payable under Insurance Companies' Deposits Act 1953 to Public Trust.	– Insurance Companies (Ratings and Inspections) Act 1994 – Insurance Companies' Deposits Act 1953.

Financial product	Who generally issues?	Subject to Securities Act 1978?	Issuer subject to Financial Reporting Act 1993?	Rating of issuer required?	Independent trustee/statutory supervisor and trust deed/deed of participation required?	Entry requirement for issuer?	Government or legislative supervision?
8. Health insurance	Friendly societies, life insurers, mutual companies, general insurers.	No.	Only if issued by a company (other than an "exempt" company).	Not yet (but in the pipeline).	No.	Bond payable under Insurance Companies' Deposits Act to Public Trust.	– Insurance Companies' Deposits Act – Insurance Companies (Ratings and Inspections) Act (Registrar's powers of inspection).
9. Other insurance	Friendly societies, life insurers, mutual companies, general insurers.	No.	Only if issued by a company (other than an "exempt" company).	Not yet (but in the pipeline).	No.	Bond payable under Insurance Companies' Deposits Act to Public Trust.	– Insurance Companies' Deposits Act – Insurance Companies (Ratings and Inspections) Act (Registrar's powers of inspection).
10. Superannuation a) Defined benefit schemes b) Defined contribution schemes	Large companies with employer schemes, life insurers and other companies with public schemes, private schemes.	Yes (both types, if issued to the public), except that small employer schemes exempt from prospectus requirements (proposal to exempt all employer schemes in the pipeline).	Yes (both types), if issued to the public.	No.	No (both types).	None.	– Superannuation Schemes Act 1989 – Government Actuary – Trustee Act 1956 – Securities Act (and Securities Commission).
11. Unit trusts	Banks, life insurers.	Yes, if issued to the public.	Only if issued to the public.	No.	Yes.	Managers of unit trusts required to pay bond under Unit Trusts Act 1960.	– Unit Trusts Act – Trustee Act – Securities Act (and Securities Commission).

Financial product	Who generally issues?	Subject to Securities Act 1978?	Issuer subject to Financial Reporting Act 1993?	Rating of issuer required?	Independent trustee/statutory supervisor and trust deed/deed of participation required?	Entry requirement for issuer?	Government or legislative supervision?
12. Derivatives, including futures and options	Banks, companies.	Yes, if issued to the public.	If issued to the public, or if issuer is a company (other than an "exempt" company).	No.	No.	None.	– Subject to Stock Exchange rules if traded via an exchange – Securities Markets Act 1988 (futures) – Futures Industry (Client Funds) Regulations 1990
13. Financial advice	Insurance agents, brokers, financial planners, financial advisers.	No.	If financial adviser is a company (other than an "exempt" company).	No.	No.	None.	– Investment Advisers (Disclosure) Act 1996 – Insurance Intermediaries Act 1994 – Secret Commissions Act 1910.

OTHER LAW COMMISSION PUBLICATIONS

Report series

NZLC R1	Imperial Legislation in Force in New Zealand (1987)
NZLC R2	Annual Reports for the years ended 31 March 1986 and 31 March 1987 (1987)
NZLC R3	The Accident Compensation Scheme (Interim Report on Aspects of Funding) (1987)
NZLC R4	Personal Injury: Prevention and Recovery (Report on the Accident Compensation Scheme) (1988)
NZLC R5	Annual Report 1988 (1988)
NZLC R6	Limitation Defences in Civil Proceedings (1988)
NZLC R7	The Structure of the Courts (1989)
NZLC R8	A Personal Property Securities Act for New Zealand (1989)
NZLC R9	Company Law: Reform and Restatement (1989)
NZLC R10	Annual Report 1989 (1989)
NZLC R11	Legislation and its Interpretation: Statutory Publications Bill (1989)
NZLC R12	First Report on Emergencies: Use of the Armed Forces (1990)
NZLC R13	Intellectual Property: The Context for Reform (1990)
NZLC R14	Criminal Procedure: Part One: Disclosure and Committal (1990)
NZLC R15	Annual Report 1990 (1990)
NZLC R16	Company Law Reform: Transition and Revision (1990)
NZLC R17(S)	A New Interpretation Act: To Avoid "Prolixity and Tautology" (1990) (and Summary Version)
NZLC R18	Aspects of Damages: Employment Contracts and the Rule in *Addis v Gramophone Co* (1991)
NZLC R19	Aspects of Damages: The Rules in *Bain v Fothergill* and *Joyner v Weeks* (1991)
NZLC R20	Arbitration (1991)
NZLC R21	Annual Report 1991 (1991)
NZLC R22	Final Report on Emergencies (1991)
NZLC R23	The United Nations Convention on Contracts for the International Sale of Goods: New Zealand's Proposed Acceptance (1992)
NZLC R24	Report for the period 1 April 1991 to 30 June 1992 (1992)
NZLC R25	Contract Statutes Review (1993)
NZLC R26	Report for the year ended 30 June 1993 (1993)
NZLC R27	The Format of Legislation (1993)
NZLC R28	Aspects of Damages: The Award of Interest on Money Claims (1994)
NZLC R29	A New Property Law Act (1994)
NZLC R30	Community Safety: Mental Health and Criminal Justice Issues (1994)
NZLC R31	Police Questioning (1994)
NZLC R32	Annual Report 1994 (1994)
NZLC R33	Annual Report 1995 (1995)
NZLC R34	A New Zealand Guide to International Law and its Sources (1996)
NZLC R35	Legislation Manual: Structure and Style (1996)
NZLC R36	Annual Report 1996 (1996)
NZLC R37	Crown Liability and Judicial Immunity: A response to *Baigent's* case and *Harvey v Derrick* (1997)
NZLC R38	Succession Law: Homicidal Heirs (1997)
NZLC R39	Succession Law: A Succession (Adjustment) Act (1997)
NZLC R40	Review of the Official Information Act 1982 (1997)

NZLC R41 Succession Law: A Succession (Wills) Act (1997)
NZLC R42 Evidence Law: Witness Anonymity (1997)
NZLC R43 Annual Report 1997 (1997)
NZLC R44 Habeas Corpus: Procedure (1997)
NZLC R45 The Treaty Making Process: Reform and the Role of Parliament (1997)
NZLC R46 Some Insurance Law Problems (1998)
NZLC R47 Apportionment of Civil Liability (1998)
NZLC R48 Annual Report (1998)
NZLC R49 Compensating the Wrongly Convicted (1998)
NZLC R50 Electronic Commerce Part One: A Guide for the Legal and Business Community (1998)
NZLC R51 Dishonestly Procuring Valuable Benefits (1998)
NZLC R52 Cross-Border Insolvency: Should New Zealand adopt the UNCITRAL Model Law on Cross-Border Insolvency? (1999)
NZLC R53 Justice: The Experiences of Māori Women: Te Tikanga o te Ture: Te Mātauranga o ngā Wāhine Māori e pa ana ki tēnei (1999)
NZLC R54 Computer Misuse (1999)
NZLC R55 Evidence (1999)
NZLC R56 Annual Report (1999)
NZLC R57 Retirement Villages (1999)
NZLC R58 Electronic Commerce Part Two: A Basic Legal Framework (1999)
NZLC R59 Shared Ownership of Land (1999)
NZLC R60 Costs in Criminal Cases (2000)
NZLC R61 Tidying the Limitation Act (2000)
NZLC R62 Coroners (2000)
NZLC R63 Annual Report 2000 (2000)
NZLC R64 Defaming Politicians: A Response to *Lange v Atkinson*
NZLC R65 Adoption and Its Alternatives: A Different Approach and a New Framework (2000)
NZLC R66 Criminal Prosecution (2000)
NZLC R67 Tax and Privilege: Legal Professional Privilege and the Commissioner of Inland Revenue's Powers to Obtain Information (2000)
NZLC R68 Electronic Commerce Part Three: Remaining Issues (2000)
NZLC R69 Juries in Criminal Trials (2001)
NZLC R70 Acquittal Following Perversion of the Course of Justice (2001)
NZLC R71 Misuse of Enduring Powers of Attorney (2001)
NZLC R72 Subsidising Litigation (2001)
NZLC R73 Some Criminal Defences with Particular Reference to Battered Defendants (2001)
NZLC R74 Minority Buy-Outs (2001)
NZLC R75 Annual Report (2001)
NZLC R76 Proof of Disputed Facts on Sentence (2001)
NZLC R77 The Future of the Joint Family Homes Act (2001)
NZLC R78 General Discovery (2002)
NZLC R79 Some Problems in the Law of Trusts (2002)
NZLC R80 Protections Some Disadvantaged People May Need (2002)
NZLC R81 Annual Report (2002)
NZLC R82 Dispute Resolution in the Family Court (2003)
NZLC R83 Improving the Arbitration Act 1996 (2003)
NZLC R84 Annual Report (2003)

Study Paper series

NZLC SP1 Women's Access to Legal Services (1999)

NZLC SP2 Priority Debts in the Distribution of Insolvent Estates: An Advisory Report to the Ministry of Commerce (1999)

NZLC SP3 Protecting Construction Contractors (1999)

NZLC SP4 Recognising Same-Sex Relationships (1999)

NZLC SP5 International Trade Conventions (2000)

NZLC SP6 To Bind their Kings in Chains: An Advisory Report to the Ministry of Justice (2000)

NZLC SP7 Simplification of Criminal Procedure Legislation: An Advisory Report to the Ministry of Justice (2001)

NZLC SP8 Determining Representation Rights under Te Ture Whenua Māori Act 1993: An Advisory Report for Te Puni Kōkiri (2001)

NZLC SP9 Māori Custom Values in New Zealand Law (2001)

NZLC SP10 Mandatory Orders Against the Crown and Tidying Judicial Review (2001)

NZLC SP11 Insolvency Law Reform: Promoting Trust and Confidence: An Advisory Report to the Ministry of Economic Development (2001)

NZLC SP12 Electronic Technology and Police Investigations: Some Issues (2002)

NZLC SP13 Treaty of Waitangi Claims: Addressing the Post-Settlement Phase: An Advisory Report for Te Puni Kōkiri, the Office of Treaty Settlements and the Chief Judge of the Māori Land Court (2002)

NZLC SP14 Liability for Loss Resulting from the Development, Supply, or Use of Genetically Modified Organisms (2002)

Preliminary Paper series

NZLC PP1 Legislation and its Interpretation: The Acts Interpretation Act 1924 and Related Legislation (discussion paper and questionnaire) (1987)

NZLC PP2 The Accident Compensation Scheme (discussion paper) (1987)

NZLC PP3 The Limitation Act 1950 (discussion paper) (1987)

NZLC PP4 The Structure of the Courts (discussion paper) (1987)

NZLC PP5 Company Law (discussion paper) (1987)

NZLC PP6 Reform of Personal Property Security Law (report by Prof JH Farrar and MA O'Regan) (1988)

NZLC PP7 Arbitration (discussion paper) (1988)

NZLC PP8 Legislation and its Interpretation (discussion and seminar papers) (1988)

NZLC PP9 The Treaty of Waitangi and Māori Fisheries – Mataitai: Nga Tikanga Māori me te Tiriti o Waitangi (background paper) (1989)

NZLC PP10 Hearsay Evidence (options paper) (1989)

NZLC PP11 "Unfair" Contracts (discussion paper) (1990)

NZLC PP12 The Prosecution of Offences (issues paper) (1990)

NZLC PP13 Evidence Law: Principles for Reform (discussion paper) (1991)

NZLC PP14 Evidence Law: Codification (discussion paper) (1991)

NZLC PP15 Evidence Law: Hearsay (discussion paper) (1991)

NZLC PP16 The Property Law Act 1952 (discussion paper) (1991)

NZLC PP17 Aspects of Damages: Interest on Debt and Damages (discussion paper) (1991)

NZLC PP18 Evidence Law: Expert Evidence and Opinion Evidence (discussion paper) (1991)

NZLC PP19 Apportionment of Civil Liability (discussion paper) (1992)

NZLC PP20 Tenure and Estates in Land (discussion paper) (1992)

NZLC PP21 Criminal Evidence: Police Questioning (discussion paper) (1992)

NZLC PP22 Evidence Law: Documentary Evidence and Judicial Notice (discussion paper) (1994)

NZLC PP23 Evidence Law: Privilege (discussion paper) (1994)

NZLC PP24 Succession Law: Testamentary Claims (discussion paper) (1996)

NZLC PP25 The Privilege Against Self-Incrimination (discussion paper) (1996)

NZLC PP26 The Evidence of Children and Other Vulnerable Witnesses (discussion paper) (1996)

NZLC PP27 Evidence Law: Character and Credibility (discussion paper) (1997)

NZLC PP28 Criminal Prosecution (discussion paper) (1997)

NZLC PP29 Witness Anonymity (discussion paper) (1997)

NZLC PP30 Repeal of the Contracts Enforcement Act 1956 (discussion paper) (1998)

NZLC PP31 Compensation for Wrongful Conviction or Prosecution (discussion paper) (1998)

NZLC PP32 Juries in Criminal Trials: Part One (discussion paper) (1998)

NZLC PP33 Defaming Politicians: A response to *Lange v Atkinson* (discussion paper) (1998)

NZLC PP34 Retirement Villages (discussion paper) (1998)

NZLC PP35 Shared Ownership of Land (discussion paper) (1999)

NZLC PP36 Coroners: A Review (discussion paper) (1999)

NZLC PP37 Juries in Criminal Trials: Part Two (discussion paper) (1999)

NZLC PP38 Adoption: Options for Reform (discussion paper) (1999)

NZLC PP39 Limitation of Civil Actions (discussion paper) (2000)

NZLC PP40 Misuse of Enduring Powers of Attorney (discussion paper) (2000)

NZLC PP41 Battered Defendants: Victims of Domestic Violence Who Offend (discussion paper) (2000)

NZLC PP42 Acquittal Following Perversion of the Course of Justice: A Response to *R v Moore* (discussion paper) (2000)

NZLC PP43 Subsidising Litigation (discussion paper) (2000)

NZLC PP44 The Future of the Joint Family Homes Act (discussion paper) (2001)

NZLC PP45 Reforming the Rules of General Discovery (discussion paper) (2001)

NZLC PP46 Improving the Arbitration Act 1996 (discussion paper) (2001)

NZLC PP47 Family Court Dispute Resolution (discussion paper) (2002)

NZLC PP48 Some Problems in the Law of Trusts (discussion paper) (2002)

NZLC PP49 Protecting Personal Information from Disclosure (discussion paper) (2002)

NZLC PP50 Entry, Search and Seizure (discussion paper) (2002)

NZLC PP51 Striking the Balance: Your Opportunity to Have Your Say on the New Zealand Court System (discussion paper) (2002)

NZLC PP52 Seeking Solutions: Options for Change to the New Zealand Court System (discussion paper) (2002)