

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ
INC**

SUBMISSION
TO THE
MINISTRY OF ECONOMIC DEVELOPMENT
ON THE
REVIEW OF FINANCIAL PRODUCTS AND
PROVIDERS

Insurance

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Introduction

The Investment Savings and Insurance Association ("ISI") welcomes the opportunity to comment on the Discussion Document *Insurance* issued as part of the Review of Financial Products and Providers ("RFPP"). Our comments are made on behalf of our members who are the issuers and managers of life insurance, superannuation and managed funds listed at the end of this paper. Our members are keenly interested in the proposals put forward for regulation of the financial services industry and we have appreciated the extensive consultation on these issues with officials and advisory groups.

ISI generally supports the overall framework for regulation of the financial services industry and the registration proposal, but we do have some specific comments to make on the proposals for insurance.

General Comments

ISI commends the Ministry of Economic Development for the process followed in the RFPP and the opportunity it presents for the regulation of financial services to be considered in a comprehensive manner. The discussion documents produced by MED together provide a very useful overview of the application of different pieces of legislation to the various products and services available within the industry.

We endorse the approach to financial services regulation from the point of view that comparable products and services should be regulated on a comparable and consistent basis in order to increase the protection and understanding of consumers and reduce the cost of compliance for providers. One of the key outcomes to be hoped for must be an improvement in the environment for saving in New Zealand in order to raise the level of personal saving and increase the pool of local savings available for investment.

As noted above, ISI members are the companies issuing and managing life insurance, superannuation and managed funds in New Zealand. That involves various ISI members in most of the activities reviewed as part of the RFPP: insurance, superannuation, collective investment schemes, platforms and portfolio management services, the offering of securities and consumer dispute resolution and redress. Reinsurance companies (all based offshore) are also members of this association and a key participant in the life insurance industry.

All ISI members have an interest in New Zealand maintaining a robust and efficient financial services system which has the confidence and respect of the New Zealand public and local and international institutions. ISI has taken a leading role for the industry in commenting on law reform issues. Key issues in recent years have been the recommendations for review of the Life Insurance Act 1908 and the review of the Securities Act and Regulations.

We are aware of the need for financial services regulation in New Zealand to take account of responsibilities towards the security of international financial markets and

ISI has provided submissions to recent Ministry of Justice discussion documents on anti-money laundering and countering the financing of terrorism (FATF Recommendations). As most ISI members are trans-Tasman companies, we are also acutely aware of the issues around trans-Tasman mutual recognition.

A holistic approach to regulation of the financial services industry should ensure that the design of a new regime takes into account the need to improve the environment for personal saving in New Zealand while harmonising where possible with Australia and also meeting our international obligations in the area of financial security.

The RFPP discussion documents propose to apply the same regulatory regime to life insurance products with a savings component, superannuation and managed funds on the basis that they are comparable products and should be regulated on the same basis. ISI supports the general approach involving registration of financial institutions and two main regulators (prudential and market conduct), with collective investment schemes and their issuers being supervised by trustees who are approved and supervised by the Securities Commission. We do not, however, support life insurance policies with a savings component being treated as collective investment schemes.

We have the following comments to make specifically on the *Insurance* discussion document.

Insurance

Outcomes and Reasons for Intervention

ISI endorses the outcomes set out in paragraph 35. We have been urging a review of the Life Insurance Act 1908 for many years and welcomed the Law Commission review of life insurance in 2004. Our submissions to the Law Commission included support for:

- Increased responsibilities for directors to protect policyholders' interests
- A requirement for each life insurer to obtain actuarial advice in certain circumstances and to have a company actuary with specific duties to advise the directors
- A regulator for the life insurance industry
- Enhanced financial disclosure requirements
- A minimum capital requirement
- Local incorporation, with exemption by the regulator for existing insurers subject to certain criteria
- Life insurance business in a separate statutory fund from other business
- Actuarial Standards for life insurance business to be approved by the regulator

While there have not been any problems with business failure in the life insurance industry in New Zealand in recent history, we acknowledge that there will be benefits for both consumers and companies in revising outdated features of the current legislation.

We agree with the reasons for regulatory intervention that have been identified but recommend that caution should be exercised in the extent of detailed prescriptive regulation.

ISI has previously recommended that the life insurance industry should have a regulator and we support the proposals summarised in paragraph 13. The reason for needing a regulator is that life insurers are in the business of providing long-term guarantees to members of the public who may have difficulty switching products in later years when their health status has deteriorated. This is a key point that differentiates life insurance from other services and it calls for specialist oversight.

As noted above, we also acknowledge the pressure for additional regulation coming from New Zealand's international obligations, particularly in the area of anti-money laundering.

Registration

ISI support for the proposal for registration of financial institutions is set out in our submission on the *Overview of the Review and Registration of Financial Institutions* discussion document. Our support is subject to further detail on the Regulator's requirements for registration, such as board composition, suitability of key persons, fit and proper person vetting, functions and responsibility and external auditors.

Licensing and Prudential Regulation

ISI supports the general proposal for a licensing regime and agrees with the proposal that an insurer would need to have a physical presence in New Zealand in order to obtain a licence. This proposal does require clarification of what would constitute a physical presence. We also look forward to further consultation on the criteria for approval of agents for overseas entities that do not have a licence, and who would set the criteria.

For the reasons given below, we do not accept that a separate licence should be required for life, health and general insurance. This would be consistent with there being no requirement for banks to have separate licences although different banks undertake very different kinds of business.

Separate Classes

We recommend that health and life insurance business should be able to be covered under one licence and general insurance business under a separate licence (with flexibility of classification for certain products that have characteristics of both life and general, such as trauma insurance). We acknowledge that each class of insurance has different risk exposure and may have different capital and solvency requirements. However, a requirement for separate licensing for each class may artificially influence the way products are brought to the market and will increase the costs of administration without providing any extra benefits for consumers.

Health and life insurance have complementary business practices and are developed, sold and administered on a very similar basis. There are benefits for customers in having the management of those products integrated for claims administration, policy wordings and underwriting, not least of which would be avoiding the flow-on effects of higher administration costs.

Additional benefits for customers from life and health business being covered under a single licence and set of prudential requirements include access to a wider selection of products and increased product innovation and competition.

Segregation of Funds but not Separate Incorporation

ISI does not support the option for the Regulator to require separate incorporation under the Companies Act for different classes of business. We consider that such a requirement would add compliance costs that would need to be passed on to consumers without adding significantly to the protection provided by other prudential requirements.

We have previously proposed a legal requirement that identifiable and separately tagged assets must be maintained with the sole purpose of meeting claims in the life insurance business and properly sanctioned dividends or capital transfers to the life insurance company shareholders. Life insurance companies should be able to write personal sickness and accident, health and death by accident policies through the life insurance fund or, in the case of a company that undertakes more than life insurance business, establish a subsidiary or define a separate statutory fund.

With regard to the proposal on connected lending, we would not support any arrangement that prevents investment of life company funds with a registered bank where the life insurance company and the bank are part of the same corporate group.

Solvency and Capital Proposals

ISI supports the proposals for a solvency support plan, flexible start-up capital requirement and enhanced on-going solvency requirements.

Although the solvency support plan is a start up requirement we recommend that it should have a focus of five years rather than the proposed three, to recognise the longer start up phase in this long term industry. Quite often a new company will take a few months after a licence is issued before it starts writing business and the pace of writing business could take several quarters to build up.

Legal Form of Foreign Insurers

We consider that, with the exception of existing insurers, any foreign insurer doing business in New Zealand should be required to incorporate in this country and comply with local regulatory requirements. We would, however, support the Regulator having an exemption facility to determine whether a foreign insurer may operate without local incorporation where specific criteria are met and there is acceptable home jurisdiction regulation.

It is difficult to see the justification for having lighter licensing requirements for small insurers as the risk to the policyholder may be greater than for a large company.

We recommend that reinsurance companies should also be exempt from the requirement for local incorporation. There are no domestic reinsurers and requiring an off shore reinsurance company to incorporate in New Zealand will only limit the number of reinsurers available to NZ insurers.

Ratings

We support Option 2 in paragraph 3.6.4, which would not make a rating mandatory for life insurance. Ratings do not provide a good guide to long term solvency and their benefit is reduced by the fact that they tend to be a lag indicator of problems rather than a lead indicator. Ratings have a tendency only to look forward over the short to medium term rather than the longer periods over which life policies typically operate.

We accept the possible benefits of ratings outlined in paragraph 3.6.4.1 but consider these are outweighed by the limitations set out in paragraph, 3.6.4.2. Some life insurance companies will continue to seek ratings on a voluntary basis, but we do not believe that it is appropriate or necessary to mandate a requirement for ratings, given that there will be oversight by the Regulator.

If a mandatory rating requirement is introduced it must be applied to all insurers without exception.

Transition of Existing Insurers

We support the set transition period in Option 1 in paragraph 3.6.5, with the proviso that the Regulator should have the power to consider applications for a more flexible approach in certain limited circumstances.

Insurer Appeal Rights

ISI recommends that the appeal right for the licensing and de-licensing decisions made by the Regulator should be on the basis of both merit review and judicial review.

Monitoring and Supervision

Although, as the discussion document acknowledges, there have been no calamities in the New Zealand insurance market under the current supervisory regime, we agree that there are power asymmetries that make supervision by a Regulator advantageous for policyholders.

We endorse the proposals for public reporting but would appreciate clarification of what is intended by the requirements in paragraphs 232 and 240 that reporting be done on a solo and consolidated group basis. If it is intended that insurers would need to report on non-insurance entities within a group significantly more administrative compliance cost will be incurred.

We note that the value of reports to the Regulator may be limited if insurers are not confident that information provided to the Regulator (other than that intended for public disclosure) will be kept confidential and not disclosed under the Official Information Act or similar legislation.

As a general comment, we recommend caution in the approach to regulation to ensure that reporting to the Regulator does not usurp the responsibility of the life insurance company board of directors for ensuring the financial soundness of the company.

Intervention

ISI supports the proposal that the Regulator should have an escalating series of possible interventions, to be applied as justified. We recommend that the Regulator should be required to give reasonable notice before conducting any on site inspections. We agree that a graduated response is appropriate to minimise the risk of insurer failure but, as noted in paragraph 247, there must be prescribed criteria for intervention by the Regulator to ensure that it does not exceed acceptable bounds. We look forward to consultation on these criteria.

We also recommend that directors and senior management should be protected from self-incrimination in respect of anything they say or disclose at a meeting with the Regulator and furthermore that they should be entitled to an indemnity when acting in accordance with the Regulator's directions.

Market Conduct Regulation***Disclosure***

ISI supports the proposals regarding clarification of the duty of disclosure and remedies for misstatement and non-disclosure. We note that it is proposed to remove the insurer's right to avoid the contract when the insured has answered carelessly and replace it with the ability to avoid on the grounds of fraud. Greater detail is needed on the circumstances needed to meet the test of fraud.

The second grounds for avoiding a contract in paragraph 283 will require further detail. It is likely that this will result in longer and more complex proposal documents in order to ensure specific questions are asked for all information that could possibly be relevant to assessing the risk. It is common for the assessment process to take longer than 10 days for life and health insurance and for only restricted benefits to be available to the applicant until the full assessment is completed. We recommend that the third bullet point in paragraph 283 allow around 30 days.

While paragraph 284 notes that it is intended to prevent insurers relying on "catch all" questions, they are an essential feature of the increasing amount of business sold through call centres and direct mail. Increasing the complexity of the application process will limit the development of simplified channels for distribution of life insurance. However, paragraph 294 appears to allow insurers to continue to rely on "catch all" questions as long as their recourse in the event of non-disclosure or misstatement would be restitution rather than avoidance.

Reinsurance companies will also have an interest in finding an acceptable way of limiting the complexity of proposal documents without increasing the risk undertaken by insurers and reinsurers.

We agree that insurers should be required to warn applicants of their duty to disclose and the consequences of not doing so. Where, despite such warnings, there is innocent non-disclosure and misstatement we support the restitution approach. We suggest, however, that the restitution remedies proposed for life insurance should be amended as follows:

- Where information was not disclosed that would have resulted in a premium loading, the insurer should be able to retrospectively reduce the sum assured to the level that would have been available for the level of premium actually paid.
- Where the policy is a one claim life insurance contract payable only on death the option of excluding a condition from future cover could not be used. That option could, however, be exercised where there was a supplementary health or trauma benefit and a claim arose for undisclosed condition that could be excluded from a future death claim.

Assignments and Mortgages

We are generally supportive of the proposal for a notice procedure to register assignments and mortgages.

Intermediaries and Agency

Life insurance companies distribute their products using a variety of intermediary channels including single agency, multi-agency, bank employees and direct mail. The appropriate regulation of personal financial advice has been covered in the discussion document *Financial Intermediaries*, on which ISI submitted comments in October, and we understand that the proposal in this discussion document is intended solely to clarify whether an intermediary is acting on behalf of the insurer or the applicant at the time of contract formation.

ISI supports the proposal that an intermediary should be required to disclose to an applicant for insurance whether the intermediary is working for the insurer or the applicant. We have some doubt about the extent to which most applicants will understand the implications of the additional disclosure but we consider that associated changes to dispute resolution facilities and the adviser regulation mentioned above will provide sufficient consumer protection.

Product Disclosure

ISI does not agree that product disclosure is an appropriate area for regulation. A life insurance policy document is the basis of the contract between insurer and insured and that is the appropriate place for all details of the policy to be disclosed. Our concerns with the model disclosure form in the discussion document are that it would duplicate the material which must be provided in the policy document and may confuse the insured about which document is the actual contract.

We agree that it is in the interests of both the insurer and the insured to have clarity around the terms of the contract but we do not accept that an additional document is the best way to achieve that.

The light handed regulation that has existed for life insurance has been effective and successful. We understand that complaints relating to product disclosure from life insurance represent less than 1% of claims referred to the Insurance and Savings Ombudsman.

Insurance operates in a small but highly competitive market – the existence of independent advisers as one of the major distribution lines acts as an efficient and effective filter in the interests of the consumer.

Disclosure in the insurance market takes the form of a policy document containing all the information applicable to the contract. Further, insurance offers a “look and see” period allowing the consumer to return the policy if it does not meet requirements.

The IAIS principles for conduct of insurance business state that:

“Insurers and intermediaries should pay due regard to the information needs of their customers and treat them fairly.”

This principle is interpreted as including communicating:

- Relevant and meaningful information in a timely and comprehensive manner to enable the customer to make a balanced and informed decision;
- The benefits and any risks to the customer in a fair and balanced way; and
- The obligations of both the provider and the customer in a clear and understandable way.

Specifically, it suggests that customers be given information about:

- The intermediary (if applicable) and especially its status, ie whether the intermediary is independent or tied, eg whether the intermediary acts for the insurer or the customer;
- The insurer;
- The product, eg price, cover, conditions, aims of product, risk factors, guarantees, special exclusions, etc.
- Charges; and
- Complaints handling and other contractual arrangements.

ISI believes that for life insurers these principles are adhered to currently in the industry.

ISI members comply with a Manual of Practice Standards that includes specific provision on – Sale of Term/Life or Disability Insurance, Policy Illustrations and Promotional Statements.

ISI is in the process of reviewing its Manual of Practice Standards to ensure they are relevant and as far as possible aligned with Australian life insurance requirements. This review has been placed on hold awaiting the outcome of the MED Review of Financial Products and Providers.

We believe that the existence of self-regulation by the industry plays an important part in the current apparently effective disclosure process in existence.

ISI recommends that in the absence of any failure the existing status quo be maintained and that industry associations be encouraged to review and improve where possible the existing self-regulation.

List of ISI Members

ISI MEMBERS

American International Assurance
AMP Financial Services
Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
Public Trust
RGA Reinsurance Co. of Australia Ltd
Save and Invest Ltd
Sovereign Ltd
Swiss Re Life & Health Australia Ltd
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