

# **Review of Financial Production Providers: Prudential Regulation of Insurance**

## **Cabinet & Economic Development Committee Office of the Minister of Finance Cabinet Paper**

### **Introduction**

1. All insurers should be subject to prudential supervision as people must have confidence in the integrity of *all* our financial markets.
2. Insurers dealing with the public must also have minimum levels of capital adequacy to justify asking the public to rely on them. However, Captives do not deal with the public, but rather with members of their own organisations prepared to assume responsibility for their own risk protection. To impose the same capital adequacy requirements on Captives as apply to insurers who deal with the public will discourage firms from managing their own insurance risks in New Zealand, without benefiting anyone.
3. In terms of risk protection, there is nothing new in drawing a distinction based on whether a financial service provider is dealing with the public. This distinction underpins the Securities Act; our primary risk protection legislation for investors in financial products. We support any initiative that permits public confidence in financial service providers, but it is not necessary as part of that exercise to discourage a financial service designed to promote the concept of organisations with sufficient knowledge and ability to manage their own risks being allowed and encouraged to do so.
4. If the regime applying to Captives in New Zealand is more onerous than the regimes in other jurisdictions that implicitly acknowledge that capital adequacy can be assessed differently where it backs self-reliance, then this will discourage major global businesses from using New Zealand as a domicile for Captives – this is not in the interests of those organisations, or New Zealand, and, moreover, does not benefit anyone.
5. For the above reasons, we wish to highlight some areas where specific provision needs to be made to address Captives although, as you will see, we are generally supportive of the changes and agree that, for the most part, they can apply to Captives.
6. Our only concern is to distinguish between prudential financial supervision, and risk protection for members of the public (Captives do not insure members of the public).

The Reserve Bank has prepared for the Cabinet a paper on the Prudential Regulation of Insurance Companies.

### **Page 9, Item 13 states**

I am proposing that all providers of insurance in New Zealand are subject to prudential regulations and, in addition, market conduct regulations so that the policyholders can have confidence that the obligations of Insurers will be fulfilled irrespective of the size or corporate form of the Insurance Provider.

### **Paragraph 39**

The definition of Insurance Provider would be independent of corporate form so that any Limited Company, branch of a Limited Company, Building Society, Finance Company, Friendly Society, Credit Union, Discretionary Mutual Organisation, Captive Insurance Company, Trust or any other corporate form which provides insurance will be included within the regime and subject to prudential supervision.

### **NZCIA Comment**

*The NZCIA would like a captive insurance company to be defined in the consultation document.*

### **Page 10, Licensing, Paragraph 45**

The existing licensing regime will be used for all insurers using the licensing criteria set out below. The application of criteria will incorporate a degree of variation to reflect the different risks inherent in different products and so the need, possibly, for higher or different prudential requirement for either Life, Health and General Insurance and the fact that Captives do not offer their products to the public.

### **NZCIA Comment**

*Under this paragraph, the captive is not defined as being a separate organisation from a Life Insurer, Health Insurer or*

a General Insurer. The NZCIA believes that the captive should be defined in the legislation and in the licensing requirements, and have a separate licensing mechanism defined for their specific business risk, given that it is not offered to the public.

#### **Paragraph 47, Licensing Criteria**

The purpose of licensing is to ensure that Insurers are fit for business by demonstrating their capacity to manage the business and undertake, identify and manage risks effectively and have sufficient financial strength.

a) **Minimum Capital Requirement**

It is anticipated that the initial amount specified in regulations will be \$2M.

**NZCIA Comment**

*The NZCIA believe that a \$2M capital requirement for captive insurance companies is excessive. They offer insurance within a group, rather than “to the public”. In recognised captive jurisdictions around the world, the capital requirements for single parent captive insurance companies start at US\$120, 000 In Bermuda, US\$250, 000 in Hawaii and Vermont, and Singapore \$400, 000 in Singapore.*

*It is our belief for New Zealand to continue to thrive as a captive domicile, we need to have a capital requirement consistent with recognised captive domiciles. In this case, we are proposing a minimum capital requirement of \$500, 000 for a captive insurance company to be domiciled in New Zealand,*

b) Sufficient financial strength both at the time of application and projected in relation to its size and nature and risks of the insurance business.

**NZCIA Comment**

*The NZCIA is in support of this regulation of licensing requirement and we will spell out later in our licensing suggestions on how to enhance this.*

c) The insurer must have a financial strength rating issued by a rating agency approved by the Bank.

**NZCIA Comment**

*The NZCIA believe this is excessive for captive insurance companies. One of the primary reasons for forming a captive insurance company is to lower the cost of insurance for a corporate group. The cost of obtaining and maintaining a rating with a recognised rating agency such as Standard and Poors is approximately A\$50,000. These costs are not warranted for a captive insurer because it only insures related parties.*

d) Levels of risk that are suitable to the nature of the business, Insurer's business and risk management policies, systems and reports and other procedures that are effective to manage the amount and nature of the Insurer's risk.

**NZCIA Comment**

*We are in support of this licensing criteria. All captive insurance companies constantly monitor the level of risk they retain for the policies they underwrite and the amount of capital they have available to meet the potential losses. These are all done in conjunction with the overall risk management philosophy of the parent company and how best to achieve that.*

e) Directors and Senior Managers are sufficiently qualified and appropriate for the business.

**NZCIA Comment**

*The NZCIA is in support of this requirement and, in fact, most captive domiciles around the world require a resident director on the Board of Directors of the captive insurance company. The resident director is generally a captive insurance professional who has sufficient experience to guide the captive with help from parent company directors to ensure that the financial and underwriting goals are met.*

f) Suitable ownership, corporate form and other appropriate governance arrangements.

**NZCIA Comment**

*The NZCIA is in support of this licensing requirement and believes that all captive insurance companies should be duly incorporated with companies.*

g) Appropriate actuarial and accounting arrangements

**NZCIA Comment**

*Again, the NZCIA comment is in support of this licensing criteria. A captive insurance company should be subject to an actuarial review of its loss reserves per annum, the creation of an actuarially driven IBNR, and the production of audited financial statements on an annual basis with those reports being filed with the Reserve Bank.*

- h) The extent and nature of connected lending and non-insurance activities undertaken

**NZCIA Comment**

*A captive insurance company should be allowed to invest its funds with its parent, i. e. interconnected lending. It is accepted investment practise in all recognised captive domiciles that a captive insurance company is allowed to lend its investment funds as part of its investment philosophy. These investments would be governed by an "arms length" investment arrangement, signed promissory notes and commercial rates of return. These investment requirements are in line with the major domiciles around the world, i.e. Bermuda, Vermont, Singapore, Guernsey.*

- l) The Actuary and Auditor of the insurer are satisfactory to the Bank and there are no matters of an accounting and actuarial nature which cause the Bank concern.

**NZCIA Comment**

*We are in favour of this licensing requirement.*

- (j) Corporate form or other arrangements that provide adequate separation between different types of insurance business.

**NZCIA Comment**

*The captive insurance company should be exempt from this licensing requirement because a captive only insures related parties. Its driving concern is to decrease the cost of insurance for its corporate group.*

- k) For foreign branches, the home country's legal, accounting and prudential supervision requirements are considered satisfactory to the Bank.

**NZCIA Comment**

*The Reserve Bank should ensure that all foreign insurers meet, at a minimum, the New Zealand requirements for operating in New Zealand.*

**NZCIA Licensing Requirements**

The NZCIA would like to propose the following licensing requirements for captive insurance companies.

- A Business Plan, including risks to be underwritten and five-year financial projections
- Names, addresses and work experience of proposed Directors with at least one resident Director
- Names, addresses and work experience of proposed Captive Managers Capital contribution
- A statement of its capital
- Ultimate owner of shares
- Latest set of audited Financial Statements from the parent company
- Name and address and consent of Auditors
- Name and address and consent of Bankers
- Name and address and consent of Investment Advisors Name and address and consent of Consulting Actuary

Once this information has been submitted to the Regulator, the Regulator could then issue a licence for the captive insurance company.

**Page 11, paragraph 51, Minimum Capital****NZCIA Comment**

*The minimum capital requirement has been discussed by the NZCIA and it is our belief that captive insurance companies should be exempt from the \$2M requirement, and be required to post a \$500,000 capital contribution, which must be maintained at all times as a minimum solvency requirement.*

**Page 11, Financial Strengths, paragraph 52**

Solvency requirements calculations performed by the Insurer's Actuary are designed to ensure that an Insurer has sufficient assets to meet its obligations to existing policyholders and creditors under these circumstances. Solvency calculations should be defined and regulations based upon New Zealand Actuary returns developed by the New Zealand Society of Actuaries.

**NZCIA Comment**

*It is our belief that captives should not be subject to the New Zealand Actuarial Standards due to the nature of risk they underwrite. Captive insurance companies should be subject to international Financial Reporting Standard 4, which is in compliance with the IAIS guidelines.*

**Page 13, Ratings, paragraph 56**

I propose that all insurance providers be required to obtain and disclose financial strength ratings subject to granting an exemption from this requirement for small insurers issued by a Rating Agency, approved by the Bank.

**NZCIA Comment**

*NZCIA is not in favour of captives having a rating due to the nature of the risk they underwrite, the parental company financial strength and the captive is only insuring the members of the Group. Ratings are designed to support offerings to the public; not members of the issuer's own group who can be expected to understand the insurer's financial capability.*

**Risk Management, paragraph 67**

The NZCIA is in favour of this requirement and is, in fact, practised by all captive insurance companies.

**Paragraph 68, Fit and Proper**

I propose that the Directors and certain Senior Management of an insurer must meet the Bank's Fit and Proper positive assurance requirements of the Bank or perform positive assurance, positive earn, positive fit and insurance checks.

**NZCIA Comment**

*NZCIA is proposing that there be a Resident Director with captive insurance experience on the Board of all captive insurance companies located in New Zealand. This captive Resident Director and the captive Resident Manager will provide the Board of Directors with guidance on risk management, insurance mechanisms, compliance and prudential management and the ethical running of captive insurance companies. We believe this will be sufficient to ensure a Fit and Proper organisation is domiciled in New Zealand.*

**Accounting and Actuarial Practices, Paragraphs 76 and 77**

The NZCIA is in favour of a qualified Actuary valuing the insurance liabilities of a captive insurance company.

**Paragraph 77**

The NZCIA is in favour of maintaining a satisfactory accounting system to ensure that the accounts of the captive insurance company truly reflect the Insurer's business.

**Paragraph 96, Six-monthly Public Financials and Director Attestations**

We propose that annual audited financial statements reporting under Financial Reporting Act 1993 must be met by all insurers with no exceptions for size. These financials together with disclosure of credit rating and the directors' attestation that are proposed below will comprise the annual disclosure statement. It is further proposed that insurers will also publish six monthly versions of disclosure statement which will include reduced version of the annual financial statement so as to limit the compliance cost for insurers.

**NZCIA Comment**

*The NZCIA is in favour of six monthly financial and directors attestation statements in accordance with the Financial Reporting Act 1993.*

**Captive Definition**

The NZCIA would like a definition which is consistent with the International Association of Insurance Supervisors and that definition that has been accepted in jurisdictions where captives are commonly domiciled, i.e. Bermuda, Cayman Islands, Singapore, Vermont, Guernsey, that the captive is an entity that only insures entities that in the terms of international accounting standards are:

- a) its parent
- b) a related entity, i.e. under joint control
- c) in a joint control (joint venture) with that entity or an entity of the type described in a) or b) above
- d) an associate of that entity or an entity of the type described in a) or b) above.

We believe that if this definition is included into the legislation it would further enhance New Zealand's standing in the international community and help to continue to develop captive insurance companies as an economic benefit for all New Zealanders.