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Life Insurance

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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 Commissioners are:

The Honourable Justice J Bruce Robertson – President
Richard Clarke QC
Eddie Durie
Frances Joychild
Professor Ngatata Love QSO JP
Warren Young
Helen Aikman (Consultant)
Neville Trendle (Consultant)

The Executive Manager of the Law Commission is Bala Benjamin
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

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Glossary

ASRB	Accounting Standards Review Board established under the Financial Reporting Act 1993
ALRC	Australian Law Reform Commission
annuity	a policy where, in return for a lump sum, a regular income stream is paid until death or for a number of years
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
audit actuary	independent auditor of actuarial aspects of financial statements
CER	Australia New Zealand Closer Economic Relations Trade Agreement
captive insurer	insurer that provides insurance only to companies in the same company group as the insurer
central regulator	a government entity with extensive powers of prudential supervision including licensing and minimum capital requirements
Companies Register	the register maintained by the Registrar of Companies under the Companies Act 1993
consumer protection regulation	regulation aimed at ensuring retail consumers have adequate information, are treated fairly and have adequate avenues for redress
critical illness insurance (or 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
disability insurance (or policy)	a policy that provides for payment (lump sum or regular) if the insured becomes disabled as defined by the policy
endowment insurance (or policy)	a policy that provides a guaranteed amount of money to be paid at a specified date or age, or on earlier death
equity security	any interest in, or right to a share in, or in the share capital of, a company
Fair Insurance Code	the Fair Insurance Code of the Insurance Council of New Zealand
financial condition report	an annual actuarial investigation into the financial condition of an insurer, currently 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 financial markets
Financial Reporting Standard 34 (FRS 34)	Financial Reporting Standard No 34 issued by the Institute of Chartered Accountants of New Zealand in November 1998
financial safety regulation	regulation that prescribes particular standards or qualities of service and that aims to reduce the risk of financial failure
FPIA	Financial Planners and Insurance Advisers Association
FSA	Financial Services Authority established under the Financial Services and Markets Act 2000 (UK)
general insurance	fire and general insurance
GN5/Guidance Note 5	Guidance Note 5 issued by the New Zealand Society of Actuaries on 31 December 1999
Government Actuary	part of the Insurance and Superannuation Unit of the Ministry of Economic Development
government monitor	a single government entity that acts as prudential supervisor for all life insurers
health insurance (or policy)	a policy that provides a benefit payable in the event of sickness

HFANZ	Health Funds Association of New Zealand Inc
HGCA	Human Genetic Commission of Australia
IAIS	International Association of Insurance Supervisors
IAIS Insurance Core Principles (or IAIS Principles)	IAIS Insurance Core Principles and Methodology, October 2003
IASB Proposals	International Accounting Standards Board proposals for international financial reporting standards for insurance contracts
ICANZ	Institute of Chartered Accountants of New Zealand
ICNZ	Insurance Council of New Zealand
ICP	Insurance Core Principle of the IAIS Principles
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
income protection insurance (or policy)	a policy that provides cover for loss of income through sickness/accident/inability to work
Insolvency Law Reform Bill	the Bill prepared by the Ministry of Economic Development and released for consultation in April 2004
Insurance and Savings Ombudsman (ISO)	Insurance and Savings Ombudsman established under the ISO Scheme
insurance bond	a policy where a single or series of deposits is paid into a savings or superannuation portfolio and includes an element of life cover
Investment Savings and Insurance Association (ISI)	the current representative body for the life industry (which resulted from a merger of the Life Offices Association and the Investment Funds Association of New Zealand)
ISI Manual	Investment Savings and Insurance Association Manual of Practice Standards
ISO Scheme	Insurance and Savings Ombudsman Scheme established in 1995

LAC guidelines	<i>Legislation Advisory Committee Guidelines on Process and Content of Legislation</i> , 2001 edition, 2003 supplement
Life Insurance Actuarial Standards Board	established under the Life Insurance Act 1995 (Australia)
life insurance (or policy)	life insurance as defined in the Insurance Companies (Ratings and Inspections) Act 1994 (see paragraph 1.2)
life insurer	an entity offering life insurance
Life Offices Association (LOA)	the representative body for the life insurance industry until 1996
long term policy	a policy under which the insurer's liability extends beyond 12 months, or which the policyholder has a right to renew annually on payment of the premium
mortgage repayment insurance	a life policy that provides for repayment of the policyholder's liability under a mortgage in the event of the policyholder's death
NZSA	New Zealand Society of Actuaries
non-renewable risk only policy	a risk protection only life policy for a specified duration or event with no right of renewal or no right of renewal on standard terms
OECD	Organisation for Economic Co-operation and Development
participatory security	any security other than an equity security, debt security, unit in a unit trust, interest in a superannuation scheme, or a life insurance policy
PDS	product disclosure statement
policyholder agent	a private sector entity that acts as prudential supervisor on behalf of policyholders to monitor the solvency position of the insurer
Periodic Report Group 2003	the Periodic Report Group is established under the Retirement Income Act 1993 every six years
prudential supervisor	an entity with power to take action if the independently actuarially audited financial statements filed under the Financial Reporting Act 1993 (or other disclosures by the life insurer) disclose solvency concerns

PS1/Professional Standard 1	issued by the NZSA on 1 January 1990
PS3/Professional Standard 3	issued by the NZSA on 21 December 1998
Registrar of Companies	established under the Companies Act 1993
reinsurer	any company or other entity that enters into a contract of reinsurance of life insurance as reinsurer
renewable risk only policy	a risk protection only life policy renewable each year by the policyholder on standard terms
Retirement Commissioner	established under the Retirement Income Act 1993
risk only policy	a life policy that does not include any investment element
savings policy	a life policy that combines a savings arrangement and risk protection, such as a traditional whole of life policy or endowment policy
Securities Commission	established under the Securities Act 1978
short term policy	a policy that has a maximum duration of 12 months
total and permanent disability insurance (or 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 policy)	the same as critical illness insurance
voluntary administration	the business rehabilitation regime proposed in the Insolvency Law Reform Bill
whole of life insurance (or policy)	a policy under which the sum assured, plus any bonuses, is paid only on the death of the life insured

18 November 2004

The Hon David Benson-Pope
Minister Responsible for the
Law Commission
Parliament Buildings
Wellington

Dear Minister

I am pleased to present to you Report 87 of the Law Commission, *Life Insurance*, which we submit to you under section 16 of the Law Commission Act 1985.

Yours sincerely

J Bruce Robertson
President

Foreword

THIS REFERENCE has invited recommendations on the most appropriate way to regulate the provision of life insurance in New Zealand. It is nearly 100 years since the enactment of the Life Insurance Act 1908 and that was substantially a re-enactment of legislation from 1873. While the principles underlying parts of that Act are sound, many of its provisions are outdated, and the Act is well overdue for review. In the ensuing period, financial markets in general and the role of life insurance in particular have changed dramatically.

Life insurance policyholders face clearly identifiable issues. They often find themselves effectively “locked in” to particular policies, as a result of surrender values or their own declining health. They find the often complex and technical nature of life insurance products difficult to understand, a problem that is compounded by the actuarial aspects of life insurance. They can be a disparate group, with no effective means of placing pressure on an insurer, and with limited options for changing their policies or insurers.

Having considered the existing law, various regulatory options, regimes operating overseas and submissions received, we are satisfied it would be appropriate to integrate life insurance regulation further with the regulation of other financial products. A separate Life Insurance Act is not needed. The regulatory regimes in place, in particular under the Securities, Companies and Financial Reporting Acts, go a long way towards providing all that is required for life insurance.

However, we do recommend improved disclosures and actuarial checks, to respond to the unique aspects of the life insurance business. The disclosure regime in general works well for the securities to which it presently applies, which includes life insurance policies with an investment element, and, in our view, it should be extended to cover risk only life insurance policies as well. We also recommend the appointment of an agent to assist policyholders to monitor insurer solvency, while recognising that a government monitor could be an alternative option.

Our proposals include an exemption regime, which would operate to exempt Australian and other overseas-based insurers from certain requirements, if they can establish that they are subject to equivalent requirements in their home jurisdictions.

We recommend that the Life Insurance Act 1908 be repealed. A new Insurance Contracts Act should be enacted to replace Part 2 of the Life Insurance Act 1908, and to gather together (and in some cases re-enact) other provisions relating to life insurance and general insurance, which are presently spread across insurance legislation.

We have incorporated into the draft Insurance Contracts Bill key recommendations from our 1998 report, *Some Insurance Law Problems* (NZLC

R46), in particular, relating to the insured's duty of disclosure, "claims made" policies, and third-party claims. Although the proposed Bill is not a comprehensive insurance code, it provides a platform that can be built on in the future.

Throughout the project we have been conscious of the close relationship between New Zealand and Australia, and of the predominance of Australian-based life insurers in the New Zealand market. Accordingly, we have sought solutions that are primarily suited to New Zealand conditions, but that are also compatible with the Australian approach to regulation of life insurance.

Australia has opted for a central government regulator, the Australian Prudential Regulation Authority (APRA), which is responsible for prudential supervision of the Australian financial services industry (not just life insurance), and which is supported by detailed rules governing many aspects of the businesses of financial product providers. New Zealand has not taken this approach to the regulation of the financial services industry.

Some of the features of the life insurance regime that we are recommending are also found in the Australian regulatory regime, in particular, the extension of product disclosure to risk only life insurance policies. However, we have concluded that it would not be appropriate or advantageous to adopt the whole of the Australian regulatory model for the regulation of life insurance in New Zealand. It would be inconsistent with the way we regulate most other financial products and providers in this country, and would have the potential to cause regulatory arbitrage, where providers seek to tailor products in order to avoid certain aspects of the regulatory regime.

Our conclusion is that the same approach to regulation should apply to all financial products that are offered to members of the public, whether of an investment or insurance nature – a special regime applying only to life insurance cannot be justified. Our approach aims to ensure that internationally recognised principles are included within a regulatory framework appropriate for the relatively small size of our industry.

J Bruce Robertson
President

Preface

THIS REPORT 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.

In December 2003 the Commission released the discussion paper *Preliminary Paper 53: Life Insurance*. Submissions were invited, and 37 were received. A consultation draft of this report was circulated to submitters in August 2004, and 24 submissions on that draft were received. The names of the submitters to the discussion paper and/or the consultation draft are contained in appendix D. We gratefully acknowledge the assistance provided by those submitters.

We also wish to thank our consultants, Tony Baldwin and Graeme Edwards, who greatly assisted us in reaching our conclusions and preparing this report, and Scott Murray from the Parliamentary Counsel Office who skilfully prepared the Insurance Contracts Bill attached as appendix C.

A full summary of our proposals for change is contained in chapter 3. We have attempted to keep the report succinct and have not repeated background law and other information, which can be found in our discussion paper.

The Commissioner who had principal responsibility for this project was Richard Clarke QC. The researchers were Victoria Stace, Rachel Hayward, Claire Phillips and Joanna Hayward.

Recommendations

Repeal of Life Insurance Act 1908

- R1 The Life Insurance Act 1908 should be repealed and not replaced (paragraph 3.8).

Life insurers to incorporate as companies

- R2 All life insurers that offer life policies to the New Zealand public, or that remain liable under such policies, should be required by the Securities Act 1978 to incorporate as companies in New Zealand, unless exempted by the Securities Commission on certain criteria (paragraphs 3.9–3.16).

Disclosure

- R3 The Securities Act 1978 regime should be extended to cover life insurance policies that do not have an investment element (risk only policies) (paragraphs 4.7–4.8).
- R4 The advertising provisions of the Securities Act 1978 and regulations 8 and 9 of the Securities Regulations 1983 should be extended to cover risk only policies. Other advertising provisions set out in the Securities Regulations 1983 should be reviewed to determine to what extent they are appropriate for risk only policies (paragraphs 4.9–4.13).
- R5 The “investment statement” required by the Securities Act 1978 should be renamed the “product disclosure statement” and should be required in respect of all life insurance policies (paragraphs 4.14–4.17).
- R6 An exemption regime should apply to renewals and variations of risk only policies, similar to that currently provided by the Securities Act (Renewals and Variations) Exemption Notice 2002 (paragraphs 4.18–4.20).
- R7 The prospectus regime under the Securities Act 1978 should be reviewed for the purpose of determining both the information that needs to be disclosed and the best way of disclosing it. Pending the completion of such a review, a prospectus should be required for risk only policies offered to the New Zealand public (paragraphs 4.21–4.27).
- R8 The request disclosure regime under the Securities Act 1978 should be extended to cover risk only policies (paragraphs 4.28–4.29).
- R9 The periodic disclosure regime under section 54A of the Securities Act 1978 should be implemented in relation to life insurance policies, subject to an appropriate exemption regime (paragraphs 4.30–4.36).
- R10 The prospectus requirements for new start-up life insurers should include forecast financial statements for the first year of operation, audited by an auditor and an audit actuary (paragraphs 4.37–4.38).

- R11 A life insurer should be required to notify the prudential supervisor of a material adverse change to the insurer's solvency position as soon as the insurer is aware, or should reasonably be aware, of the change; and the prudential supervisor should be empowered to require the life insurer to notify all policyholders of the change (paragraphs 4.39–4.42).
- R12 The requirements for investment statements should be amended to make it clear that, where there is an element of discretion in the returns achieved by a life insurance policyholder, the key factors affecting the exercise of that discretion must be disclosed (paragraph 4.50).
- R13 Life insurers should be required to disclose the current surrender basis and the assumptions underlying it to life insurance policyholders on request, together with any change in the current surrender basis, as compared with the surrender basis disclosed at the time of sale, or five years previously, whichever is the later. At the same time, where there are options other than surrender available to the policyholder that may be more advantageous to the policyholder, the insurer should be required to disclose that there are other options available, and should prominently display a recommendation that the policyholder seek advice in this regard (paragraphs 4.51–4.52).
- R14 The Securities Act 1978 and Securities Regulations 1983 should be amended to incorporate requirements for the use of prospective information similar to those set out in the Investment Savings and Insurance Association (ISI) Standard for Benefit Projections Involving Investment Performance, to apply if benefit projections are given (paragraphs 4.54–4.56).
- R15 The Securities Regulations 1983 should be amended to require life insurers to disclose on request the following sorts of information in relation to allocation of profits:
- information as to which bonuses are guaranteed once allocated (reversionary bonuses), and which are completely discretionary on termination;
 - the bonus rates for the last five years, separated for reversionary and terminal bonuses;
 - the actual investment returns on the assets backing the life policy for the same period;
 - the mix of the assets backing the life policy (paragraphs 4.57–4.65).

Financial reporting

- R16 The Financial Reporting Act 1993 requirements to prepare, audit and register annual financial statements should be extended to cover all issuers (including non-company issuers) of risk only life insurance policies to the public (as well as issuers of savings policies) (paragraphs 5.9–5.10).
- R17 The financial standard applicable to life insurers that issue life policies to the New Zealand public should be reviewed for the purpose of including sufficient disclosure on solvency matters to enable “monitors” of a life insurer (including the audit actuary and prudential supervisor) to form an accurate view of the solvency position of the life insurer. In particular, the level of disclosure required relating to reinsurance arrangements should be increased (paragraphs 5.12–5.16).
- R18 The Financial Reporting Act 1993 should be amended to provide for the approval of actuarial standards in the same way as it currently provides for approval of financial

reporting standards. The Accounting Standards Review Board should be augmented by the inclusion of appropriate actuarial representation (paragraphs 5.17–5.23).

- R19 New Zealand Society of Actuaries Guidance Note 5 should be reviewed (or new actuarial standards introduced) to ensure that the prudential capital requirements for life insurers offering life policies in New Zealand are set at an appropriate level (paragraphs 5.24–5.26).
- R20 All life insurers that offer life policies to the New Zealand public should be required by the Financial Reporting Act 1978 to obtain an independent actuarial audit of the actuarial aspects of their financial statements, subject to an exemption regime for overseas life insurers (operated by the Securities Commission). The actuarial auditor should be appointed by the life insurer, and approved by the auditor. The audit actuary's report should be annexed to the auditor's report (paragraphs 5.27–5.30).
- R21 The Financial Reporting Act 1993 should be amended to give the Securities Commission a power to approve persons to act as audit actuaries, having regard to such criteria and on such terms and conditions as the Securities Commission thinks fit, and to revoke any such approval. The approvals and revocations of approval to be by notice in the *New Zealand Gazette* (paragraphs 5.31–5.34).
- R22 The financial reporting standards should require the financial statements of a life insurer to state the principles upon which the valuation and distribution of profits among policyholders are made, and as between shareholders and policyholders, and any classes of either group (paragraphs 5.37–5.38).
- R23 Life insurers should have ongoing reporting requirements to the prudential supervisor, in particular to provide copies of each prospectus and half yearly certificate, and give notification in the event of material adverse changes (paragraphs 5.39–5.40).
- R24 The audit actuary should have a “whistle-blowing” role in the event of becoming aware of any matter relevant to the exercise or performance of the powers or duties of the prudential supervisor (paragraph 5.41).
- R25 Section 50 of the Securities Act 1978 should be extended (or an equivalent section enacted) to the effect that auditors of life insurers have obligations to report to the prudential supervisor, by providing copies of reports and other information, and, in particular, to report to the life insurer and prudential supervisor on becoming aware of matters relevant to the exercise or performance of the powers or duties of the prudential supervisor (paragraph 5.41).
- R26 Persistent failure to comply with the Financial Reporting Act 1993 should be included as a ground on which a person can be disqualified from acting as a director, under the Companies Act 1993 (paragraph 5.43).

Prudential supervision

- R27 There should be a “prudential supervisor” for every life insurer (but not a reinsurer), who has certain powers to monitor the financial condition of the life insurer and take enforcement action if necessary. The prudential supervisor could be either a private sector “policyholder agent” or a “government monitor”. There should be an exemption regime operated by the Securities Commission (paragraphs 6.1–6.5).
- R28 If the prudential supervisor is to be a government entity (a government monitor), either the Securities Commission or the Reserve Bank of New Zealand should undertake this role. The costs of the government monitor should be met by industry levies (paragraphs 6.7–6.10).

- R29 If the prudential supervisor is to be a private sector entity (a policyholder agent), each life insurer should appoint its own policyholder agent by contract from a list of persons approved for this purpose by the Securities Commission, which would monitor the performance of all policyholder agents and revoke approval where appropriate (paragraph 6.11).
- R30 The prudential supervisor should have power to request further information, to conduct investigations, and to apply for voluntary administration or liquidation (paragraph 6.12).
- R31 The powers of the Registrar of Companies under Part 2 of the Insurance Companies (Ratings and Inspections) Act 1994 in relation to life insurers should be repealed (paragraphs 6.13–6.15).
- R32 If the voluntary administration regime contained in the Insolvency Law Reform Bill is enacted, then it should be amended to include the prudential supervisor as a person entitled to apply to the High Court for appointment of an administrator, and “creditors” should include prospective or contingent creditors, such as policyholders. If the voluntary administration regime is not enacted, then a regime similar to judicial management should be enacted that allows the prudential supervisor and any policyholder to apply to the High Court for appointment of an administrator of a financially troubled life insurer (paragraphs 6.16–6.18).
- R33 Sections 30, 30A and 31 of the Life Insurance Act 1908 should be moved to the Companies Act 1993 (paragraph 6.19).
- R34 In relation to amalgamations of life insurers, Part 13 of the Companies Act 1993 should be amended as suggested in paragraphs 6.26 and 6.27 (paragraphs 6.20–6.27).
- R35 The prudential supervision role for life insurers should be undertaken by private sector policyholder agents approved and monitored by the Securities Commission, rather than being undertaken by a government monitor (paragraphs 6.28–6.35).

Financial advisers, analysts and ratings

- R36 The development of a new regulatory framework for financial advisers is a top priority, and any new framework should apply to all persons who offer financial advice (including advice on life insurance) to the New Zealand public (paragraphs 7.7–7.19).
- R37 The Government and the life insurance industry should promote and support the establishment and operation of a number of independent and competent life insurance analysts to provide public comparative information on the solvency, activities and life policies of life insurers operating in New Zealand (paragraphs 7.20–7.25).
- R38 Until independent and competent analysts of New Zealand life insurers and policies become well established, every life insurer offering life policies to the public in New Zealand (or that continues to be liable under life policies offered in New Zealand) should be required to have a financial strength rating given by an approved rating agency. The Government should publish a table on the internet (and provide hard copies to public libraries and Citizens’ Advice Bureaux) stating the financial strength rating of every life insurer offering life policies to the New Zealand public, and any negative change in such a rating during the previous 12 months (paragraphs 7.26–7.35).

- R39 The Government should arrange for the Consumers' Institute of New Zealand Inc or another suitable body to have a substantial ongoing public educational role in relation to life insurance (paragraph 7.36).

Insurance Contracts Act

- R40 A new Insurance Contracts Act based on the Bill provided in appendix C should be enacted (paragraphs 8.1–8.7).
- R41 In relation to transfers by life insurers of life policies held by members of the New Zealand public, provisions should be included in the Insurance Contracts Bill as suggested in paragraphs 8.82–8.86 (paragraphs 8.69–8.86).
- R42 The Insurance Contracts Bill should include a process for life insurers to have policy terms amended by the High Court for administrative reasons, so long as notice is given to policyholders and the prudential supervisor who may oppose such an amendment (paragraphs 8.87–8.91).

Reinsurance

- R43 Overseas life reinsurers that are carrying on business in New Zealand, offering reinsurance in respect of the issue to the New Zealand public of life insurance, should continue to be subject to the requirements of the Companies Act 1993 that apply to overseas companies carrying on business in New Zealand (paragraphs 9.4–9.5).
- R44 Overseas reinsurers carrying on the business in New Zealand of reinsuring liabilities under life policies offered to the New Zealand public should be required by the Financial Reporting Act 1993 to register audited financial statements under that Act that comply with the relevant financial reporting standards, and the actuarial information in them should be required to be actuarially audited, unless an exemption has been granted by the Securities Commission (paragraphs 9.6–9.7).
- R45 New Zealand-established reinsurers that reinsure life policies offered to the New Zealand public should be required by the Financial Reporting Act 1993 to register audited financial statements under that Act that comply with the relevant financial reporting standard, and the actuarial information in those statements should be required to be actuarially audited (paragraph 9.10).
- R46 The actuarial solvency standard for life insurers should be reviewed to ascertain whether closer scrutiny of reinsurance arrangements and reinsurers is required (paragraph 9.13).
- R47 Life insurers should be required by the relevant reporting standard to disclose the name of the reinsurer and a brief description of any reinsurance arrangement that constitutes a material asset of the life insurer (paragraphs 9.14–9.15).

Cross border issues

- R48 Overseas life insurers offering life policies to the public in New Zealand should be required to incorporate in New Zealand, subject to an exemption regime operated by the Securities Commission (paragraphs 10.6–10.7).
- R49 The power of the Registrar of Companies under section 11(3) of the Financial Reporting Act 1993 to exempt a reporting entity incorporated outside New Zealand

from the requirement to prepare financial statements that comply with New Zealand financial reporting standards (and to comply instead with the reporting standards of the entity's home country) should be transferred to the Securities Commission (paragraph 10.11).

- R50 Overseas life insurers offering life policies to the public in New Zealand should be required to comply with the Financial Reporting Act 1993 to prepare, audit and register financial statements, and to have those statements independently actuarially audited, subject to an exemption regime (in relation to the actuarial audit) to be operated by the Securities Commission (paragraph 10.12).
- R51 Overseas life insurers offering life insurance to the public in New Zealand should be required to appoint a policyholder agent (if that is the method of prudential supervision chosen for life insurers). The Securities Commission should have the power to exempt overseas life insurers from the prudential supervision requirement on certain criteria (paragraph 10.13).
- R52 The Corporations (Investigation and Management) Act 1989 should be amended to clarify that "creditors" in section 4 includes contingent and prospective creditors (paragraph 10.14).
- R53 Overseas life insurers offering life policies to the public in New Zealand (or remaining liable under such policies) that are exempted by the Securities Commission from the requirement to incorporate as a company in New Zealand should be required to register as overseas companies under the Companies Act 1993 (paragraphs 10.17–10.19).
- R54 The Securities Act 1978 should require all life policies issued by life insurers that offer to the public to provide that the insurer will abide by a decision of the High Court of New Zealand, and that the policy will be governed by New Zealand law (subject to an exemption regime to be operated by the Securities Commission in relation to the requirement for a policy to be governed by New Zealand law) (paragraph 10.20).
- R55 The Securities Commission should provide information to the public on internet offers of life insurance from offshore entities in the course of performing its function under section 10(d) of the Securities Act 1978, including guidance on what laws are applicable, and issue warnings as appropriate. This information should also extend to guidance about solicitations from offshore financial intermediaries (paragraphs 10.34–10.35).
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1

Introduction

Purpose of life insurance

- 1.1 LIFE INSURANCE has two important roles in New Zealand:
- to enable people and businesses to manage the financial risks of individuals' deaths; and
 - to provide vehicles for savings and investment.¹

Meaning of life insurance

- 1.2 For the purposes of this report, we use the definition of “life insurance” in the Insurance Companies (Ratings and Inspections) Act 1994, which is:
- ... 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.²

This definition does not include insurance for death by accident or as the result of a specified sickness or disease. Some submitters have suggested that the definition should be extended to include other types of insurance often provided by life insurers, such as disability and trauma insurance. These types of insurance are examples of the market adapting to provide the products consumers want, and highlight that it is not sensible to focus on the regulation of life insurance in isolation. In chapter 12 we discuss the potential for extending our proposals and to these and various other types of insurance, including health and general.

- 1.3 We use “life insurer” to mean any company or other entity that enters into a contract of life insurance as insurer; and “reinsurer” to mean any company or other entity that enters into a contract of reinsurance of life insurance as reinsurer.

¹ For a fuller discussion of the purpose of life insurance, see chapters 1 and 2 of *Life Insurance* (NZLC PP53, Law Commission, Wellington, 2003).

² Insurance Companies (Ratings and Inspections) Act 1994, s 2. The Insurance Law Reform Act 1977 contains a similar definition. Section 2 of the Act 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.

Types of life policies

- 1.4 There is a wide range of financial products now available that are primarily life insurance or that include a life insurance component.
- Traditional mixed-risk protection and investment policies, such as whole of life and endowment, are still being sold, albeit in much lower numbers than in previous years. In this report, as in Preliminary Paper 53 (the discussion paper), these types of policies, together with others that include an investment element and annuities, are called “savings policies”.
 - Risk protection only policies, with no investment element (referred to as “risk only policies” in this report), which include:
 - risk protection only policies that are renewable each year on standard terms, which form the majority of life policies now sold (referred to as “renewable risk only policies” in this report);
 - risk protection only policies for a specified duration or event that contain no right of renewal, or no right to renew on standard terms (referred to as “non-renewable risk only policies” in this report).³
 - There are also other products that include a life insurance component. Insurance bonds, for example, offer minimal death cover but provide a means of pooling investors’ funds. Superannuation schemes and disability policies may include a life insurance element.

New financial products continue to emerge, some of which include a life insurance component, as life insurers and other issuers seek to meet the demands of consumers.

- 1.5 When considering the appropriate regulatory response for life insurance, it is important to bear two points in mind:
- While a large number of savings policies still exist, considerably fewer of these products are now sold.
 - The range of financial products on offer is continually changing and evolving. Life insurers may offer products that have an investment element or elements of other types of insurance, and other issuers may offer products with a life insurance component.
- 1.6 These factors highlight that life insurance is increasingly part of the broader financial market, rather than a distinct and separate product.

New Zealand life insurance market

- 1.7 It is also important to consider the nature of the New Zealand life insurance market. There are a number of locally owned insurers, but the larger proportion of the market is dominated and serviced by overseas, mainly Australian-based, insurers. Several operate in New Zealand via a branch rather than a locally incorporated subsidiary. In addition, many New Zealand life insurers are subsidiaries of overseas-owned banks (for example, Westpac Life, BNZ Investments and Insurance, NBNZ Life Insurance and ANZ Life). Generally

³ In this report, insurance for death by accident, or as the result of a specified sickness or disease, is excluded from the definition of “life insurance”, see para 1.2.

speaking, these bank-owned life insurers provide risk only policies, but not savings policies.

Existing regulation of life insurance

- 1.8 At present, the life insurance industry in New Zealand is regulated both by entity-focused legislation, such as the Life Insurance Act 1908 (the Life Act) and the Companies Act 1993, and by activity-focused legislation, such as the Securities Act 1978 and the Financial Reporting Act 1993.
- 1.9 The Life Act is nearly 100 years old and well overdue for review.
- 1.10 All life insurers (other than captive insurers, reinsurers, and insurers solely offering risk only policies) are covered by the requirements of the Securities Act 1978, because they are issuers of securities to the public. This Act requires certain information to be disclosed to the public and regulates advertising.
- 1.11 The Financial Reporting Act 1993 requires all life insurers that are either companies, or “issuers” under the Securities Act 1978, to prepare financial statements. Additional requirements, such as registration and auditing of those statements, are imposed on issuers and overseas companies that are carrying on business in New Zealand.
- 1.12 All life insurers that are companies incorporated in New Zealand are subject to the Companies Act 1993. That Act, among other things, imposes duties on directors and provides for certain creditors’ remedies. If a life insurer carrying on business here is a branch of an overseas company, the Companies Act 1993 requires registration, the filing of annual returns, and enables creditors, including prospective creditors, to apply for liquidation of the assets in New Zealand.⁴ If a life insurer is established in a non-company structure (such as a partnership or friendly society), it will be subject to the provisions of the relevant Act (for example, the Partnership Act 1908 or the Friendly Societies and Credit Unions Act 1982). Other generic Acts, such as the Financial Reporting Act 1993, may or may not apply, depending on such factors as the nature of the life insurance business being undertaken.
- 1.13 Life insurers operating in New Zealand are also covered by a range of other regulatory requirements such as the Fair Trading Act 1986 and the Consumer Guarantees Act 1993.⁵

Philosophical basis for regulation

- 1.14 In chapter 2 of the discussion paper we discussed the philosophy of financial regulation, and identified different types of regulation, namely financial market integrity regulation, consumer protection regulation and financial safety regulation. We also noted the need to consider the costs of regulation. In preparing chapter 2 of the discussion paper, we used as our starting point the ideas and principles in chapter 5 of the Wallis Report “Philosophy of Financial Regulation”.⁶

⁴ Companies Act 1993, Part 18. Many of the provisions of the Companies Act do not apply to overseas companies, notably the provisions on directors’ duties.

⁵ See NZLC PP53, above n 1, chapter 5 for further discussion of these Acts.

⁶ *Financial System Inquiry Final Report* (Australian Government, Canberra, 1997).

- 1.15 Another way of considering these issues is as follows. The primary role of securities markets is to enable the efficient aggregation of capital for the purpose of taking business risks, with a view to growing the value of capital. The primary role of insurance markets is to enable efficient aggregation of capital for the purpose of spreading risk, with a view to avoiding possible losses in the value of capital.⁷ These two markets can be said to be variations within the spectrum of maintaining and enhancing the overall financial circumstances of individuals and entities.
- 1.16 The fundamental driver of performance in securities and insurance markets is the interplay between sellers (issuers) and buyers (consumers). A range of intermediate parties also play important roles – auditors, actuaries, brokers, analysts and advisers. But consumers (with their agents and advisers) are the key monitors, because they have the strongest incentives to pressure issuers to perform. However, many factors, including the lack of financial sophistication of most consumers, the complexity of many financial products and financial statements, the large number of widely dispersed consumers, and the absence of individual consumer influence, often make it hard for consumers to monitor an issuer’s performance and enforce its obligations effectively.
- 1.17 The purpose of regulation of securities and insurance markets is to overcome these hurdles for consumers, to enable them to carry out more effectively their monitoring and enforcement role.⁸ Thus, the key aims of regulation are to promote:
- economic efficiency in these markets – this includes lowering costs, pressuring prices to reflect costs, and constant innovation in the range of products and services offered to meet consumer demands better; and
 - fairness for consumers consistent with efficiency, particularly if competition is weak with an inequality of bargaining position for consumers relative to issuers.
- 1.18 The aim of an efficient and fair regulatory regime for securities and insurance is not to eliminate the risks associated with a product or its issuer, but to provide consumers with a reasonable opportunity to be informed of the possible risks and returns and to assist them to protect their interests. Returns tend to be related to the level of risk. Individual consumers can decide how much risk they wish to take on. The most effective way of managing risk is to diversify properly across products and issuers.
- 1.19 The principal regulatory mechanism for achieving these key aims in New Zealand and various other countries (including the United States of America, United

⁷ Human life represents a capital value, by way of future earning potential.

⁸ As noted in our discussion paper (para 2.11), we consider there is no systemic rationale for prudential regulation of life insurance. In particular, life insurers are not involved in the payments system, there is less contagion risk, and it is less likely there could be a run on a life insurer because funds cannot generally be withdrawn on demand (although a run on surrenders of policies might be possible). Life insurers are not generally regarded as fundamentally important to the functioning of the economy. We assume life insurers will not tend to become more like banks. There is an issue as to whether general insurers could be more systemically important because of the needs of various businesses for certain types of general insurance.

Kingdom and Australia) is public disclosure.⁹ The International Association of Insurance Supervisors (IAIS) has noted that public disclosure of reliable and timely information helps prospective and existing policyholders, and other market participants, to understand the financial position of insurers and the risks to which they are subject.¹⁰ The IAIS states that risk disclosure is critical to the operation of a sound market:

- When provided with appropriate information that allows them to assess an insurer's activities and the risks inherent in those activities, markets can act efficiently, rewarding those companies that manage risk effectively and penalising those that do not.
- Public disclosure provides consumers with information for making judgements about insurers before entering into contracts. While individual policyholders do not always have the ability or resources to assess an insurer's financial stability or understand disclosures, other market participants such as analysts, shareholders, and the news media can help policyholders monitor insurer activities.¹¹

1.20 In New Zealand, since 1908,¹² the Life Act has required some disclosure by life insurers and has also given the Minister responsible for the administration of the Life Act and the Government Actuary certain functions and powers designed to assist in the monitoring and enforcement of life insurers' obligations.

1.21 There are features of life insurance that differentiate it from other financial products. In particular, the nature of the business involves calculation and assessment of actuarial risks. This actuarial aspect of life insurance can be viewed as the justification for the current legal requirements for an annual financial condition report and certain actuarial reporting to the Ministry of Economic Development.

1.22 Our attention has been drawn to another analysis of the basis for regulation of life insurance, namely that set out in the World Bank publication *The Development and Regulation of Non-Bank Financial Institutions*.¹³ This analysis is similar to the description of the philosophy of financial regulation contained in chapter 5 of the Wallis Report, and focuses on the "information asymmetries" that exist between insurers and insureds.

1.23 In our view, the key issues to be addressed by life insurance regulation are:

- consumers cannot always readily understand the products offered;
- consumers have difficulty monitoring the performance of insurers; and
- consumers have difficulty enforcing their rights as policyholders.

⁹ In 1980, the Securities Commission set out the principles behind the drafting of the Securities Regulations. (Securities Commission, *Proposals for the Enactment of Regulations Under the Securities Act 1978*, Wellington, 1980, para 3.1). It expressly rejected the philosophies of merit regulation or deterrence as a foundation for regulating the securities market, describing the principle of disclosure as the cornerstone of its recommendations.

¹⁰ International Association of Insurance Supervisors *Guidance Paper on Public Disclosure by Insurers* (Guidance Paper No 4, 2002) <www.iaisweb.org> (last accessed 28 October 2004).

¹¹ International Association of Insurance Supervisors, above n 10, paras 2-4.

¹² And earlier under predecessor legislation.

¹³ Jeffrey Carmichael and Michael Pomerleau *The Development and Regulation of Non-Bank Financial Institutions* (World Bank, Washington, DC, 2002).

1.24 The first problem, relating to understanding the nature of products offered, can be addressed by disclosure rules and improving the quality of financial advice. With regard to the second and third problems, there is, broadly speaking, the “market” solution (which empowers consumers), the “central regulator” solution (which gives a government body the monitoring and enforcement role) and the “co-regulatory” solution (which involves both a government regulator and private sector monitors/enforcers). A major downside of the “central regulator” solution is the risk of creating an implicit government guarantee of insurer performance. By contrast, the “market” solution aims to ensure consumers can themselves, or by their agents, monitor insurers’ performance and, if necessary, enforce their rights. As well as avoiding the implicit government guarantee issue, a “market” solution is less likely to discourage innovation by insurers. A “co-regulatory” solution generally enables a government regulator to determine which private sector participants perform the monitoring and/or enforcement roles, and to monitor the performance of those private sector participants.¹⁴

Recent developments in New Zealand

1.25 In recent years:

- The public disclosure regimes in the Securities Act 1978 and Financial Reporting Act 1993 have been applied to life insurers issuing savings policies in order to:
 - strengthen the ability of consumers to assess the strengths and weaknesses of life insurers’ savings products and the performance of those life insurers; and
 - put disciplines on those life insurers to ensure their offerings are properly prepared and described, and their financial affairs are properly managed.
- The Companies Act 1993 has been strengthened, notably by including explicit directors’ duties, imposing a solvency test, and providing clear processes for company amalgamations.

1.26 The Government is also considering the enactment of a new voluntary administration regime for companies along the lines of the regime in Australia, and the development of a new regulatory regime for financial intermediaries.

Structure of report

1.27 This report is structured as follows:

- chapter 2 summarises the problems that have been identified;
- chapter 3 provides an overview of our proposals;
- chapters 4 to 8 elaborate on our proposals;
- chapter 9 looks at issues relating to reinsurers;
- chapter 10 discusses cross border issues;

¹⁴ For example, approval of debt security trustees by the Securities Commission, and the relationship between the Securities Commission and securities exchanges under the Securities Markets Act 1988.

- chapter 11 assesses the costs and benefits of our proposals;
 - chapter 12 considers the potential application of our proposals to non-life insurance;
 - appendix A explains why alternatives raised in our discussion paper have not been adopted, and addresses various issues raised in that paper that are not covered elsewhere in this report;
 - appendix B compares our recommendations with the IAIS Insurance Core Principles;
 - appendix C sets out a proposed new Insurance Contracts Bill, as outlined in chapter 8;
 - appendix D sets out the names of submitters to the discussion paper and/or to the consultation draft of this report.
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2

The problems

Introduction

2.1 **I**N THE DISCUSSION PAPER we broadly divided our assessment of the issues into:

- financial market integrity issues;
- consumer protection issues;
- financial safety issues;¹⁵
- other issues (such as cross border issues).

2.2 As a result of consultation and submissions received, we have identified various problems with the present life insurance regime as outlined below. These problems cut across the categorisation referred to in paragraph 2.1 in many respects, but generally, problems 2 to 6 (paragraphs 2.3 to 2.9) are consumer protection issues, problems 7 and 8 (paragraphs 2.10–2.11) are financial market integrity issues, and problem 9 (paragraphs 2.12–2.13), the policyholders’ lack of enforcement powers, is, in large part, a financial safety issue.

Problem 1 – the Life Insurance Act 1908 is outdated

2.3 The Life Act is out of date or unsatisfactory in many respects, and is generally overdue for review. In particular:

- much of Part 1 relates to the deposit required to be made by life insurers. The amount of the deposit (\$500 000) is so small as to be of little value in securing policyholders’ benefits. The rationale for requiring a deposit needs to be revisited;
- section 15, which requires a separate fund for life insurance receipts, is confusing and has not been effective in creating a statutory fund;
- the schedules require details of investments in, among other things, “British Government Securities”, “Indian and Colonial Government Securities”, “Railway and other debentures”. If these schedules are to be retained, they need to be relevant to current conditions;
- the financial statements required by the Act, and in particular the actuary’s statement of valuation of liabilities (schedule 6), are generally acknowledged as being insufficient to enable assessment of financial soundness.

¹⁵ For definitions of these terms, see paras 2.6 to 2.10 of our discussion paper.

- 2.4 However, many of the principles underlying the Life Act are sound. The concepts of requiring public disclosure of financial information, the review of that information by an independent actuary, and the provision of a range of powers available in the event of financial unsoundness, form the basis of an effective life insurance regime. Since the enactment of the Life Act, various other statutes regulating the financial market have been enacted, including the Securities Act 1978, the Financial Reporting Act 1993, and the Companies Act 1993, that, to some extent, cover the same ground as the Life Act.

Problem 2 – no initial information disclosure required for risk only policies

- 2.5 The initial disclosure regime of the Securities Act 1978 (both the investment statement and prospectus) does not apply to risk only policies. As mentioned in paragraph 1.15, risk only policies can be said to have a similar economic function to savings policies, and there are similar issues in relation to buyer understanding of the policies offered.

Problem 3 – problems with financial advisers

- 2.6 A major concern expressed in the submissions on the discussion paper related to the problems that are seen to exist with financial advisers, in particular conflicts of interest and competence.¹⁶

Problem 4 – lack of independent analysis

- 2.7 Independent analysis of publicly available information relating to life insurers and life policies is weak. This is of particular concern in relation to savings policies.¹⁷

Problem 5 – problems with Part 2 of Life Insurance Act 1908

- 2.8 Some problems have been identified regarding specific provisions in Part 2 of the Life Act, which relates largely to the terms of life policies.¹⁸ A more general problem is that legislative provisions relating to life and other types of insurance are scattered throughout various Acts. It would be sensible for these to be modernised, reviewed and drawn together in one enactment.

Problem 6 – problems with Securities Act 1978

- 2.9 Specific problems with the Securities Act 1978 are:
- The requirements for investment statements do not specifically address disclosures about surrender values and allocation of profit rules, and the practice as to what is disclosed varies.
 - The only requirement for the start up of new life insurers is the \$500 000 deposit obligation under the Life Act. By way of contrast, new issuers of

¹⁶ For further discussion of this problem, see chapter 7.

¹⁷ For further discussion of this problem, see chapter 7.

¹⁸ For details of the problems identified, see chapter 8.

debt securities are required to appoint a trustee who monitors, among other things, the issuer's solvency, and equity floats are required to raise a minimum amount specified in the prospectus before they can proceed.

- The prospectus regime is seen as unduly costly and in need of general review.
- The periodic information disclosure regime under section 54A of the Securities Act 1978 has not been implemented. Information both about the policies and the life insurer on an ongoing basis would be beneficial.

Problem 7 – issues in relation to transfers and amalgamations

- 2.10 The current process for a life insurer transferring its obligations under life policies to another life insurer is not subject to any significant degree of scrutiny. There are also some problems with the existing Companies Act 1993 procedure for amalgamations of company life insurers, in particular regarding the persons who are entitled to be sent a copy of an amalgamation proposal.

Problem 8 – problems with the Financial Reporting Act 1993 regime

- 2.11 The following problems exist with the Financial Reporting Act 1993 regime:
- There are gaps in the coverage of that Act, in particular in relation to risk only life insurers (and also local reinsurers). Risk only life insurers are not “issuers” and therefore not covered by the auditing and registration requirements. Non-company risk only life insurers are not covered at all.¹⁹
 - The solvency information required currently in relation to life insurers is not comprehensive enough to enable an independent analyst to form a view on the financial soundness of an insurer.
 - The practice as to the extent of solvency information disclosed under the relevant reporting standards varies.
 - While the Act provides for the approval of financial reporting standards, there is no equivalent approval system for actuarial standards.

Problem 9 – policyholders’ lack of enforcement options/powers

- 2.12 As discussed in chapter 1, it is important that consumers have the ability to pressure issuers to perform their role properly (see paragraphs 1.14 to 1.24). Policyholders have a limited range of options available in the event that the publicly disclosed financial information for a life insurer reveals financial unsoundness. In particular:
- There is a limited range of options under the Life Act, Companies Act 1993, Corporations (Investigation and Management) Act 1989, and Insurance Companies (Ratings and Inspections) Act 1994, and some of these Acts require a high threshold before any power of intervention may be exercised;
 - policyholders are a disparate group and seldom capable of understanding technical financial information;

¹⁹ Unless their own governing Act requires compliance with the Financial Reporting Act 1993.

- the Government Actuary has come to be seen as a quasi-regulator, when this is not the role he or she is resourced for. Under the Life Act, the Government Actuary's role is limited to being an independent actuarial auditor.
- 2.13 Policyholders also have limited options to change their life policies or insurers. In particular, they may be "locked in" to particular policies, because of low surrender values or declining health.

Problem 10 – cross border issues

- 2.14 For a number of reasons, including the existence of CER and the fact that New Zealand's life insurance market is dominated by overseas (mainly Australian) life insurers, it is important to consider whether New Zealand's laws should be consistent or coordinated with those of certain overseas countries, in particular, Australia, or alternatively, how the regimes operating overseas can be accommodated within our regime.
- 2.15 There are enforcement problems in addition to those referred to in paragraph 2.12, if the life insurer is an overseas entity.
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3

Proposals

Introduction

- 3.1 **A**S HAS ALREADY BEEN MENTIONED, the present New Zealand life insurance regime has lasted, largely intact, for more than 100 years. This suggests that the problems referred to in chapter 2 have not been regarded by the community as pressing. Nevertheless, we believe that their cumulative effect is now such that this part of the law requires reform.
- 3.2 The path along which the regulation of life insurance has been proceeding in recent years (in particular, the Companies Act 1993, Securities Act 1978 and Financial Reporting Act 1993, see paragraph 1.25) is, in our view, the right one.
- 3.3 We believe the same regime should largely apply to all financial products that are offered to members of the public, whether of an investment or insurance nature. There is not a case for a special regime applying only to life insurance.
- 3.4 We outline our proposals below. These represent an extension of the public disclosure philosophy referred to in paragraphs 1.14 to 1.24. We believe this approach should be preferred over a merit-based regulatory regime.
- 3.5 While the New Zealand and Australian regulatory regimes are similar in relation to financial market integrity and consumer protection issues (see appendix B of the discussion paper), they are markedly different in relation to financial safety issues. In this area, Australia has adopted the model of a central regulator, the Australian Prudential Regulation Authority (APRA), bolstered by detailed rules that govern many aspects of the businesses of financial product providers. To date, New Zealand has not gone down this route.
- 3.6 We believe that the regulation of life insurance should be consistent with the regulation of other financial products, because inconsistency is likely to distort the development of new kinds of financial products (for example, products that have both investment and insurance aspects) and otherwise hinder the efficient management of financial resources. At present, market integrity and consumer protection legislation is generally consistent across the New Zealand financial markets, but financial safety legislation is not (see appendix C of our discussion paper).
- 3.7 Our specific recommendations are for the most part set out in the subsequent chapters that elaborate on our proposals. Where the discussion of a proposal is confined to this chapter, the recommendation is included here. A full list of recommendations is set out at the front of this report. Our proposals are broadly as follows.

Repeal the Life Insurance Act 1908

- 3.8 The Life Act should be repealed and not replaced. Some of its provisions should be re-enacted in new or existing legislation, but much of it has outlived its usefulness. For example:
- the provisions requiring life insurers to make deposits are no longer required (see paragraph A7 of appendix A);
 - the actuarial report and abstract is no longer needed in view of the Financial Reporting Act 1993, although the requirements of that Act in relation to life insurance need some modification (see chapter 5);
 - the provisions relating to liquidation of life insurers should be included in the liquidation provisions of the Companies Act 1993 (see paragraph 6.19);
 - the provisions relating to overseas companies, not already covered by the Companies Act 1993, should be included in the Securities Act 1978 (see paragraph 10.20);
 - the provisions relating to judicial management of life companies will be unnecessary if the voluntary administration provisions proposed by the Government are included in the Companies Act 1993. If the voluntary administration regime is not enacted, a regime similar to judicial management should be enacted (see paragraphs 6.16 to 6.18);
 - Part 2 provisions relating to life insurance policies should be re-enacted in a new Insurance Contracts Act (see chapter 8);
 - the provisions authorising the Ministry of Economic Development to require further information from life insurers should become a power of a prudential supervisor (see paragraph 6.12).

Recommendation

R1 The Life Insurance Act 1908 should be repealed and not replaced.

Life insurers to be companies incorporated in New Zealand, unless exempted

- 3.9 One of the options considered in the discussion paper was whether all life insurers operating in New Zealand should be required to do so through a company incorporated here. In Australia, APRA requires incorporation as a condition of registration under the Life Insurance Act 1995 (Aust).
- 3.10 The major advantage of requiring local incorporation as a company is that it would bring all life insurers operating in New Zealand under the provisions of the Companies Act 1993 and, in particular, its provisions relating to directors' duties, prohibitions on who may act as a director, amalgamations, liquidations and (potentially) voluntary administration. This would avoid the need to create special regimes to deal with these issues in relation to life insurers that are not locally incorporated companies.
- 3.11 The views expressed in submissions and consultation were generally supportive of a requirement for life insurers to incorporate under the New Zealand Companies Act 1993, although some were concerned that it would create

significant additional costs and compliance issues, and others felt that it would be inconsistent with the regulatory requirements for other financial products. In our view, many of these concerns can be accommodated by providing for an exemption regime for life insurers that are not locally incorporated as companies but that operate under equivalent regulatory requirements. Assuming such a regime is adopted, we believe that the advantages of requiring local incorporation as companies outweigh the disadvantages.

- 3.12 We therefore consider that the Securities Act 1978 should be amended to require all life insurers that offer life policies to the New Zealand public, or that remain liable under such policies, to be companies incorporated under the New Zealand Companies Act 1993, unless exempted by the Securities Commission on certain criteria. While the list of criteria should be open ended, we suggest it should include satisfactory equivalent requirements for directors' duties, prohibitions on who may act as a director, amalgamations, liquidations and voluntary administration (if enacted in New Zealand). In the case of overseas-incorporated life insurers, the criteria for exemptions should also include equal treatment of New Zealand policyholders with other policyholders (including on a liquidation). Any overseas life insurer that is exempted from the requirement to incorporate as a company in New Zealand should be required to register as an overseas company under the Companies Act 1993 (see paragraphs 10.17 to 10.19).
- 3.13 We think it is likely that, because of the existing regulatory requirements in Australia, the Securities Commission would exempt from the requirement to incorporate as a company in New Zealand those life insurers who are incorporated in Australia and that wish to offer life policies in New Zealand on the same terms as offered in Australia.
- 3.14 The requirement to incorporate as a company in New Zealand, unless exempted, would apply not only to overseas life insurers but also to New Zealand life insurers that would otherwise choose another form of entity, such as a friendly society or a partnership. Such entities could apply for an exemption from the Securities Commission, but in our view this should be granted only if the Securities Commission was satisfied that the entity was subject to requirements equivalent to the Companies Act 1993 in the respects mentioned above.
- 3.15 An exemption from the requirement to incorporate as a company in New Zealand should not of itself exempt a life insurer from the proposed disclosure and prudential supervisor requirements of the Securities Act 1978 (see chapters 4 and 6) or the requirements of the Financial Reporting Act 1993, including the actuarial audit of financial statements (see chapter 5).
- 3.16 The requirement to incorporate as a company in New Zealand would not include any requirement to have New Zealand resident directors. This would be relatively easy to circumvent, and raises the difficult issue of what constitutes residency.

Recommendation

R2 All life insurers that offer life policies to the New Zealand public, or that remain liable under such policies, should be required by the Securities Act 1978 to incorporate as companies in New Zealand, unless exempted by the Securities Commission on certain criteria.

Extend information disclosure under Securities Act 1978

- 3.17 The existing information disclosure regime under the Securities Act 1978 should be extended to cover risk only as well as savings policies. This will mean that an investment statement (renamed a product disclosure statement, to be consistent with Australian terminology) will be required for risk only as well as savings policies. In addition, advertising of all these policies will be subject to the Securities Act 1978, and request disclosure under section 54B of that Act will apply.
- 3.18 We consider that most of the information required by the Securities Act 1978 to be included in a prospectus for savings policies should also be publicly disclosed in respect of risk only policies. However, the prospectus may not be the most appropriate disclosure vehicle, and consider that there should be a review of the whole prospectus regime. Until this review takes place, risk only policies should be subject to the prospectus regime. The Securities Regulations 1983 should be amended to require a newly established life insurer to include audited forecast financial statements in its first prospectus. The Securities Act 1978 already contains a broad power for the Securities Commission to exempt persons from any of the disclosure provisions of that Act, and the Government is presently considering the introduction of a trans-Tasman mutual recognition regime for the offering of securities to the public.
- 3.19 The periodic disclosure regime in section 54A of the Securities Act 1978 should be implemented in relation to life policies.
- 3.20 Further disclosure should be required in relation to the allocation of profits and surrender values for savings policies.

For further discussion of these proposals, see chapter 4.

Extend the Financial Reporting Act 1993 to all life insurers offering to the public

- 3.21 The Financial Reporting Act 1993, which requires the registration of audited financial statements from issuers of securities to the public, should be extended to apply to life insurers that offer risk only policies to the public in New Zealand, as well as those that offer savings policies (to which the Act already applies). Furthermore, the Act should be amended to provide for the approval of actuarial standards in the same way as it currently provides for approval of accounting standards. The Accounting Standards Review Board (ASRB) should be augmented by the inclusion of appropriate actuarial representation.
- 3.22 The Financial Reporting Act 1993 contains a power for the Registrar of Companies to allow overseas companies to file financial statements that accord with overseas law, rather than New Zealand law, if the overseas law is substantially the same as New Zealand law. This power should be retained but transferred to the Securities Commission.
- 3.23 Various changes to the relevant reporting standard are required to improve the disclosures relevant to the solvency of life insurers.

For further discussion of these proposals, see chapter 5.

Independent actuarial audit

- 3.24 The Financial Reporting Act 1993 should be amended to require the actuarial aspects of financial statements registered by life insurers to be audited by an actuary who is independent of the life insurer and has been approved for this purpose by the Securities Commission, as well as the normal audit of the financial statements by an independent chartered accountant. The actuarial aspects of financial statements should be required to accord with actuarial standards approved under that Act. The Securities Commission should be empowered to exempt overseas life insurers from these requirements on certain criteria.
- 3.25 The actuarial auditor should have a “whistle-blowing” role.
For further discussion of these proposals, see chapter 5.

Prudential supervisor

- 3.26 In order to provide support for disparate and relatively powerless life insurance policyholders, there should be, in respect of each life insurer that is offering or has offered life policies to the public in New Zealand, a person (a prudential supervisor) who monitors the insurer’s financial information and is authorised to obtain information from, and in certain circumstances take action against, the life insurer in the interests of policyholders.
- 3.27 The prudential supervisor could be either:
- a *policyholder agent* – a private sector person (such as a trustee corporation or firm of chartered accountants) appointed by the life insurer from a list of persons approved by the Securities Commission for this purpose;²⁰ or
 - a *government monitor* – either the Securities Commission or the Reserve Bank of New Zealand, which would perform this role in respect of all life insurers.
- 3.28 If there was to be a government monitor, the terms and conditions of its appointment as such would need to be legislated. If there was to be a policyholder agent, the terms and conditions would be individually negotiated, with certain statutory minima.
- 3.29 The Securities Commission should be empowered to exempt overseas life insurers from this requirement on defined criteria.
- 3.30 Life insurers should have ongoing reporting obligations to the prudential supervisor.
- 3.31 Prudential supervisors should have new powers in respect of transfers of life policies between life insurers, amalgamations, and modernising the administrative terms of old life policies.
For further discussion of these proposals, see chapters 6 and 8.

Financial intermediaries

- 3.32 It is vital that appropriately skilled and experienced advisers and market analysts are available to assist consumers to choose life products that are appropriate for their needs, and to monitor the performance of life insurers and reinsurers.

²⁰ As is the case with debt securities under the Securities Act 1978.

The Government should encourage the development of market analysts, and move quickly to improve the regulatory regime for financial advisers.

For further discussion of these proposals, see chapter 7.

Financial strength rating

- 3.33 Until independent market analysts who regularly review all life insurers and reinsurers operating in New Zealand become well established, every life insurer offering life policies to the public in New Zealand (or that continues to be liable under life policies offered in New Zealand) should be required to have a financial strength rating given by an approved credit rating agency.²¹ The financial strength rating should not be more than 12 months old and published by the life insurer on the internet and in its product disclosure statement under the Securities Act 1978. The life insurer should also be required to publish any negative change in such a rating during the past 12 months. There should be no exemptions from this requirement for overseas life insurers. In addition, the Government should facilitate the publication on the internet of a table stating the financial strength rating of every life insurer offering life policies to the New Zealand public and any negative change in such a rating during the previous 12 months.²² In time, such a table could be expanded to include comparative information on the kinds of products offered by each life insurer and their terms and conditions.

For further discussion of these proposals, see chapter 7.

Life reinsurers

- 3.34 Life reinsurers should be subject to the Companies Act 1993, the Financial Reporting Act 1993 and other legislation of general application. Because reinsurers do not offer financial products to the public they should not be subject to the Securities Act 1978. The Financial Reporting Act 1993 should be amended to cover reinsurers that are incorporated in New Zealand. Overseas reinsurers that are registered as overseas companies in New Zealand should continue to be subject to the Financial Reporting Act 1993, including the requirement for an actuarial audit (unless exempted by the Securities Commission).

For further discussion of these proposals, see chapter 9.

A new Insurance Contracts Act

- 3.35 A new Insurance Contracts Act should be enacted to replace Part 2 of the Life Act and to re-enact other insurance law reform Acts.
- 3.36 New provisions should be included in this Act in respect of the transfer of life policies between life insurers, and the modernising of the administrative terms of old life policies.

For further discussion of these proposals, see chapter 8.

²¹ Many life insurers and reinsurers already have ratings on a voluntary basis.

²² As is done now by the Insurance and Superannuation Unit of the Ministry of Economic Development in respect of insurers required to obtain a rating under the Insurance Companies (Ratings and Inspections) Act 1994.

Amendments to the Companies Act 1993

- 3.37 Various, relatively minor, amendments should be made to the Companies Act 1993 to recognise the role of the prudential supervisor in amalgamations, liquidations and the proposed voluntary administration regime, and to bring forward the provisions relating to the liquidation of life insurers that are presently contained in the Life Act. The existing provisions in the Companies Act 1993 relating to company amalgamations should also be amended to give prudential supervisors access to information about proposed amalgamations. Section 383 of the Companies Act 1993 should be amended to include persistent failure to comply with the Financial Reporting Act 1993 as a ground for disqualification as a director.

Cross border issues

- 3.38 We make a number of recommendations on how the above proposals would relate to overseas life insurers, and on the enforcement of policyholder rights against such life insurers.

For further discussion of cross border issues, see chapter 10.

Summary of application of proposed regime to overseas life insurers

- 3.39 In summary, our proposed life insurance regime would have the following effect on overseas incorporated life insurers carrying on business in New Zealand:
- An overseas life insurer would be required to operate in New Zealand through a New Zealand incorporated company, subject to an exemption regime operated by the Securities Commission. We would expect an exemption to be granted if the Securities Commission was satisfied that the insurer was subject to law in its home country that offered protection to New Zealand policyholders equivalent to our Companies Act 1993 in terms of directors' duties, prohibitions on defaulting directors, amalgamations, voluntary administration and liquidation, and equality of standing with home-based policyholders on liquidation.
 - Overseas life insurers would generally have to comply with New Zealand law regarding product disclosure. Australian life insurers may at some future point have access to a mutual recognition regime if the current Ministry of Economic Development proposals on trans-Tasman mutual recognition of offers of securities are adopted and extended to life insurance. In any event, Australian and other overseas life insurers would be entitled to apply for an exemption from the Securities Commission under section 5(5) of the Securities Act 1978.
 - Australian and other overseas life insurers would be required to prepare, audit and register annual financial statements under the Financial Reporting Act 1993, which complied with our financial reporting standards, except that in relation to New Zealand branches of overseas life insurers, the Securities Commission would have the power (transferred to it from the Registrar of Companies) to allow registration of statements that comply with the reporting requirements of the law of the home country, where those requirements are substantially the same as the Financial Reporting Act 1993.

- Registered financial statements of overseas life insurers would have to be accompanied by an independent actuarial report on the actuarial aspects of those statements, in addition to the usual auditor’s report, subject to the Securities Commission having the power to grant an exemption from this requirement on defined criteria. The Securities Commission would have the power to approve as audit actuary, a suitably qualified actuary working in the home jurisdiction of the overseas life insurer.
- All overseas life insurers would be required to state in their life policies issued in New Zealand that the insurer will abide by the decision of the High Court of New Zealand and, unless exempted by the Securities Commission, that the policy will be governed by New Zealand law.
- If the prudential supervisor is to be a policyholder agent rather than a government monitor, every overseas life insurer would be required to appoint a policyholder agent. The Securities Commission would have the power to exempt an overseas life insurer (whether operating in New Zealand via branch or subsidiary) from the prudential supervisor requirement, if certain criteria are satisfied. Those criteria would include the following:
 - the New Zealand operations of the overseas life insurer are prudentially supervised to no less a standard in the life insurer’s home country;
 - the prudential supervisor is no less competent and trustworthy than the New Zealand prudential supervisor;
 - New Zealand policyholders’ interests will be given equal priority by the prudential supervisor with other policyholders.
- If prudential supervision is to be provided by a government monitor, overseas life insurers could similarly obtain an exemption from supervision, on the basis of equivalent criteria.

Education

- 3.40 In addition to the measures referred to above, we consider that the Government should arrange for a suitable body (for example, the Consumers’ Institute of New Zealand Inc) to undertake a public educational role in relation to life insurance, and provide such a body with sufficient resources to perform this role properly.

For further discussion of these proposals, see chapter 7.

Other matters we have considered

- 3.41 In reaching our conclusions, we have considered a number of possible regulatory measures that we have rejected. These and our reasons are outlined in appendix A, together with a number of other issues raised in our discussion paper and not discussed elsewhere in this report.
- 3.42 We have considered the implications of the fact that many life insurance policies, in particular traditional savings policies such as whole of life and endowment, and renewable risk only policies, have a “locked in” characteristic. Policyholders are often unable to switch to another insurer in the event that

they have concerns about their policy or the insurer that has issued it, without incurring significant costs or markedly worse terms, because of low surrender values or declining health. In our view, the appropriate regulatory response to this issue is to improve the disclosure requirements, consumer education, and the standards of financial advice, all of which we have recommended.

- 3.43 In appendix B we outline the IAIS Insurance Core Principles and compare our proposals against them. Our proposals comply with the IAIS Principles to a large extent, although in some cases we have proposed methods of compliance that differ from those adopted by other countries, the regulatory regimes of which we have considered.
- 3.44 We have not reviewed the taxation implications of our proposals. We note there may be such implications for domestic and overseas life insurers that would be required to incorporate as New Zealand companies unless exempted by the Securities Commission.
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4

Product disclosure

Introduction

- 4.1 **N**EW ZEALAND'S APPROACH to regulating securities markets does not attempt to insulate investors from economic risk – risk is seen as an inherent part of these markets. Instead, the emphasis is on disclosure – trying to ensure that information about the key costs, benefits and risks is made available to investors in a timely manner.
- 4.2 An argument sometimes made against disclosure is that many people do not read or understand the material disclosed to them. Even if that is true, it is not a reason to abandon disclosure. We believe disclosure is likely to be more cost effective than other prescriptive or merit-based regimes, the costs of which tend to outweigh the benefits. Also, once information is disclosed, it is available not only to individual investors, but also to analysts and advisers, who can digest and disseminate it, or use it to produce comparisons and recommendations for investors. Disclosure has the added advantage that it requires issuers of securities to consider each of the matters to be disclosed, and to ensure that these matters have been adequately addressed before the security is offered to the public.
- 4.3 The extent of the disclosure required presently for life policies depends on whether or not the policy is a “savings policy” (that is, a life policy that has an investment element). If it is, the disclosure regime under the Securities Act 1978 will apply. Much of the actual content of this regime is contained in the Securities Regulations 1983, rather than the Act itself.²³
- 4.4 The initial disclosure required for a savings policy includes an investment statement, which is a succinct document that contains “key information” about the policy and must be received by the policyholder, and a prospectus, which contains detailed information about the issuer and must be registered with the Registrar of Companies and provided on request to the policyholder. The Securities Commission has the power to suspend or prohibit an investment statement,²⁴ and to suspend or cancel a registered prospectus.²⁵
- 4.5 The investment statement is an advertisement for the purposes of the Securities Act 1978, and is subject to the requirements of that Act and the Securities Regulations 1983 relating to advertisements for securities. Issuers of savings policies are also obliged to comply with the advertising provisions of the Securities Act

²³ The Life Act also contains various ongoing financial disclosure requirements for life insurers – see para 4.30.

²⁴ Securities Act 1978 s 38F.

²⁵ Securities Act 1978 s 44.

1978, and to provide on request a copy of any financial statements registered under the Financial Reporting Act 1993 that are referred to in the prospectus.²⁶

- 4.6 These disclosure requirements do not apply to risk only policies. There was widespread support in submissions and consultation for more information being disclosed in relation to risk only policies, but there was less agreement as to the form such disclosure should take.

Extension of Securities Act 1978 to risk only policies

- 4.7 In Australia, a new disclosure regime applies to all industries offering financial products or services. An insurance policy is treated as a financial product irrespective of whether it has an investment element to it. The definition of “financial products” in the Corporations Act 2001 (Aust) includes not only facilities through which a person makes a financial investment, but also through which a person manages financial risk.²⁷
- 4.8 In New Zealand, a life policy without an investment element (a risk only policy) is not treated as a security under the Securities Act 1978. Risk only policies have a similar economic function to investment products – their object is to spread risk, with a view to mitigating possible losses of financial resources. To make informed decisions about the financial stability of a life insurer, or the suitability of a particular risk only policy, people need reliable, clear and timely information. The Securities Act 1978 regime is designed to ensure the provision of such information to the public and, in our view, should extend not only to life policies with an investment element, but to risk only policies as well. The effect of such an extension is considered below.²⁸

Recommendation

R3 The Securities Act 1978 regime should be extended to cover life insurance policies that do not have an investment element (risk only policies).

Advertisements for risk only policies

- 4.9 The Fair Trading Act 1986 applies to life insurance contracts. The Act prohibits people in trade from engaging in misleading or deceptive conduct, and prohibits certain types of misleading representations about goods or services, including (among others) false claims that goods or services are of a particular price or standard, or have particular benefits or uses.²⁹ The Commerce Commission is responsible for enforcement of this Act.

²⁶ Securities Act 1978 s 54B.

²⁷ Corporations Act 2001 (Aust) s 763A.

²⁸ We note that in extending the Securities Act 1978 disclosure requirements to risk only policies, account will need to be taken of group life policies. We expect that Securities Act 1978 disclosure would be made to the individuals insured by the policy, assuming that they are “members of public” within the terms of the Act. But there may be exceptions where individual disclosure is not required, for example where a group life policy is issued to a superannuation scheme trustee and the Securities Act 1978 disclosure regime applies to the interest in that scheme, or where an employer takes out insurance over the lives of key employees primarily to mitigate the employer’s risk rather than the employee’s risk.

²⁹ Fair Trading Act 1986 s 13.

- 4.10 Advertisements for securities (including savings policies) must comply with the provisions of the Securities Act 1978 and the Securities Regulations 1983.³⁰ Generally, an issuer is free to advertise its offer as it pleases, as long as 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.³¹ The Securities Regulations 1983 set out other specific requirements in relation to advertisements, for example, in relation to assets and guarantees.³²
- 4.11 The Securities Commission has the power to prohibit the distribution of an advertisement if, in its opinion, the advertisement does not comply with the Act, or is likely to mislead, deceive or confuse, or is inconsistent with the prospectus.³³
- 4.12 The Fair Trading Act 1986 applies to life insurance policies whether they are risk only or savings policies. We recommend that the requirements of regulations 8 and 9 of the Securities Regulations 1983, and the advertising provisions of the Securities Act 1978, should apply to risk only policies as well as savings policies, consistent with our recommended extension of the disclosure requirements of the Securities Act 1978. Extension of these advertising provisions would ensure that the Securities Commission has similar powers to prohibit the distribution of an advertisement in relation to a risk only policy as it has for a life policy with an investment element.
- 4.13 The other specific advertising provisions set out in the Securities Regulations 1983 should be reviewed to determine to what extent they are appropriate for risk only products.

Recommendation

R4 The advertising provisions of the Securities Act 1978 and regulations 8 and 9 of the Securities Regulations 1983 should be extended to cover risk only policies. Other advertising provisions set out in the Securities Regulations 1983 should be reviewed to determine to what extent they are appropriate for risk only policies.

Product disclosure statements for risk only policies

- 4.14 One of the key disclosure vehicles for financial products in the Australian market is the product disclosure statement, or PDS. Generally, a financial services provider must give a retail client a PDS at or before the time of recommending or offering to sell or issue a financial product.³⁴ The requirements for disclosure under this part of the Corporations Act 2001 (Aust) do not generally apply to a share or debenture of a body, or a right or interest in either.³⁵

³⁰ Securities Act 1978 s 38–38B, Securities Regulations 1983 Part 2.

³¹ Securities Regulations 1983, reg 8 and 9.

³² Securities Regulations 1983, regs 11, 12, 13, 14, 15 (prospective financial information).

³³ Securities Act 1978, s 38B.

³⁴ Corporations Act 2001 (Aust), ss 1012A–K.

³⁵ Corporations Act 2001 (Aust), s 1010A. Chapters 6CA and 6D of that Act provide for disclosure in relation to these securities.

- 4.15 We consider that the New Zealand Securities Act 1978 investment statement requirements should be extended to cover risk only policies, and the investment statement should be renamed the “product disclosure statement”.
- 4.16 The product disclosure statement for risk only policies should provide information about the same matters as is presently required for investment statements, except that information that relates only to investment products should, of course, be omitted. In other words, the information required for a risk only policy should be (in broad terms) as follows:
- what sort of financial product is this?
 - who is involved in providing it for me?
 - how much do I pay?
 - what claims can I make under the financial product and how much will I be paid?
 - what are my risks?
 - can the financial product be altered?
 - how do I cancel my financial product?
 - who do I contact with enquiries about my financial product?
 - is there anyone to whom I can complain if I have problems with the financial product?
 - what other information can I obtain about this financial product?
- 4.17 A life insurer may not need to produce a separate document to provide this information to a policyholder or potential policyholder – it could all be set out in the policy itself.³⁶

Recommendation

R5 The “investment statement” required by the Securities Act 1978 should be renamed the “product disclosure statement” and should be required in respect of all life insurance policies.

Renewals and variations

- 4.18 Presently, regulations provide exemptions from some requirements of the Securities Act 1978 where an existing security is renewed or varied in certain respects.³⁷ Where an existing security is renewed, or varied by extending the time for payment of money due or to become due by the issuer, these include an exemption from the requirement under section 37A(1)(a) that a subscriber must receive an investment statement before subscribing for a security.
- 4.19 Where a security varies the terms or conditions of an existing security (other than by extending the time for payment of money due or to become due by the

³⁶ Pursuant to s 38E(3) of the Securities Act 1978, an investment statement may include information in addition to that required by the Act and Securities Regulations 1983.

³⁷ Securities Act (Renewals and Variations) Exemption Notice 2002, reg 5 and 7.

issuer, or by changing the issuer), relevant exemptions include that from the prospectus requirements in section 37 and the investment statement requirements in section 37A. These exemptions are subject to the condition that a written statement must be sent to the security holder setting out the terms, purpose and effect of the proposed variation, the steps necessary to bring it into effect, and details of any other material matters.

- 4.20 We envisage that a similar exemption regime should apply in relation to risk only policies. A new product disclosure statement would not, therefore, be automatically required every time a policy was renewed or varied.

Recommendation

R6 An exemption regime should apply to renewals and variations of risk only policies, similar to that currently provided by the Securities Act (Renewals and Variations) Exemption Notice 2002.

Prospectus for risk only policies

- 4.21 For the reason outlined in paragraph 4.8, much of the information that a life insurer is presently required to provide in a prospectus for savings policies should also be provided by life insurers for risk only policies offered to the public. The information required in a prospectus for a savings policy includes details about the insurer, directors, guarantors, interested persons, and summaries of financial statements, and pending proceedings. This information about the insurer is also relevant to risk only policyholders, analysts and advisers, and should be disclosed.
- 4.22 While we consider that much of the information required in a prospectus for savings policies should also be disclosed to purchasers of risk only policies, the prospectus may not be the most appropriate disclosure vehicle. There is a pressing need for a review of the prospectus regime as a whole and, in particular, of the information required to be included in a prospectus and the method by which this information is required to be made available to the public.³⁸
- 4.23 In its report of December 1995, the Working Group on Improved Product and Investment Adviser Disclosure recommended that a full review of the prospectus regulations should be undertaken, because they had not been comprehensively updated since the early 1980s, despite the enactment of other legislation (such as the Financial Reporting Act 1993), which impacted on those requirements.³⁹ The introduction of the investment statement regime recommended by the Working Group has also had implications for the prospectus requirements. No such review has been completed.
- 4.24 A prospectus may no longer be needed for life policies if the necessary information is incorporated into other existing documents, such as the investment statement, annual report or financial statements, or made available on request, or on the life insurer's website. There is, at present, considerable

³⁸ There is probably still a place for the prospectus in respect of some securities (for example, initial offerings of equity securities).

³⁹ Working Group on Improved Product and Investment Adviser Disclosure, *Implementation of Part 4 of the 1993 Accord on Retirement Income Policies, Recommendations for Improved Investment Product and Investment Adviser Disclosure, Final Report* (Wellington, 21 December 1995) 40, para 105.

overlap in the requirements for financial reporting under the Financial Reporting Act 1993, those for annual reports under the Companies Act 1993, and the prospectus requirements under the Securities Act 1978.

- 4.25 The description of the company, for example, and information about directors, promoters, auditors and advisers that are presently required in a prospectus could instead be included in the life insurer's annual report; and financial statements in summary form for the last five years could form part of the financial statements required under the Financial Reporting Act 1993.⁴⁰ Other information, such as descriptions of policies offered, could be made available on the life insurer's website, or in hard copy on request.
- 4.26 A precedent for moving information from the prospectus to another disclosure document exists in section 8 of the Securities Amendment Act 2004, which exempts employer superannuation schemes from the prospectus requirements of the Act. The exemption is subject to a requirement that specified matters must be set out in the annual report prepared under section 14 of the Superannuation Schemes Act 1989 for each financial year during which the trustees relied on the exemption.⁴¹
- 4.27 The best way of publishing the information that is presently required to be included in a prospectus is a question that applies to all securities subject to the Securities Act 1978, and we consider this is a matter that should be the focus of a separate review. Pending the completion of any such review, we consider that a prospectus should be required for risk only policies offered to the public in New Zealand. (The Securities Act 1978 does not require that a prospectus be sent to every security holder, but only that it be registered with the Registrar of Companies and be available to security holders on request.)

Recommendation

R7 The prospectus regime under the Securities Act 1978 should be reviewed for the purpose of determining both the information that needs to be disclosed and the best way of disclosing it. Pending the completion of such a review, a prospectus should be required for risk only policies offered to the New Zealand public.

⁴⁰ The Financial Reporting Act 1993 is currently under review by the Ministry of Economic Development. Some aspects of the current regime have been raised with us by overseas companies, including the requirement to register consolidated accounts and for separate New Zealand branch accounts. Any changes to these requirements may have a flow on effect for prospectus requirements.

⁴¹ Securities Act 1978, s 5B. Matters that must be reported include bankruptcy, insolvency or convictions for dishonesty of a superannuation trustee, promoter or manager of the scheme in the preceding five years; if more than 10 per cent of the scheme's assets was during the preceding year represented directly or indirectly by any securities issued by a trustee, manager or custodian of the scheme or any associated person, then a description of those securities; a brief description of any legal proceedings or arbitrations pending at the specified date that may have a material adverse effect on the scheme, and a statement by the trustees (or directors) as to whether, in their opinion, the value of the scheme's assets relative to its liabilities (including contingent liabilities) or the ability of the scheme to pay its debts as they become due in the normal course of business, have materially and adversely changed since the specified date.

Request disclosure

- 4.28 Under the Securities Act 1978 specified information must be disclosed by issuers to security holders if they request it.⁴² The documents that a security holder may request include:
- copies of the most recent annual report;
 - the most recent financial statements required to be registered under the Financial Reporting Act 1993;
 - any deed of trust or participation;
 - any guarantee of payment, together with the most recent annual or half yearly financial statements of the guarantor;
 - the most recent prospectus and investment statement relating to securities of the kind held by the security holder; and
 - if prospective information about returns or financial information about the issuer was included in any disclosure material, a comparison of actual returns or results against the prospective information.
- 4.29 These requirements should be extended so that appropriate information is available on request to holders of risk only policies.

Recommendation

R8 The request disclosure regime under the Securities Act 1978 should be extended to cover risk only policies.

Periodic disclosure

- 4.30 Apart from initial disclosure by means of the product disclosure (investment) statement and prospectus, what ongoing obligations should life insurers have to disclose information periodically to policyholders? At present, the Life Act, which governs all life insurers and reinsurers carrying on business in New Zealand,⁴³ requires some ongoing disclosure by life insurers. Each year, every life insurer must prepare both a statement of its revenue account and a statement of its financial position, in the forms contained in the schedules to the Life Act.⁴⁴ These must be accompanied by an abstract of a report from a qualified auditor. Also, once in every year, each life insurer must cause an investigation to be made into its financial condition by an actuary.⁴⁵ Professional Standard 1 of the New

⁴² Securities Act 1978, s 54B, Securities Regulations 1983, reg 23A. A fee must be paid for some information.

⁴³ Life Insurance Act 1908 - in relation to Parts 1 and 1A of the Act, s 2 provides the following definition of a company:

... 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 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.

⁴⁴ Life Insurance Act 1908, ss 16 and 17.

⁴⁵ Life Insurance Act 1908, s 18.

Zealand Society of Actuaries sets out the matters that the actuary should address when examining and reporting on a life insurer's financial condition, and states that the report should include a calculation of the solvency position.⁴⁶ The life insurer must lodge an abstract of that actuarial report, and a statement of its life insurance and annuity business, in forms set out in the schedules to the Life Act. Statements and reports must be lodged with the chief executive of the Ministry of Economic Development within nine months of the close of the life insurer's financial year. In practice, they are sent to the Insurance and Superannuation Unit of the ministry where the Government Actuary is based.

- 4.31 We are recommending that the Life Act be abolished, and that all financial reporting requirements be included in the Financial Reporting Act 1993 – see chapter 5.
- 4.32 Apart from these financial reporting requirements, what other obligations are there for periodic disclosure by life insurers? In 1995, the Working Group on Improved Product and Investment Adviser Disclosure recommended a detailed review of what information should be disclosed on a periodic basis to security holders, and that provision should be made in the Securities Act 1978 for periodic disclosure.⁴⁷ As a result, section 54A was included in the Securities Act 1978. It provides for periodic disclosure of documents, information and other matters as prescribed by regulations made under the Act. However, this section has not been implemented – no regulations have yet been prescribed for this purpose.
- 4.33 In Australia, section 1017D of the Corporations Act 2001 sets out specific periodic reporting requirements for products with an investment component, where the holder is a retail client. The issuer must give the holder a periodic statement for each reporting period while the holder holds the product. Each reporting period lasts for a period determined by the issuer (but not more than a year). Periodic statements must give the holder information that the issuer reasonably believes the holder needs to understand his or her investment. Specifically, the statement must include:
- opening and closing balances;
 - termination value of the investment at the end of the period;
 - a summary of transactions in relation to the product during the period;
 - increases in contributions by the holder during the period;
 - return on investment during the period;
 - details of any change in circumstances affecting the investment not otherwise notified;
 - anything else specified by regulations.
- 4.34 There is a need in New Zealand for periodic disclosure to policyholders for savings policies, and also for risk only policies. We note that, at present, annual

⁴⁶ New Zealand Society of Actuaries Professional Standard 1, standard 4.2.3. The standard refers the actuary to the NZSA's Guidance Note No 5.

⁴⁷ Working Group on Improved Product and Investment Adviser Disclosure, above n 39, 92, para 255, 95, para 258.

reports are generally only sent to shareholders of a life insurer, and not to policyholders (who are creditors). As a matter of practice, holders of savings policies and risk only policies usually receive annual notices containing information about their policies that relate to premiums, fees and charges and the amount of cover. This practice should be a legal requirement.

4.35 We consider that the periodic disclosure regime under section 54A of the Securities Act 1978 should be implemented to require that, on an annual basis, holders of savings policies and risk only policies receive:

- notice of any change in the rating of the life insurer since the last such notice;⁴⁸
- notice of the right to request information as described in paragraph 4.28;
- information to help policyholders monitor their policies, such as information for both the last and the next year in relation to:
 - the amount of premiums;
 - the life cover provided;
 - fees and charges;
 - in the case of savings policies, returns achieved, together with details as to which bonuses are guaranteed once allocated and which are discretionary.

4.36 We appreciate that there will be cases where it will be appropriate for the Securities Commission to grant exemptions from these requirements, for example, single premium policies (such as single premium mortgage protection plans), which were set up on the basis that there would be no annual mailings. However, we consider that periodic disclosure should apply to policies that are renewed annually, even if there is an exemption in relation to the obligation to provide a new PDS on renewal.

Recommendation

R9 The periodic disclosure regime under section 54A of the Securities Act 1978 should be implemented in relation to life insurance policies, subject to an appropriate exemption regime.

Disclosure requirements for new life insurers

4.37 When a new start-up life insurer enters the market, the financial information available to potential policyholders is necessarily limited. The prospectus requirements set out in schedule 3B to the Securities Regulations 1983 require a reference to the latest financial statements for the life insurer, but in its first year there will be no such statements.

4.38 We consider that, in those circumstances, the prospectus (or any disclosure document that replaces it) should be required to include forecast financial statements for the first year of operation, and that the statements (and the assumptions on which they are based) should be required to be audited by both an auditor and an audit actuary (see chapter 5). This will assist prospective

⁴⁸ By this we mean personal notice to the policyholder of the change - public notice is already required if the entity is subject to the Insurance Companies (Ratings and Inspections) Act 1994.

policyholders, and financial advisers and analysts, to assess the likely financial soundness of the new life insurer through its start-up phase. The half yearly certificate under section 37A (1)(c) of the Securities Act 1978 should apply in respect of these forecast financial statements.

Recommendation

R10 The prospectus requirements for new start-up life insurers should include forecast financial statements for the first year of operation, audited by an auditor and an audit actuary.

Material adverse change

- 4.39 Section 37A of the Securities Act 1978 provides that an allotment of a security will be voidable on a number of bases, including where an issuer, or a director of the issuer, knows at the time of the allotment that the investment statement or prospectus was false or misleading because it did not refer or give proper emphasis to adverse circumstances, even if those arose as a result of a change after the document was prepared.
- 4.40 An allotment will also be voidable under section 37A if the date of allotment is more than nine months after the date of a statement of financial position or interim position referred to in a prospectus. While there is provision for the directors to extend that period by a further nine months in relation to a prospectus containing a statement of financial position, this can only be done by the issuer providing a certificate signed on behalf of the directors stating that the financial position has not materially and adversely changed.
- 4.41 The effect of section 37A is that, if a material adverse change occurs during the currency of a statement of financial position or directors' certificate, the issuer must immediately file with the Registrar of Companies an amendment to the prospectus that describes the change. However, the filing of such an amendment does not necessarily bring the change to the attention of holders of the securities.
- 4.42 We consider that, in addition to the obligations imposed by section 37A of the Securities Act 1978 referred to above, life insurers should be required to notify the prudential supervisor (see chapter 6) of any material adverse change to the insurer's solvency position as soon as the insurer is aware, or should reasonably be aware, of such a change. This will avoid the need for the prudential supervisor to check the Companies Register constantly for such changes. The prudential supervisor should be empowered to require the life insurer to notify every policyholder of the material adverse change if the prudential supervisor thinks fit.

Recommendation

R11 A life insurer should be required to notify the prudential supervisor of a material adverse change to the insurer's solvency position as soon as the insurer is aware, or should reasonably be aware, of the change; and the prudential supervisor should be empowered to require the life insurer to notify all policyholders of the change.

Surrender values

- 4.43 Surrender 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. In Australia, section 207 of the Life Insurance Act 1995 (Aust) gives policyholders certain rights in relation to surrenders of policies, and requires the setting of an actuarial standard for minimum surrender values.
- 4.44 There are no specific New Zealand statutory requirements of this kind, although for new policies, the surrender basis must be disclosed in the investment statement.⁴⁹ However, investment statements vary in the degree of information they provide in this regard. The practice in savings policies of providing that the life insurer has a discretion in calculating surrender values on early termination of a policy may give rise to a concern that the discretion may not be exercised in a manner fair to policyholders.
- 4.45 Where projected surrender values have been misrepresented at the time a life policy was sold, the relevant provisions of the Securities Act 1978, the Fair Trading Act 1986, the Consumer Guarantees Act 1993 and the common law are likely to give the policyholder a remedy. However, where surrender values are determined at the insurer's discretion, the concern referred to above does not relate to misrepresentation at the time of sale (because the existence of a discretion will usually not have been misrepresented), but rather to the exercise of the discretion at the time of surrender.
- 4.46 In our discussion paper, we suggested two possible approaches to address this concern:
- follow the Australian law, with the New Zealand ASRB approving an actuarial standard for minimum surrender values; or
 - require the life insurer to obtain an independent review of whether the surrender value provisions of a policy are fair, before any person buys that type of policy.
- 4.47 There was little support expressed in consultation and submissions for minimum surrender values. In New Zealand, the issue is largely confined to policies sold many years ago, because savings policies are no longer being issued in great numbers. Concern was expressed that it would be unreasonable to introduce prescriptive rules in relation to surrender values with retrospective effect, because this would also retrospectively shift relative shareholder and policyholder value.
- 4.48 In any event, minimum surrender values will not necessarily mean an end to consumer dissatisfaction or complaint. When the Life Offices Association Code of Practice was introduced in 1990, as part of the selling process for new policies it became a requirement to provide illustrative surrender values after three, five and ten years, and if the premium on a policy was being increased by more than 10 per cent.⁵⁰ In its submission, the Insurance and Savings Ombudsman described receiving complaints where the surrender values offered by the insurers were consistent with those suggested by the original illustrations, but the consumers remained unhappy with the amounts offered.

⁴⁹ Securities Regulations 1983, sch 3D, cl 7 - types of charges, cl 9 - returns, cl 11 - risks, and cl 14 - early termination.

⁵⁰ Insurance and Savings Ombudsman submission, no 21.

- 4.49 We do not recommend the introduction of minimum surrender values in New Zealand. Nor do we believe that the answer lies in requiring an independent review to determine whether surrender value provisions are fair before a person takes out a policy. The fairness of a surrender value is a difficult issue to determine in advance, and might result in surrender values being reduced if an advance review has the effect of guaranteeing them.
- 4.50 In our view, the appropriate approach to surrender values is to deal with the issues that arise by way of initial and request disclosure. Currently, an insurer is required to disclose in the investment statement a brief description of the right of any person to surrender the policy,⁵¹ and a brief description of the key factors determining the returns.⁵² These requirements should be amended to make it clear that where surrender values are a matter for insurer discretion, it is not sufficient simply to describe the key factor determining the returns in the event of surrender as being that discretion. Where a discretion exists in relation to returns, the insurer should be obliged to disclose the key factors that determine the exercise of the discretion.

Recommendation

R12 The requirements for investment statements should be amended to make it clear that, where there is an element of discretion in the returns achieved by a life insurance policyholder, the key factors affecting the exercise of that discretion must be disclosed.

- 4.51 The insurer should also be required to disclose the current surrender basis and the assumptions underlying it to policyholders on request. Limiting this disclosure to “on request” allows the insurer to provide better-quality information to the policyholder, because it avoids the insurer having to draft broad disclosure documents to cover a range of products. To enable the policyholder to assess whether there have been any significant changes to surrender values, the insurer should also be required to disclose whether there has been any change in the current surrender basis, as compared with the surrender basis disclosed at the time of sale, or five years previously, whichever is the later.
- 4.52 An issue that many policyholders may not be aware of is that an insurer may pay a different rate of terminal bonus on surrender than on maturity. A policyholder who wants to surrender might be better off converting a whole of life policy to an endowment policy, lowering the maturity age, making the policy paid up or borrowing against it from the insurer or a third party to pay premiums. The difference in returns as a result of the higher terminal bonus could be material. Where such options are available, the insurer should be obliged to disclose the fact that there are other options that may be more advantageous to the policyholder than surrendering the policy, and should prominently display a recommendation that the policyholder seek advice in this regard. This information should be provided when a policyholder requests information about surrender values as described in paragraph 4.51.

⁵¹ Securities Regulations 1983, sch 3D, cl 14(1).

⁵² Securities Regulations 1983, sch 3D, cl 9(1)(b).

Recommendation

R13 Life insurers should be required to disclose the current surrender basis and the assumptions underlying it to life insurance policyholders on request, together with any change in the current surrender basis, as compared with the surrender basis disclosed at the time of sale, or five years previously, whichever is the later. At the same time, where there are options other than surrender available to the policyholder that may be more advantageous to the policyholder, the insurer should be required to disclose that there are other options available, and should prominently display a recommendation that the policyholder seek advice in this regard.

- 4.53 Some life insurers provide policy illustrations that include details of projected surrender values if a policy is terminated after one, two, three, five or ten years. If such illustrations are provided, they should comply with the relevant standards in the Manual of Practice Standards issued by the Investment Savings and Insurance Association (ISI). While illustrations can be useful, in some cases they can become misleading, particularly over a long period, and we do not consider they should be a mandatory disclosure requirement.

Benefit projections

- 4.54 According to the ISI Standard for Benefit Projections Involving Investment Performance (the ISI Standard), benefit projections involving investment performance must:
- be made in a form and on a basis that has been approved by the member company after taking appropriate advice; and
 - use two (sets of) projection rates (higher and lower), each of which can realistically be expected to be achieved over the life of the investment having regard to the underlying assets, and each of which is clearly stated; and
 - be net of all charges (whether implicit or explicit, direct or indirect and including all commission and other costs associated with the sale of the policy) and, where appropriate, include an allowance for inflation;
 - when allowing for inflation, include provision for increases in contribution levels and fixed fees and shall not be at a greater annual rate than the upper level of the target rate set from time to time for the Governor of the Reserve Bank;
 - not be misleading or give unrealistic expectations; and
 - be objectively fair and reasonable;

The ISI Standard sets out requirements as to the projection rates to be used. For policies with reversionary bonuses, benefit projections may require up to three projection rates.

- 4.55 The Securities Regulations 1983 provide that an advertisement must not contain prospective financial information unless it refers to the prospectus in which the information is also contained, or it contains a statement of the principal assumptions and method of calculation in accordance with which the information is calculated.⁵³ If the registered prospectus contains prospective

⁵³ Securities Regulations 1983, reg 15.

financial information, the auditor's report must state that the information, so far as the accounting policies and calculations are concerned, has been properly compiled on the footing of the assumptions made or adopted by the issuer as set out in the prospectus, and is presented on a basis consistent with the accounting policies normally adopted by the issuer.⁵⁴

- 4.56 The requirements of the ISI Standard go further than those of the Securities Regulations 1983. The ISI Standard provides useful protection for consumers, but, in our view, it is not satisfactory to leave this issue to be dealt with solely by an industry code. We do not consider that benefit projections should be mandatory. However, we recommend that the Securities Act 1978 and Securities Regulations 1983 be amended to incorporate requirements similar to those set out in the ISI Standard, which should apply if benefit projections are given. These requirements should include the following:
- the use of two or more projection rates, to be determined on criteria similar to those set out in the standard;
 - the requirement that projections must not be misleading or give unrealistic expectations;
 - the requirement that benefit projections must be objectively fair and reasonable.

Recommendation

R14 The Securities Act 1978 and Securities Regulations 1983 should be amended to incorporate requirements for the use of prospective information similar to those set out in the Investment Savings and Insurance Association (ISI) Standard for Benefit Projections Involving Investment Performance, to apply if benefit projections are given.

Allocation of profits

- 4.57 Generally, the basis on which profits are shared between the shareholders of the life insurer and the holders of its saving policies (or between different classes of policyholder) is at the discretion of the life insurer, subject to the terms of its constitution or other governing document, the terms of its savings policies, and any constraints imposed by normal competitive pressures or the long-term reputation of the insurer. As with surrender values, this sometimes gives rise to a concern that the discretion may not be exercised in a manner that is fair to savings policyholders.
- 4.58 In the actuarial abstract required by section 18 of the Life Act, the actuary must state the principles upon which the valuation and distribution of profits among policyholders are made, and whether these principles were determined by the instrument constituting the company, or by its regulations and bylaws, or otherwise. In chapter 5, we recommend that this information should be required by financial reporting standards to be included in the financial statements of each life insurer. We also recommend that the financial statements should state the principles upon which the valuation and distribution of profits is made between shareholders and policyholders (and any classes of either).

⁵⁴ Securities Regulations 1983, sch 3B, cl 12(6).

- 4.59 At present, life insurers must also include a brief description of the key factors that determine the returns to holders of savings policies in the investment statement.⁵⁵
- 4.60 In our discussion paper, we suggested that one option to address concerns about allocation of profits was to require the life insurer's actuary, or an independent actuary, to state whether the allocation is fair and equitable between classes of policyholder and between shareholders and policyholders.⁵⁶
- 4.61 Another option would be to create rules surrounding the allocation of profits, as is done in Australia, where 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 profits for a statutory fund representing an Australian participating business, at least 80 per cent of the profit must be added to policyholders' retained profits. The balance of the operating profit must be treated as, or added to, shareholders' retained profits.⁵⁷
- 4.62 There were mixed views in submissions and consultation regarding the best approach to addressing the concern about allocation of profits to savings policyholders. We note that:
- in New Zealand, savings policies are no longer a significant proportion of new sales, although they still constitute a large proportion of existing policies; and
 - for most life insurers operating in New Zealand, the basis on which profits are allocated to savings policyholders is prescribed by the life insurers' constitution or other governing document (particularly those life insurers that demutualised in recent years) and/or by overseas law.
- 4.63 We consider that the allocation of profits to savings policyholders is a matter best dealt with by way of disclosure. We have recommended at paragraph 4.50 in relation to surrender values that the current requirement that life insurers must disclose a brief description of the key factors that determine the returns should be amended to make it clear that, where there is a discretion in relation to returns, the key factors affecting the exercise of that discretion must be set out.
- 4.64 The exact detail of other disclosures required in relation to allocation of profits should be developed in consultation with the industry and the New Zealand Society of Actuaries (NZSA). However, we consider that insurers should be required to disclose the following sorts of information to policyholders on request:

⁵⁵ Securities Regulations 1983, sch 3D, cl 9.

⁵⁶ We note that in the United Kingdom, the Financial Services Authority proposes that life insurers be required to define and make available their Principles and Practices of Financial Management (by request and on the firm's website). The firm must produce an annual report to policyholders stating whether it has complied with the obligations relating to these principles and practices. A "with profits" actuary should make a written report to policyholders, to be annexed to the firm's annual report to policy holders, stating whether in the actuary's opinion, based on the information and explanations provided by the firm, the firms' report and the discretion it has exercised during the period under review may be regarded as having taken policyholders' interests into account in a fair and reasonable manner – Financial Services Authority *With-profits governance and the role of actuaries in life insurers – Feedback on CP167, made and near-final text* (London, June 2003).

⁵⁷ Life Insurance Act 1995 (Aust), s 32 (1)(b), s 60.

- Information as to which bonuses are guaranteed once allocated (reversionary bonuses) and which are completely discretionary on termination.
 - The bonus rates for the last five years, separated for reversionary and terminal bonuses. This would allow a person to see if there had been a review of bonus rates that might signal a change in financial strength (allowing for known market performance over that period).
 - The actual investment returns on the assets backing the life policy for the same period. This would allow comparison of bonus rates relative to returns between insurers.
 - The mix of assets backing the life policy, to assist with an assessment of the likely volatility of bonus rates, based on market conditions.
- 4.65 We have recommended that the periodic disclosure regime under section 54A of the Securities Act 1978 should be implemented to require that, on an annual basis, holders of savings policies and risk only policies receive specified information, including information about returns achieved in the last 12 months. This would include any reversionary bonuses.

Recommendation

R15 The Securities Regulations 1983 should be amended to require life insurers to disclose on request the following sorts of information in relation to allocation of profits:

- information as to which bonuses are guaranteed once allocated (reversionary bonuses), and which are completely discretionary on termination;
- the bonus rates for the last five years, separated for reversionary and terminal bonuses;
- the actual investment returns on the assets backing the life policy for the same period;
- the mix of assets backing the life policy.

5

Financial reporting

EXISTING POSITION

Financial Reporting Act 1993

- 5.1 **T**HE FINANCIAL REPORTING ACT 1993 is primarily financial market integrity legislation (see paragraphs 2.6 and 2.7 of the discussion paper). Its purpose is to ensure that up-to-date, accurate and understandable financial information about relevant entities is publicly disclosed on a regular basis. It requires all issuers, and all overseas companies who carry on business in New Zealand (and subsidiaries of overseas companies), to register audited financial statements with the Registrar of Companies each year. An “issuer” is a person who has issued securities for which a prospectus or investment statement under the Securities Act 1978 is required (or would be required but for an exemption granted under that Act), or a manager of a unit trust, or a person who is a party to a listing agreement with a registered stock exchange.⁵⁸ All life insurers to whom the Securities Act 1978 applies, and all overseas companies carrying on life insurance business in New Zealand, are subject to these requirements.
- 5.2 The Financial Reporting Act 1993 established the Accounting Standards Review Board (ASRB), which has the role of approving financial reporting standards submitted to it for the purposes of that Act (and various other Acts).⁵⁹

Financial reporting standards

- 5.3 The financial statements required by the Financial Reporting Act 1993 must comply with generally accepted accounting practice. In relation to overseas companies, if the Registrar of Companies is satisfied that the statements comply with the law in force in the country of incorporation, and those requirements are substantially the same as those of the Financial Reporting Act 1993, those statements are to be taken as complying with that requirement (Financial Reporting Act 1993, section 11(3)).⁶⁰
- 5.4 Generally accepted accounting practice incorporates, in the case of life insurers, Financial Reporting Standard (FRS) 34. This is the financial reporting standard

⁵⁸ Financial Reporting Act 1993, s 4.

⁵⁹ The other Acts are the Public Finance Act 1989, the Local Government Act 2002 and any Act that requires a person to comply with the Financial Reporting Act 1993 as if that person were a reporting entity (Financial Reporting Act 1993, s 24 (a)).

⁶⁰ We recommend that this power be transferred to the Securities Commission (see para 10.11).

approved by the ASRB for life insurance business.⁶¹ Under FRS 34, limited information relevant to the solvency position of a life insurer is required to be disclosed. In particular:

- clause 9 requires valuation of policy liabilities;
- clause 16.6 requires disclosure of the amount of equity retained as solvency reserves;
- clause 17 requires disclosure of information about the actuarial calculations that have been applied to meet clauses 9 and 16.6, such as a summary of key assumptions used.⁶²

5.5 Under clause 9.1.7, FRS 34 requires that measurement of policy liabilities should be undertaken in accordance with actuarial guidelines and standards issued by the New Zealand Society of Actuaries (NZSA).

5.6 The NZSA has issued a guidance note (GN5) on prudential reserving for life insurers. This prescribes the basis on which actuaries should provide advice to directors of life insurers regarding the capital necessary to give a reasonable expectation that there will be sufficient assets to:

- meet obligations to existing policyholders (including allowances for future bonuses) and creditors under a range of adverse conditions; and
- meet obligations to policyholders and creditors should all policies discontinue and surrender values be paid.

5.7 Guidance Note 5 requires that measurement of capital is to be done at least annually and the actuary is to advise the directors at any time if there is reason to believe that minimum capital requirements will not be met. This guidance note is based on the solvency standard issued by the Life Insurance Actuarial Standards Board of Australia.

5.8 In addition, the NZSA has issued a professional standard on determination of life insurance policy liabilities (PS3) for use in conjunction with New Zealand financial reporting standards, and a further professional standard (PS1) that applies when an actuary is asked to give advice to a life insurer and, in particular, sets out the matters the actuary should address when examining and reporting on the financial condition of a life insurer.⁶³

⁶¹ Financial Reporting Standard 34 is currently under review by the Financial Reporting Standards Board of the Institute of Chartered Accountants of New Zealand (ICANZ), primarily to accommodate the transition to international standards as from 1 January 2007. The Exposure Draft released by the ICANZ in 2003 shows the proposed changes, and some of the clause numbering mentioned in this chapter is affected. No significant changes to solvency disclosures are proposed.

⁶² The requirements of cls 9 and 17 are focused on policy liabilities and have only limited impact on solvency.

⁶³ There is also a solvency test contained in the Companies Act 1993. This is a different test than the solvency assessment made under GN5. The Companies Act 1993 test requires only that the company is able to pay its debts as they become due, and that the value of the company's assets is greater than the value of its liabilities, including contingent liabilities. This test must be satisfied before dividends may be declared, and is also relevant in relation to amalgamations and in a number of other circumstances concerning relations with shareholders.

PROPOSED IMPROVEMENTS

Gaps in coverage of Financial Reporting Act 1993

- 5.9 New Zealand incorporated life insurers offering solely risk only insurance must prepare financial statements that comply with the Financial Reporting Act 1993 (assuming they are not “exempt” companies, which are, generally speaking, smaller companies), but are not required to register or audit those statements.⁶⁴ Life insurers operating through a non-company structure (such as partnerships and friendly societies) and which solely offer risk only products are not covered by the Act at all. New Zealand incorporated life reinsurers (of which we understand there are none at present⁶⁵) are not covered by the registration and audit requirements, because they are not issuing to the public. It is also possible that overseas life insurers or reinsurers are not caught by the Act, if they are not “carrying on business in New Zealand”.
- 5.10 We consider that the financial statement preparation, auditing and registration requirements of the Financial Reporting Act 1993 should be extended to cover all issuers of life insurance products to the public. We recommend in chapter 4 that the disclosure requirements of the Securities Act 1978 be extended to risk only life insurance. If that recommendation is adopted, then risk only life insurers will become “issuers” for the purposes of the Financial Reporting Act 1993. This will be the case whatever form of entity is issuing the life insurance.⁶⁶

Recommendation

R16 The Financial Reporting Act 1993 requirements to prepare, audit and register annual financial statements should be extended to cover all issuers (including non-company issuers) of risk only life insurance policies to the public (as well as issuers of savings policies).

- 5.11 We note that the Financial Reporting Act 1993 is currently under review by the Ministry of Economic Development. Some aspects of the current regime have been queried in submissions to us – in particular, in relation to overseas companies, the requirements for registration of consolidated accounts, and for separate New Zealand branch accounts. We assume these requirements will be under review by the ministry. For the obligations of life reinsurers under the Financial Reporting Act 1993, see chapter 9.

⁶⁴ It is possible that for a risk only life insurer that was part of a group that included an issuer, the financial statements of the risk only insurer would have to be audited and registered as part of the group financial statements, under the Financial Reporting Act 1993. In addition, if a risk only life insurer had, at a previous point in time, offered securities for which a prospectus was required, it would be an “issuer”.

⁶⁵ Excluding captive reinsurers.

⁶⁶ Our recommendation in chapter 3 that all life insurers be required to incorporate as companies is another way of applying the Financial Reporting Act 1993 to risk only life insurers but, as it will be possible to obtain an exemption from this requirement (see para 3.12), it is more satisfactory if non-company entities are included in the Financial Reporting Act 1993 regime by virtue of being issuers.

Problems with solvency disclosures

5.12 Our consultations revealed that the practice as to what is actually disclosed under FRS 34 about a life insurer's solvency position varies, and in some cases the disclosure is not sufficient to enable a third party to form an accurate view of the solvency position of the life insurer. In order to meet the aims of:

- strengthening the ability of consumers (and their agents and advisers) to assess the strengths and weaknesses of life insurers' policies and the performance of life insurers; and
- putting disciplines on life insurers to ensure financial affairs are properly managed (see chapter 1);

it is important that the disclosures made in the publicly filed financial statements are accurate, comprehensive and understandable.

5.13 Financial Reporting Standard 34 will be replaced with an international reporting standard, as the result of the ASRB having decided that New Zealand will adopt international reporting standards, for reporting periods commencing 1 January 2007.⁶⁷ The reporting standard that will apply after that date will be the International Financial Reporting Standard (IFRS) for insurance contracts, the detail of which is still being finalised. Based on exposure drafts published by the International Accounting Standards Board, it appears likely that the relevant IFRS will be largely principle based, with little detail on the disclosures required, in particular in relation to solvency.⁶⁸ We understand that the present thinking is that New Zealand will require life insurers to continue to report in accordance with FRS 34, in addition to the IFRS.

5.14 The aim of our recommendations is to ensure that the information that is publicly disclosed through the Financial Reporting Act 1993 is sufficiently comprehensive that the audit actuary (see paragraph 5.27), the prudential supervisor (see paragraph 5.36), and independent analysts such as credit rating agencies and other market analysts (see chapter 7) are able to form an assessment of the financial condition of the life insurer.⁶⁹ We envisage that this may require including in the financial standard some of the matters currently required to be reviewed by the actuary under PS1.⁷⁰ In particular, we envisage disclosures under FRS 34 could cover information on reinsurance, related party exposures, and other types of business carried on by the insurer.

5.15 We regard disclosure of reinsurance arrangements as particularly important, and consider it desirable that life insurers be required to include in their financial

⁶⁷ Reporting entities have the option of opting into the IFRS regime as from 1 January 2005. This is to allow entities that are required to report in other countries under IFRS as from 1 January 2005 (notably Australian entities) to prepare a single set of financial statements.

⁶⁸ ED5 Insurance Contracts published by the International Accounting Standards Board requires three disclosures, on information identifying and explaining amounts in the balance sheet and income statement, on information enabling users to understand amount, timing and uncertainty of future cash flows, and on fair value of assets and liabilities.

⁶⁹ One option would be to include in the Financial Reporting Act 1993 an overriding statement of objectives, which specified that the purpose of the standards was to achieve a certain level of public disclosure, being disclosure sufficient to enable an independent, expert reader of the statements to form an accurate assessment of the financial condition of the reporting entity.

⁷⁰ Matters required to be reported under the existing sixth schedule of the Life Act should also be considered when deciding what solvency disclosures are required.

statements the names of their reinsurers, and a brief description of the reinsurance arrangements.⁷¹

- 5.16 Further work will need to be done in conjunction with the Institute of Chartered Accountants and the NZSA to determine the details of the requirements, and the interrelationship between the disclosure requirements of the financial reporting standard and the content of the actuarial standards.⁷² One option that we raise for consideration is that the solvency disclosures be contained in an annex to the financial statements.

Recommendation

R17 The financial standard applicable to life insurers that issue life policies to the New Zealand public should be reviewed for the purpose of including sufficient disclosure on solvency matters to enable “monitors” of a life insurer (including the audit actuary and prudential supervisor) to form an accurate view of the solvency position of the life insurer. In particular, the level of disclosure required relating to reinsurance arrangements should be increased.

Actuarial standards

- 5.17 At present, the NZSA issues professional standards and guidance notes for use by its members when advising insurers. These standards and notes have no legal standing. In the discussion paper, we raised the possibility of giving actuarial standards statutory recognition. There would be advantages in this in that actuaries would be required to comply with the standards,⁷³ and it is possible that the standards themselves would benefit from going through a more formal approval process. If actuarial standards are given statutory recognition, either of themselves, or by incorporation into financial reporting standards, then the issue arises as to who should set or approve them.
- 5.18 There are a number of options:
- the NZSA;
 - the ASRB, which has the function of reviewing and approving financial reporting standards submitted to it, for the purposes of the Financial

⁷¹ We note that under the requirements of the Securities Regulations 1983, life insurers are required to disclose certain information in relation to “material contracts” in the prospectus. These requirements do not currently go as far as we consider desirable in relation to reinsurance arrangements. However, the prospectus or the annual report may be a more appropriate vehicle for this particular disclosure. In addition, the directors could be required to certify that the reinsurance arrangements are secure. Reinsurance is also a consideration when determining solvency under GN5. We expect that any review of GN5 would include consideration of whether the standard needs to be more specific or stringent in this regard. See chapter 9 for further discussion of issues relating to reinsurance.

⁷² We note that the NZSA has already done a considerable amount of work on revision of the existing reporting requirements for life insurers. In particular, the NZSA has previously recommended that the sixth schedule of the Life Act be revised to set out the amount of the prudential reserving requirement and the assumptions used in that calculation.

⁷³ We envisage that the Financial Reporting Act 1993 would provide that financial statements must be prepared in accordance with the approved actuarial standards, in the same way that financial statements presently must comply with applicable financial reporting standards.

Reporting Act 1993, the Public Finance Act 1989, the Local Government Act 2002, or any other Act requiring compliance;⁷⁴

- another government agency, for example, the Securities Commission or Government Actuary;
- the Australian Life Insurance Actuarial Standards Board, perhaps reconstituted with New Zealand representation.

- 5.19 While the NZSA has an important role to play in the preparation of actuarial standards, it does not consider that it should have sole responsibility for establishing solvency standards. We agree with this view and, while we would expect that, in practice, the NZSA would have significant input into the preparation of actuarial standards, consider that the task of reviewing and approving them should fall to another body.
- 5.20 This role could be given to a government agency such as the Securities Commission or the Government Actuary, but it would be a new role for either agency and there would need to be a review of the resourcing of the agency concerned.
- 5.21 The ASRB is an obvious candidate for the task – it has a similar current statutory role and extensive experience in reviewing and approving financial reporting standards. However, it does not currently have the actuarial expertise required to set actuarial standards. One possibility is to require appropriate actuarial representation on the ASRB, to provide that expertise. This would involve a change to the Financial Reporting Act 1993.
- 5.22 Another option would be to invite the Australian Life Insurance Actuarial Standards Board to reconstitute itself as an Australasian board with New Zealand representation. It could be responsible for approving actuarial standards in both jurisdictions, but the New Zealand Government could retain a reserve power to regulate if there were grounds to regard an Australasian standard as inappropriate to circumstances here.
- 5.23 In our view, the option of including actuarial representation on the ASRB and giving that board the additional role of reviewing and approving actuarial standards is the best and most cost-effective response to the need to give statutory recognition to actuarial standards, and this is the option we recommend.⁷⁵

Recommendation

R18 The Financial Reporting Act 1993 should be amended to provide for the approval of actuarial standards in the same way as it currently provides for approval of financial reporting standards. The Accounting Standards Review Board should be augmented by the inclusion of appropriate actuarial representation.

Capital adequacy standard

- 5.24 In Australia, life insurers are required to comply with not just a solvency standard, but also a capital adequacy standard. The solvency standard is aimed

⁷⁴ Financial Reporting Act 1993, s 24.

⁷⁵ The issue of whether audit standards should also have statutory backing was raised in submissions to us. This is a matter that should be the subject of a separate review. It is not a matter that is of relevance only to life insurance but rather is relevant across the whole financial market.

at ensuring that the statutory fund of a life insurer can meet its existing liabilities as and when they fall due with a high degree of probability. By contrast, the capital adequacy standard is aimed at ensuring that the fund remains financially viable, can continue to write new business, and is likely to meet the solvency standard in three years time with a high degree of probability. It takes into account the effect of new business plans on future solvency and imposes more adverse experience assumptions. 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.⁷⁶

- 5.25 We do not recommend the adoption of a capital adequacy standard for New Zealand. The overall effect of the capital adequacy standard in Australia seems to be primarily to set another threshold that, if not met, gives the regulator, APRA, power to take action. Under the regime we propose, the public financial disclosures should be sufficient to enable an accurate view to be formed of a life insurer's financial condition. In addition, the prudential supervisor, who has the primary role of supervising solvency, will have access to confidential information of the life insurer (such as any financial condition report), and will be able to ask for this at any time. Only certain enforcement actions will require thresholds to be met, for example, appointing a voluntary administrator or liquidator. See chapter 6 for further discussion of the powers of the prudential supervisor.
- 5.26 We do recommend that the solvency standard (which currently exists in GN5) be reviewed. This may be necessary in any event to ensure a good fit with the new international standards. It may be that the prudential capital requirements of life insurers operating in New Zealand should be greater, with the aim of including additional "buffers" such as exist under the Australian capital adequacy standard. It would be appropriate (in particular) as part of that review to ensure that GN5 requires proper account to be taken of any other business the life insurer may be conducting, in light of the fact that we are not recommending life insurers be required to operate their life business through a separate statutory fund (see appendix A).⁷⁷

Recommendation

R19 New Zealand Society of Actuaries Guidance Note 5 should be reviewed (or new actuarial standards introduced) to ensure that the prudential capital requirements for life insurers offering life policies in New Zealand are set at an appropriate level.

Audit of actuarial information in financial statements

- 5.27 Financial statements of life insurers that offer savings policies to the public and of overseas companies that carry on business in New Zealand must be audited.⁷⁸ This provides a mechanism for checking on the quality of the work done by the insurer's accountants and actuaries. However, our consultations revealed that

⁷⁶ This description of the capital adequacy standard is taken in large part from a speech by Craig Thorburn, refer to footnote 69 of the discussion paper.

⁷⁷ A copy of the Australian standard can be obtained from APRA's website: <www.apra.gov.au> (last accessed 28 October 2004).

⁷⁸ Financial Reporting Act 1993, ss 15 and 19.

the extent to which actuarial information, in particular on solvency issues, is audited, varies. It is highly desirable that, just as the accounting information in a life insurer's financial statements is required to be audited by an independent accountant, there be an audit of the actuarial information included in those financial statements by an independent actuary. We therefore recommend that all life insurers that offer life policies to the New Zealand public be required by the Financial Reporting Act 1993 to obtain an independent actuarial audit of the actuarial aspects of their financial statements within the same timeframe as the auditor's report on the accounting aspects of the statements. The independent actuarial auditor would provide a report on the actuarial aspects of the financial statements of the life insurer, which would state that the audit actuary has formed the view that, from an actuarial perspective, the insurer's assessment of solvency is true and fair (or not) and the assumptions used by the insurer in making that assessment are reasonable and in accordance with the relevant standards (or not).

- 5.28 The Securities Commission should be authorised to grant exemptions from the requirement to obtain an independent actuarial audit, in relation to overseas companies (see further chapter 10).⁷⁹
- 5.29 Recent proposals in the United Kingdom have considered the desirability of requiring an independent actuarial audit of valuation of liabilities by life insurers. The latest proposal is to require the auditor to obtain an independent actuarial report internally, and to state that such a report has been obtained. This is similar, but not identical, to the actuarial audit function we propose. The UK Financial Services Authority (FSA) Policy Statement PS04-16 gives the reasons why the decision was made in the United Kingdom to merge the accounting and actuarial audit reports. In particular, the auditing profession expressed concerns that there would be confusion over who was responsible for the different reports. Our understanding is that, under the latest proposal, the auditor's sign off will cover the entire financial statements, including the actuarial aspects. However, the auditor can state that it has relied on the audit actuary as far as actuarial matters are concerned.
- 5.30 We believe that, in New Zealand, it is preferable that both the auditor and the audit actuary be appointed by (and be liable for negligence to) the life insurer, but the insurer should have to obtain the auditor's agreement before appointing any particular audit actuary. Furthermore, the audit actuary's name should be disclosed in the auditor's report, and the audit actuary's report should be signed by the audit actuary and annexed to the auditor's report.

Recommendation

R20 All life insurers that offer life policies to the New Zealand public should be required by the Financial Reporting Act 1993 to obtain an independent actuarial audit of the actuarial aspects of their financial statements, subject to an exemption regime for overseas life insurers (operated by the Securities Commission). The actuarial auditor should be appointed by the life insurer, and approved by the auditor. The audit actuary's report should be annexed to the auditor's report.

⁷⁹ With regard to the application of the actuarial audit requirement to life reinsurers, see chapter 9.

Approval of audit actuaries

- 5.31 We believe that, in order to ensure that audit actuaries have sufficient skills, experience and integrity to perform their role, they must be persons who have been approved for this purpose by a suitable body. The role we have recommended for an audit actuary will involve high reliance on the professionalism, independence and ability of that person. In our view, the risks entailed in incompetent or reckless performance of that role meet the threshold for regulation. A mechanism is required to ensure that audit actuaries are independent, skilled, experienced and reliable, and that procedures exist to prevent those who are not from performing this role.
- 5.32 We do not consider that the NZSA should be asked to take on the role of approving audit actuaries until the New Zealand actuarial profession is larger and has more resources available. We suggest instead that every audit actuary must be a person who is currently approved for this purpose by a government agency. The Financial Reporting Act 1993 could contain this requirement, and also set, or require a government agency to set, criteria for approval, and for revocation of approval. The persons need not be citizens of, or resident in, New Zealand, but should be persons against whom effective legal action can in practice be taken if they fail to perform their duties as audit actuaries properly.
- 5.33 The criteria could include the following:
- that the person be a Fellow of NZSA or of an equivalent body in Australia, the United Kingdom, Canada, the United States of America, or any other comparable country;
 - he or she must have a minimum of five years post-qualification experience working in life insurance;
 - he or she must be familiar with the New Zealand life insurance industry;
 - he or she must be independent of any life insurer in respect of which he or she acts as audit actuary.
- 5.34 The question then arises as to which government agency should undertake the approval role. Possible options include the Government Actuary and the Securities Commission. For the same reasons that are given in chapter 6 in relation to who could be the prudential supervisor, in particular the undesirability of vesting a power of this nature in a single individual, we consider that the Securities Commission should have this role. It presently has similar powers under section 48 of the Securities Act 1978, to approve people to act as trustees or statutory supervisors for the purposes of that Act. The approval is by notice in the *New Zealand Gazette*, on such terms and conditions as the Securities Commission thinks fit, and may be revoked in the same way. This approval mechanism is also appropriate in the case of audit actuaries.

Recommendation

R21 The Financial Reporting Act 1993 should be amended to give the Securities Commission a power to approve persons to act as audit actuaries, having regard to such criteria and on such terms and conditions as the Securities Commission thinks fit, and to revoke any such approval. The approvals and revocations of approval to be by notice in the *New Zealand Gazette*.

Monitors of financial information

- 5.35 We recognise that the actuarial information disclosed in the financial statements, as improved by the above recommendations and independently audited, is likely to be of such complexity that it would be unreasonable to expect most policyholders to understand it or make an assessment of the solvency position of the life insurer. However, the information will be available to other “monitors” who assist or act on behalf of the policyholder, such as financial advisers, the financial media and financial analysts (including credit rating agencies). Our recommendations relating to financial advisers and analysts are set out in chapter 7.

Prudential supervisor

- 5.36 We also believe that there should be an entity that can, on behalf of the policyholders, assess the publicly disclosed, independently audited, financial statements of a life insurer, and, if a lack of financial soundness is revealed, take further action. This recognises that policyholders are non-experts and, importantly, are a disparate group who, while having various creditors’ remedies under the Companies Act 1993,⁸⁰ are unlikely to be able to act effectively if financial soundness issues are disclosed. We call this entity the “prudential supervisor”. The action available to the prudential supervisor would range from requesting further information from the insurer, directors, auditor, and audit actuary (which could be requested at any time), through to conducting investigations, and ultimately applying to the High Court for the life insurer to be put into voluntary administration (or an equivalent regime), potentially receivership, or liquidation. The prudential supervisor could be either a private sector body appointed by the life insurer (a policyholder agent) or a government body (a government monitor). The requirement for life insurers to have a prudential supervisor should be contained in the Securities Act 1978 and the Securities Commission should be authorised to grant exemptions from this requirement, particularly for overseas life insurers that operate under overseas laws that provide equivalent protection for New Zealand policyholders. Further discussion of the prudential supervisor is contained in chapter 6.

Financial condition report

- 5.37 At present, each life insurer (and reinsurer) is required, by section 18 of the Life Act, to cause an annual investigation to be made into its financial condition by an actuary. An abstract of that actuary’s report is required to be filed with the chief executive of the Ministry of Economic Development under section 21. We propose that the Life Act be repealed. We recommend that all financial reporting requirements be included in the Financial Reporting Act 1993, and that the requirements of the relevant standards be robust enough for readers of the financial statements to be able to form an accurate view of the life insurer’s financial condition. We do not see it as the role of legislation to require the life insurer’s board to obtain internal actuarial reports. We expect that actuarial advice would be sought and any reports would be accessible by the audit actuary and the prudential supervisor, on a confidential basis (except that they could be disclosed in any court proceedings).

⁸⁰ In particular, s 241 Companies Act 1993 gives creditors, including contingent and prospective creditors, the right to apply to court to have a liquidator appointed and the court may appoint a liquidator if it is satisfied that the company is unable to pay its debts.

- 5.38 The current statement made by the actuary under section 18 of the Life Act includes the principles upon which the valuation and distribution of profits among the policyholders are made, and whether these principles were determined by the instrument constituting the company, or by its regulations or bylaws or otherwise.⁸¹ In our view, the financial reporting standards should require this information to be included in the financial statements of each life insurer. The financial statements should also state the principles upon which the valuation and distribution of profits are made between shareholders and policyholders, and any classes of either group. This requirement should be supported by standards as to the nature of the disclosures required (because it will not be sufficient just to state generally that policyholders are treated equitably). (For further discussion of the allocation of profits, see chapter 4.)

Recommendation

R22 The financial reporting standards should require the financial statements of a life insurer to state the principles upon which the valuation and distribution of profits among policyholders are made, and as between shareholders and policyholders, and any classes of either group.

Ongoing monitoring

- 5.39 We recommend that the prudential supervisor for a life insurer have an ongoing monitoring role in relation to the life insurer throughout each financial year.
- 5.40 We recommend that, in addition to the Securities Act 1978 obligation either to register a new prospectus or provide a certificate updating the existing prospectus each half year,⁸² life insurers be required to:
- provide a copy of each prospectus and half yearly certificate to the prudential supervisor as soon as it has been registered; and
 - notify the prudential supervisor at any time in the event of material adverse change to the insurer's solvency position.

As is common in the case of debt security trustees, it would be possible for a policyholder agent to negotiate additional reporting by a life insurer, for example, quarterly solvency certificates. This negotiated additional reporting will not be possible if a government monitor is the prudential supervisor. For further discussion of the role and identity of the prudential supervisor, see chapter 6.

Recommendation

R23 Life insurers should have ongoing reporting requirements to the prudential supervisor, in particular to provide copies of each prospectus and half yearly certificate, and give notification in the event of material adverse changes.

- 5.41 We believe that the audit actuary should have a “whistle-blowing” role in the event that the audit actuary becomes aware of any matter that, in his or her opinion, is relevant to the exercise or performance of the powers or duties of the

⁸¹ Life Insurance Act 1908, sch 6, cl 2.

⁸² Securities Act 1978, s 37A.

prudential supervisor. The audit actuary would be required to report the matter to the life insurer and send a copy of that report to the prudential supervisor. This is similar to the whistle-blowing role that an auditor of an issuer of debt securities has under section 50 of the Securities Act 1978. We also recommend that section 50 be extended to cover auditors of life insurers, so that life insurer auditors have whistle-blowing obligations to the prudential supervisor.

Recommendations

R24 The audit actuary should have a “whistle-blowing” role in the event of becoming aware of any matter relevant to the exercise or performance of the powers or duties of the prudential supervisor.

R25 Section 50 of the Securities Act 1978 should be extended (or an equivalent section enacted) to the effect that auditors of life insurers have obligations to report to the prudential supervisor, by providing copies of reports and other information, and, in particular, to report to the life insurer and prudential supervisor on becoming aware of matters relevant to the exercise or performance of the powers or duties of the prudential supervisor.

5.42 We suggest that the ongoing monitoring provisions be included in the Securities Act 1978.

Enforcement issues

5.43 Section 383 of the Companies Act 1993 sets out the circumstances in which the High Court may disqualify a person from acting as a director. Persistent failure to comply with the Companies Act 1993 or the Securities Act 1978 is included as a ground. We recommend that persistent failure to comply with the Financial Reporting Act 1993 should also be included in section 383 (1)(c)(i) of the Companies Act.

Recommendation

R26 Persistent failure to comply with the Financial Reporting Act 1993 should be included as a ground on which a person can be disqualified from acting as a director, under the Companies Act 1993.

6

Prudential supervision

Introduction

- 6.1 **A** KEY PART of our proposed regime for life insurers is that someone has power to take action if the independently actuarially audited financial statements filed under the Financial Reporting Act 1993 (or other disclosures by the life insurer) disclose solvency concerns.
- 6.2 The rationale for the creation of this role is to ensure that the pressures created from the threat of effective enforcement are real. These pressures are essential to a well functioning market. Policyholders are not well placed to take action themselves (for example, conducting further examinations or investigations, or instituting liquidation proceedings under the Companies Act 1993) for a variety of reasons, but perhaps most importantly because policyholders are normally highly fragmented in number and size of stakeholding.
- 6.3 The creation of this role will put policyholders in a similar position to holders of debt securities. The aim is to provide a mechanism for putting effective pressure on an insurer, as a large creditor can. This is a key part of an efficiently operating market (see chapter 1), giving policyholders (buyers) the means to pressure insurers (sellers) to perform.
- 6.4 The requirement for the appointment of a prudential supervisor is a financial safety and consumer protection measure, because its aim is to provide a mechanism whereby policyholders can pressure insurers to perform (and potentially replace management), thereby reducing the risk of insurer failure. However, the prudential supervisor we envisage, while it could potentially be a government entity, is not a central regulator.⁸³ Its role is a narrowly defined one, being to analyse publicly disclosed financial statements (including forecast statements in the case of a new insurer), receive prospectuses, directors' half yearly certificates and notifications of material adverse change, receive any notifications of "problems" from audit actuaries, and act only if financial

⁸³ In particular, the prudential supervisor differs from a central regulator of the type contemplated by the World Bank publication *The Development and Regulation of Non-Bank Financial Institutions* (above n 13). The focus of the World Bank regulator is to ensure that the promises made by insurers have an acceptably high probability of being met, and involves the imposition of prescriptive rules or standards governing the prudential behaviour of insurers. By contrast, the prudential supervisor contemplated by this report is effectively acting as a substitute for the policyholders, who are themselves not well placed to put pressure on insurers to perform. Its focus is on analysis of (primarily public) financial information. It has a limited range of powers including investigations and ultimately applying for liquidation. It could have the power to replace management, especially if a private sector entity is the prudential supervisor. It is similar to the prudential supervisor contemplated by the Accident Insurance Act 1998 (repealed).

unsoundness issues are revealed.⁸⁴ It is essentially a representative of the policyholders and could have as an additional role an advocacy function on the policyholders' behalf (see paragraphs 6.20 to 6.27 and 8.69 to 8.91).

- 6.5 Many of the functions that would be undertaken by a central regulator under a different regulatory model are important and will be carried out by other entities under our proposed regime, such as the Securities Commission, the ASRB and the courts. This applies, for example, to the setting of standards on financial and actuarial matters, and approving actuarial auditors. Liaising with other regulators both offshore and within New Zealand is also important (we envisage this role will be undertaken by the Securities Commission or possibly the Reserve Bank of New Zealand).⁸⁵ The courts will have a role in relation to approving transfers of policies and amalgamations. Supervision of financial intermediaries is also important (we comment further on this subject in chapter 7). Certain other functions we do not consider necessary. This applies, for example, to registration or licensing of life insurers and imposing preconditions to starting up business. Further discussion of other measures that we do not consider necessary is contained in appendix A.

Recommendation

R27 There should be a “prudential supervisor” for every life insurer (but not a reinsurer), who has certain powers to monitor the financial condition of the life insurer and take enforcement action if necessary. The prudential supervisor could be either a private sector “policyholder agent” or a “government monitor”. There should be an exemption regime operated by the Securities Commission.

Who could be the prudential supervisor?

- 6.6 The prudential supervisor could potentially be one government entity for all life insurers (a government monitor) or it could be a separate private sector entity (for example, an accounting firm or trustee company) for each life insurer (a policyholder agent). In determining the range of matters to be considered when deciding who best to have this role, we found it helpful to refer to the Legislation Advisory Committee (LAC) guidelines.⁸⁶ The LAC guidelines are designed to set out the central aspects of the process of making legislation and the elements of the content of legislation that should always be addressed. Chapter 8 of the guidelines sets out the issues to be considered when creating a new public power (that is, a power conferred on a public authority by legislation being a discretion to act or not act, and decide what action to take). Part 2 of chapter 8 sets out matters to be considered when deciding who is the appropriate person to have a public power. Those matters include:

⁸⁴ The power to request further information would be exercisable at any time.

⁸⁵ Who should take on this role depends on what form of prudential supervision is selected, see discussion later in this chapter. If the Securities Commission is the government monitor, or a private sector policyholder agent must be appointed, then the Securities Commission is the appropriate entity to perform this role (and note that under s 10(ca) of the Securities Act 1978, one of the functions of the Securities Commission is to cooperate with overseas regulators). If the Reserve Bank of New Zealand is to be the government monitor, it should perform this role.

⁸⁶ Legislation Advisory Committee *Guidelines on Process and Content of Legislation* (Ministry of Justice, Wellington, 2001 edition and 2003 supplement).

- how confined is the power?
- are wide discretions involved?
- is there a high or low policy content in decision making?
- is the public interest relevant?
- is a specialist body appropriate?
- what degree of independence is desirable?
- what procedure is appropriate, formal or informal?
- how important are the individual rights involved?
- what safeguards over the power are appropriate (for example, appeals)?

Issues relevant to government monitor

6.7 The possible candidates for a government entity to act as government monitor are:

- the Securities Commission;
- the Registrar of Companies;
- the Government Actuary;
- the Reserve Bank of New Zealand;
- a new statutory entity.

6.8 The following matters are relevant when considering whether one of the above government entities should be the sole prudential supervisor:

- Whoever takes on this role will need to be adequately resourced to act for the policyholders of all life insurers subject to the Financial Reporting Act 1993 (including overseas companies), excluding those insurers exempted by the Securities Commission from the requirement to have a prudential supervisor (see paragraph 10.13).
- Resourcing will include the need to have or be able to access actuarial expertise.
- In general terms, it is not desirable to vest a power of this nature in one individual. A more balanced and considered approach would be gained from a group of individuals, for example, a board of directors. (A court is an exception to this rule, but the lack of group balance and consideration is made up for by an established adversarial system and rights of appeal).
- A government entity would probably not be liable either to the life insurer or policyholders for negligence or other misconduct. To impose liability on a government entity would effectively create a Crown guarantee of insurer solvency (although it would be possible to require the entity to take out insurance and exempt the Crown from any liability).
- The costs of performing the role of prudential supervisor would be met by life insurers (but ultimately consumers). If the prudential supervisor was a government entity, the costs could be met by either a levy or fees payable by life insurers.

- It may be more appropriate to use a government entity if there is a policy/public interest element to the decision-making process. There is little or no such element in this case because the role and powers will be to protect the interests of policyholders (there being no systemic issues – see footnote 8). It will largely be a factual (non-policy) issue whether or not financial unsoundness is revealed by financial information, and what steps should be taken to protect policyholders.
- A prudential supervisor should have complete independence from the Government and life insurers, being accountable only to policyholders.
- With regard to procedural requirements, a reasonably informal procedure would be appropriate in the early stages of a prudential supervisor’s response to financial unsoundness (discussions, enquiries and so on) followed by increasing formality if the problem was not resolved.
- In terms of the importance of individual rights, the prudential supervisor will have a range of powers that could have serious consequences for a life insurer and its shareholders and policyholders. The power should therefore be exercised at a senior level in a specialist, well-resourced body.
- In terms of the safeguards over the powers of a government entity as prudential supervisor, the powers would need to be carefully defined in statute and any action of the government entity would be subject to judicial review.
- Imposing a government entity as a prudential supervisor will create a structure different from that which exists for other types of financial instruments, for example, debt and participatory securities (where a private sector entity acts as the prudential supervisor).

6.9 The following matters are specifically relevant to the entities listed in paragraph 6.7 above:

- The Securities Commission has a range of other similar powers and functions (it reviews prospectuses, polices advertisements and investment statements, issues exemptions, and has powers of inspection) and is responsible for liaison with offshore regulators.⁸⁷ However, the new prudential supervisor role would comprise different powers and functions and would need to be resourced accordingly.
- The office of the Registrar of Companies is the section of the Ministry of Economic Development that, in practice, currently receives the statements, abstracts and Government Actuary’s report under the Life Act. It also receives the financial statements under the Financial Reporting Act 1993, and registers credit ratings for non-life insurers. The Registrar of Companies is authorised to carry out investigations under the Corporations (Investigation and Management) Act 1989 and has powers of inspection under the Insurance Companies (Ratings and Inspections) Act 1994. This office would need to be further resourced to take on this extra role.
- The Government Actuary’s current role under the Life Act is similar to that of an actuarial auditor. Under that Act, the Ministry of Economic Development is required to send to the Government Actuary the statements and actuarial abstracts received under that Act, and the Government Actuary

⁸⁷ Securities Act 1978, s 10 (ca).

is required to report back (to the Minister). The Government Actuary is not currently resourced to take on the role of prudential supervisor.

- The Reserve Bank of New Zealand undertakes prudential supervision of banks. This function has similarities with the prudential supervisor role, but is focused on mitigating systemic risks, not acting to safeguard the interests of a specific group of investors. The Reserve Bank of New Zealand is also not currently resourced to take on the role of prudential supervisor.

6.10 We consider that the two government entities suitable for taking on the role of prudential supervisor are the Securities Commission and the Reserve Bank of New Zealand. Both are independent of the Government and life insurers, and each has a board consisting of a number of members with experience of the financial markets.⁸⁸ The Securities Commission has a monitoring role already in relation to savings policies, in that it is authorised to suspend or cancel advertisements, investment statements and prospectuses relating to those policies. However, its primary focus is on conduct (or market integrity) regulation, and prudential supervision would be a new role for it. The Reserve Bank, as noted, is already involved in prudential supervision of banks, for systemic stability reasons. Both entities would need to be resourced accordingly to take on this new role.

Recommendation

R28 If the prudential supervisor is to be a government entity (a government monitor), either the Securities Commission or the Reserve Bank of New Zealand should undertake this role. The costs of the government monitor should be met by industry levies.

Issues relevant to policyholder agents

6.11 Another option would be for life insurers to use a private sector entity as prudential supervisor. The private sector entity would be a person chosen by the life insurer from a list of persons approved for this purpose by the Securities Commission,⁸⁹ and would be appointed by the life insurer by contract. We consider the following matters are relevant to this option:

⁸⁸ The Reserve Bank of New Zealand board is an advisory board (with responsibilities to keep the performance of the Bank and the Governor under review), with the management function being vested in the Governor. From the perspective of the considerations relevant to who could perform the role of prudential supervisor referred to in para 6.8, this is not as desirable as where management is the responsibility of a group of individuals such as a board.

⁸⁹ Under s 48 of the Securities Act 1978, only a trustee corporation or person approved by the Securities Commission may act as a trustee in relation to debt securities or statutory supervisor in relation to participatory securities. "Trustee corporation" means the Public Trust, the Maori Trustee or any corporation authorised by any Act to administer the estates of deceased persons and other trust estates. Under the Trustee Companies Act 1967 there are currently five companies authorised to administer deceased persons' estates. They are Trustees Executors Limited (previously Tower Trust Ltd), AMP Perpetual Trustee Company NZ Ltd, PGG Trust Ltd, New Zealand Permanent Trustees Ltd and The New Zealand Guardian Trust Company Ltd. We consider that trustee corporations should require approval by the Securities Commission before they could undertake the role of policyholder agent. As a general principle, we consider that the law should not specify named organisations as being appropriate for a particular role, because those organisations may change over time and cease to be appropriate. It is preferable for there to be a government entity conducting ongoing monitoring of the performance of such organisations.

- Trustee companies and other approved persons already carry out a similar role in relation to publicly issued debt securities and participatory securities under the Securities Act 1978, and there are similarities between certain life policies and investment products for which an approved person is already required.
- An approved person would be required to be independent of the life insurer and have sufficient expertise and financial backing to perform the role properly.
- An approved person would normally, and could be required to, have a board of directors experienced in financial markets.
- An approved person would normally be liable to the life insurer and policyholders for negligence or breach of contract, and, unlike a government entity, this would provide a significant incentive for it to perform its role properly.
- The costs of the approved person would be negotiated with the life insurer and met by the life insurer (and ultimately by consumers).
- The specific terms of the approved person's role could be set out in the contract and tailored (within statutory guidelines) to meet the individual circumstances of each life insurer.⁹⁰ The terms of the contract could also be changed over time to adapt to market conditions. By contrast, if the prudential supervisor was a sole government entity, it would be difficult to have anything other than one set of rules for all life insurers.⁹¹
- The contract could include solvency levels or tests appropriate to each life insurer (subject to actuarial standards) and would clearly set out the approved person's powers, including the power to initiate receivership or voluntary administration. In addition to monitoring solvency, the contract could provide that the approved person would monitor cash flows, investment practices, major transactions, profit allocation policies and other matters of interest to policyholders. It could, for example, require the life insurer to inform the policyholder agent of significant changes in the solvency position of the insurer's parent company.
- The contract could also set out the form and frequency of information to be provided to the policyholder agent, for example, it would be possible for the policyholder agent to require quarterly certificates from the directors, in addition to the half yearly certificates required under the Securities Act 1978.
- An approved person could take a charge over the life insurer's assets as security for the policyholders (trustee companies do this for debt securities). In

⁹⁰ The extent to which the role of the private sector policyholder agent would need to be set out in law depends to some degree on the level of competition between potential policyholder agents. One option may be to set out in law the policyholder agent's duty at a general level. This would include ongoing monitoring of the solvency condition of the relevant life insurer, and to take action if solvency issues are disclosed. We note in this context that under the Accident Insurance Act 1998 (now repealed), the duties of prudential supervisors were set out in the Act, including such duties as monitoring the solvency of the insurer, identifying any material risk that the insurer will become insolvent, and to take action under the trust deed.

⁹¹ The reason for this is that if the government entity was able to provide different terms for different life insurers, that would create a situation where allegations of unfairness could arise, and the government entity could be exposed to actions for judicial review.

addition, an approved person could have the power to appoint a receiver. The threshold at which appointment of a receiver would be possible would be a matter for negotiation. The ability to replace management in this way is an important one. It would, in theory, be possible to provide for a statutory receivership regime if the prudential supervisor was a government entity, but this would require including in the relevant legislation (probably the Securities Act 1978) a schedule of powers, and the threshold for action would be the same for all insurers.

- In relation to new life insurers, an approved person would be unlikely to take on the role of policyholder agent unless the insurer had demonstrated commercial viability and adequate capitalisation. This would effectively give rise to a mechanism for “vetting” new life insurers.
- A policyholder agent should have a statutory obligation to inform the Securities Commission of any action it proposed to take in relation to an overseas life insurer, or a life insurer who was part of an overseas group, in order that the Securities Commission could liaise with any offshore regulator who may have an interest in that insurer.
- The Securities Commission should be required to monitor the performance of persons approved as policyholder agents and revoke the approval of any person whose performance is unsatisfactory.

Recommendation

R29 If the prudential supervisor is to be a private sector entity (a policyholder agent), each life insurer should appoint its own policyholder agent by contract from a list of persons approved for this purpose by the Securities Commission, which would monitor the performance of all policyholder agents and revoke approval where appropriate.

Prudential supervisor’s powers

6.12 We consider that the prudential supervisor would need to have the following powers at the minimum (whether it is a government or private sector entity):

- to request further information from the life insurer, auditors and audit actuary;⁹²
- to undertake an investigation if necessary, in the event that publicly or confidentially disclosed financial information revealed financial unsoundness issues; and
- to apply for voluntary administration (under the new regime proposed in the Insolvency Law Reform Bill),⁹³ or liquidation of the life insurer.⁹⁴

⁹² The duty imposed on auditors of debt and participatory securities under s 50(3) of the Securities Act 1978 to provide information on request could provide a model for this provision, at least in relation to the auditor and audit actuary.

⁹³ If that regime is not enacted, then we recommend the introduction of a regime similar to judicial management, see para 6.18.

⁹⁴ It would also be highly desirable for the prudential supervisor to have the power to take over director control (by appointing a receiver) in order to “trade out” of an insolvency situation. This would be a matter for negotiation if there was a policyholder agent (we envisage a power of appointing a receiver would be included), and may be a possibility if there was a government monitor, but that would require a statutory receivership regime.

Recommendation

R30 The prudential supervisor should have power to request further information, to conduct investigations, and to apply for voluntary administration or liquidation.

Comparison with existing investigative powers

- 6.13 In relation to investigative powers, the Registrar of Companies presently has the power under the Corporations (Investigation and Management) Act 1989 to initiate an investigation of a life insurer, and powers of inspection under the Insurance Companies (Ratings and Inspections) Act 1994. However, there are a number of differences between the powers we propose the prudential supervisor would have and the Registrar's existing powers. For example, under the Corporations (Investigation and Management) Act 1989, the Registrar has no duty or obligation to supervise the affairs of any corporation, or to operate a system of supervision, or exercise any power in respect of any particular corporation. Further, the threshold for the Registrar acting under that Act is fairly high. The corporation must either be operating fraudulently or recklessly, or action must be necessary to preserve the interests of members or creditors or to act in the public interest, and the members, creditors or public interest must not be able to be adequately protected under the Companies Act 1993 or any other lawful way.⁹⁵ The Corporations (Investigation and Management) Act 1989 was designed to deal with corporate collapses of such magnitude that the normal legal procedures available to a corporation, its members and creditors would be inadequate. Under the Insurance Companies (Ratings and Inspections) Act 1994, the Registrar has a power to require life (and other) insurance companies to produce documents for the purpose of determining whether the company is unable to pay its debts. The inspector's report becomes admissible in liquidation proceedings.
- 6.14 In addition, under the Securities Act 1978, the Securities Commission has certain powers of inspection and enforcement for the purposes of that Act, the Securities Markets Act 1988, or any Act listed in the first schedule. These powers are limited to the operations of those Acts.
- 6.15 We propose that the prudential supervisor be given powers under the Companies Act 1993 to apply to the High Court to place a company into voluntary administration (or equivalent regime) or liquidation. If there was a policyholder agent then the contract of appointment could also include the power to appoint a receiver (a statutory receivership regime is also possible). The powers under the Corporations (Investigation and Management) Act 1989 and the Securities Act 1978 referred to above should remain,⁹⁶ but the powers of the Registrar of Companies under Part 2 of the Insurance Companies (Ratings and Inspections) Act 1994 in relation to life insurers could be repealed (because these would duplicate the prudential supervisor's powers).

⁹⁵ Operating fraudulently or recklessly means contracting debts that the corporation did not honestly believe it would be able to pay, or carrying on business recklessly or operating with intent to defraud creditors or members.

⁹⁶ We recommend in chapter 10 that the Corporations (Investigation and Management) Act 1989 be amended to clarify that "creditors" includes contingent and prospective creditors, see para 10.14.

Recommendation

R31 The powers of the Registrar of Companies under Part 2 of the Insurance Companies (Ratings and Inspections) Act 1994 in relation to life insurers should be repealed.

Voluntary administration regime

- 6.16 The prudential supervisor should have the ability to put the life insurer into voluntary administration under the proposed voluntary administration regime in the Insolvency Law Reform Bill released by the Ministry of Economic Development in April 2004.⁹⁷ The voluntary administration regime is similar to receivership, except that a receiver acts primarily for the creditor who appointed it. A voluntary administrator is a more neutral entity, acting on behalf of all creditors. Reports and accounts are to be made by the administrator to the Registrar of Companies. The voluntary administration regime is designed to provide a mechanism for the business and affairs of an insolvent company to be administered in a way that maximises the chances of the company continuing in existence, or, if that is not possible, results in a better return for the company's creditors and shareholders than would result from immediate liquidation.
- 6.17 The regime would need to enable the prudential supervisor to be a person entitled to apply to the High Court for appointment of an administrator, and to clarify the nature of policyholders' interests as those of creditors (because there is an issue as to whether policyholders are only contingent or prospective creditors). There is currently no threshold for appointment of an administrator by the High Court, but this may change.⁹⁸ Under the proposed regime, the administrator is required to come up with a proposal as to how the company could meet its debts, which is voted on by creditors. If the proposal is accepted, a deed administrator is appointed to carry out the proposal. Voluntary administration could lead to liquidation, either by vote of the creditors, or application by the administrator. The prudential supervisor would need to be included in section 241 of the Companies Act 1993, as a person entitled to apply to the High Court for the appointment of a liquidator.
- 6.18 We see little point in perpetuating the existing judicial management regime in the Life Act (where the emphasis is on carrying on the business and preserving the assets) if there is a new voluntary administration regime that applies to all companies and is (similarly) designed to facilitate business rehabilitation for viable companies. If the voluntary administration regime is not enacted, then a regime similar to judicial management should be. Such a regime would enable the prudential supervisor and any policyholder (or other creditor) to apply to the High Court for appointment of an administrator.⁹⁹ The threshold for the

⁹⁷ The Bill can be obtained from the Ministry of Economic Development website: <www.med.govt.nz> (last accessed 28 October 2004).

⁹⁸ Any threshold would likely refer to the fact or likelihood of insolvency, which is the threshold for appointment by the liquidator or company. The power to appoint an administrator must exist before the fact of insolvency, particularly in view of the definition of "insolvent" in the Bill. A more appropriate test may be that the company "may become" insolvent. Issues of protection for the prudential supervisor arise in this context, and consideration should be given to the High Court having a power to grant the prudential supervisor immunity from claims by the insurer in the event of an unsuccessful application.

⁹⁹ The existing requirement in the Life Act that the Minister make the application should be removed.

appointment being made should be similar to that which exists under the judicial management regime, that is, that there is a likelihood that the insurer is, or will be unable to, meet any of its liabilities to policyholders.

Recommendation

R32 If the voluntary administration regime contained in the Insolvency Law Reform Bill is enacted, then it should be amended to include the prudential supervisor as a person entitled to apply to the High Court for appointment of an administrator, and “creditors” should include prospective or contingent creditors, such as policyholders. If the voluntary administration regime is not enacted, then a regime similar to judicial management should be enacted that allows the prudential supervisor and any policyholder to apply to the High Court for appointment of an administrator of a financially troubled life insurer.

Liquidation of life insurer

6.19 The Life Act includes a number of provisions relevant to the liquidation of life insurers. These should be inserted into the Companies Act 1993. The effect of these provisions is that:

- a life insurer may only be put into liquidation by an order of the High Court (section 30);
- the liquidator shall determine the amount of the liability of the insurer to each policyholder (section 30A);
- the High Court may, in the case of an insolvent insurer, reduce the amount of the contracts of the company instead of putting the company into liquidation (section 31).

Recommendation

R33 Sections 30, 30A and 31 of the Life Insurance Act 1908 should be moved to the Companies Act 1993.

Amalgamations

6.20 We raised as an issue in the discussion paper the implications for policyholders where life insurers amalgamate. As with transfers of life policies by life insurers (see chapter 8), amalgamations have the potential to compromise the interests of policyholders if insurers amalgamate with others that are in a weaker financial position.

6.21 A number of submissions supported the suggestion that life insurers should be subject to additional measures to protect policyholders where they amalgamate.

6.22 Part 13 of the Companies Act 1993 provides a statutory regime for amalgamations. Under the “standard” regime,¹⁰⁰ an amalgamation proposal may

¹⁰⁰ An alternative short-form regime exists where the amalgamation is for a holding company and one of its wholly owned subsidiaries, or where two companies are wholly owned or indirectly owned by the same person (Companies Act 1993, s 222).

be approved by each company's shareholders once the board of directors of each amalgamating company has resolved that:

- in its opinion, that the proposal would be in the best interests of the company; and
- it is satisfied on reasonable grounds that the amalgamated company would satisfy the solvency test immediately after the amalgamation becomes effective.

6.23 Under section 221 of the Companies Act 1993, only the companies' shareholders and secured creditors are required to be provided with copies of the amalgamation proposal. Other creditors, including policyholders, do not receive copies of the proposal, although companies are required to issue a public notice advising that the amalgamation is to take place, and that copies of the amalgamation proposal are available free-of-charge for inspection, within 20 working days of the amalgamation being proposed to take effect.

6.24 Section 226 of the Companies Act 1993 enables policyholders to apply to the High Court for an order that an amalgamation proposal be reconsidered, modified or not take effect, on the basis that they would be unfairly prejudiced by the arrangement.¹⁰¹

6.25 We are of the view that although the statutory regime provides some protection for the policyholders, its usefulness may be limited if the policyholder:

- does not know that the amalgamation is to take place; or
- lacks the knowledge necessary to assess the financial implications of the amalgamation; or
- lacks the resources necessary to apply to the High Court.

6.26 We recommend therefore that Part 13 of the Companies Act 1993 be amended to provide that:

- a life insurer company that has issued life policies to the New Zealand public and that wishes to amalgamate with another life insurer or other company must provide notice of the proposed amalgamation to the prudential supervisor;
- the prudential supervisor is authorised to commission an independent actuarial report on the proposed amalgamation, at the life insurer's expense;
- both companies must provide the independent actuary with any information reasonably sought by the actuary;
- the prudential supervisor (as well as any policyholder) may apply to the High Court under section 226 for an order that the amalgamation proposal be reconsidered, modified or not take effect, on the basis that the policyholders would be unfairly prejudiced by the amalgamation.

6.27 The above requirements should apply whether the amalgamation is by the "standard" method as provided in sections 220 and 221 of the Companies Act 1993 or by the "short form" method in section 222.

¹⁰¹ An insured could apply as a "person to whom the amalgamating company is under an obligation": Companies Act 1993, s 226.

Recommendation

R34 In relation to amalgamations of life insurers, Part 13 of the Companies Act 1993 should be amended as suggested in paragraphs 6.26 and 6.27.

Summary

- 6.28 We have consulted submitters on and given a great deal of consideration to the issue of who should be the prudential supervisor. A private sector “policyholder agent” can act on behalf of a particular group of individuals and undertake an advocacy role for them. However, it is not usual for a government entity to do this. A government entity by its nature takes other matters into account, in particular the public interest. The choice therefore is between a private sector policyholder agent that would act on behalf of policyholders, and a government entity that would act as a “government monitor”. We recommend that if a government monitor is chosen, then the choice is between the Securities Commission and the Reserve Bank of New Zealand.
- 6.29 We envisage a government monitor and a private sector policyholder agent would both have the following powers:
- to monitor solvency (through review of financial statements, material adverse change notifications, whistle blowing by the audit actuary and auditor, the audit actuary’s report and half yearly directors’ certificates);
 - to request further information;
 - to conduct investigations;
 - to apply for voluntary administration (or equivalent regime) or statutory management;
 - to instigate liquidation proceedings; and
 - to monitor and, if appropriate, oppose amalgamation proposals.¹⁰²
- 6.30 In the case of the last four powers, a government monitor could appoint a private sector person (for example, a firm of chartered accountants) or government official (for example, the Registrar of Companies) to exercise the power/s on the government monitor’s behalf.
- 6.31 A private sector policyholder agent (but not a government monitor) could, by negotiation at the time of its appointment, acquire the power to appoint a receiver (supported by a charge over the life insurer’s assets).
- 6.32 Some submitters have suggested that a government monitor’s powers should go further and include the power to freeze assets, to direct the insurer to take action (for example, cease to write new business or inject more capital) and approve related party transactions. We do not support a government monitor having these additional powers. We do not believe these powers are necessary, and they effectively involve the government monitor telling a life insurer how to run its business. We also note that the government monitor would not bear any liability for exercise of these powers, and their existence could generate an illusory sense of protection for policyholders. If there is a need to build in

¹⁰² The prudential supervisor would also have a monitoring role in relation to transfers of policies and amendments to policy terms, see paras 8.69 to 8.91.

“early warning signals” of problems, this should be possible by including additional buffers in the solvency standard (see chapter 5).

6.33 In summary, we see the following advantages and disadvantages in having a private sector **policyholder agent**:

Advantages

- It would empower policyholders, who should be the key monitors of life insurer performance (see chapter 1).
- A policyholder agent would be liable to the policyholders in the event of negligent performance.
- A policyholder agent could, at the time of its appointment, negotiate specific terms relating to monitoring (over and above any statutory minimum terms) relevant to the size and scope of the life insurer’s business.
- A policyholder agent could, at the time of its appointment, by negotiation obtain the power to appoint a receiver and take a charge over the life insurer’s assets.
- The Securities Commission would monitor the performance of all policyholder agents.
- Various private sector entities would be approved by the Securities Commission as policyholder agents, with the result that there would likely be more individuals carrying out the necessary monitoring and enforcement than would be the case with a single government monitor, and each of these individuals would have to focus on only a few life insurers.
- There would be less “moral hazard” risk for the Government.

Disadvantages

- The possibility that competition or conflicts of interest could drive some private sector policyholder agents to offer reduced services or become the “soft” option, that is, not prepared to take action if financial unsoundness issues arose (but potential negligence liability and Securities Commission monitoring of approved persons should counteract this to some extent).
- The level of protection for policyholders may depend on which policyholder agent is appointed, reflecting differing approaches or standards in the industry (again Securities Commission monitoring of approved persons should counteract this to some extent).

6.34 In summary, we see the following advantages and disadvantages in having a **government monitor**:

Advantages

- Consistency of treatment of different life insurers.
- Expertise can be concentrated in one entity to apply across the whole industry as needed, as distinct from being spread among different private sector entities.
- No competitive pressures or conflicts of interest (but a government monitor may be subject to political pressure).

Disadvantages

- The risk of moral hazard (both in that consumers will be less careful because they believe that the Government is looking after their interests, and the perception of there being a government assurance of safety).
- A government monitor would not be liable to policyholders in the event of negligent performance.
- A government monitor's performance would not be regularly monitored by anyone (unlike policyholder agents who would be monitored by the Securities Commission).
- A government monitor would not have the power to place a life insurer in receivership or to take a charge over the assets (unless there was a statutory receivership power, which is unlikely, particularly because there is already a statutory management regime in the Corporations (Investigation and Management) Act 1989).
- A government monitor would be at risk of being under-resourced, even if funded by industry levies.
- There would have to be one set of regulatory powers for all life insurers. It would not be possible for the government monitor to negotiate additional powers appropriate for individual insurers.

6.35 The choice between private sector policyholder agents and a government monitor is a difficult one. On balance, we consider that the prudential supervision role should be undertaken by private sector policyholder agents approved and monitored by the Securities Commission, rather than by a government monitor.

Recommendation

R35 The prudential supervision role for life insurers should be undertaken by private sector policyholder agents approved and monitored by the Securities Commission, rather than being undertaken by a government monitor.

7

Financial advisers, analysts, ratings and education

FINANCIAL ADVISERS

- 7.1 **I**N CHAPTER 12 of our discussion paper, we considered the importance of the role of financial advisers in the life insurance industry. While traditionally in New Zealand life insurance policies have been marketed through life insurance agencies and brokers, more recently there has been a tendency for some insurers to market risk only policies directly. While investment advisers and brokers are subject to disclosure requirements under the Investment Advisers (Disclosure) Act 1996, that Act applies only to advice about or dealings in securities, as defined in the Securities Act 1978. It does not apply to risk only policies.
- 7.2 Other issues raised in our discussion paper related to the way in which financial advisers are remunerated, which may give them an incentive to give advice that is not in the best interests 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 ones. In the industry this is known as “churning” of business.
- 7.3 Other concerns include wide variations in standards, training, and ongoing education across advisers, and gaps in the availability of complaints processes for the resolution of disputes, or disciplinary systems to deal with incompetent or dishonest advisers.

Australian law

- 7.4 In Australia, financial services providers are required to be licensed, and must comply with certain conduct and disclosure obligations. The Financial Services Reform Act 2001 (Aust) extended many controls that previously applied only to stockbrokers to anyone dealing in any other type of financial product. These controls include:
- a disclosure of any interest that 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.
- 7.5 Before any financial service is provided, a financial adviser must supply a client with a financial services guide. This gives the client information about the adviser’s services and organisation. It outlines information about the kind of services being provided, including remuneration, benefits or other associations

that may affect the quality of the service provided, and information about rights the client has under the requisite dispute resolution system.¹⁰³

- 7.6 At the time a recommendation is made, or soon after, the adviser must also give the client a statement of advice, being a written record of a financial recommendation. This need not be provided if the information or advice is general in nature.¹⁰⁴

Need to improve performance of New Zealand financial advisers

- 7.7 Submissions on our discussion paper, and responses received during consultation, suggest that while debate continues about the appropriate solution, there is a need to improve the level of performance of those who offer financial advice to the New Zealand public. There is a general view that the current situation is unsatisfactory, and that those who advise consumers, not only in the life insurance industry but across the financial services market generally, must be sufficiently informed, and have the best incentives to give appropriate advice. We consider that this is the area causing the most problems in relation to life insurance, and suspect that these problems will not be reduced without further regulatory intervention.
- 7.8 However, any new regulation should apply to all persons who offer financial advice to the New Zealand public, and not just to those who advise on life insurance or any other particular form of security or insurance. Financial advice increasingly (and desirably) relates to more than one form of security or insurance, especially in view of the increasing tendency for financial products to be linked (for example, house mortgages, house and contents insurance and mortgage repayment insurance) and the growth of composite financial products (for example, health and travel insurance, and superannuation schemes that include life insurance cover).

Definitions of financial adviser and financial advice

- 7.9 A key issue in a new regulatory regime will be the definitions of “financial advice” and “financial adviser”. The definitions of “investment advice” and “investment adviser” contained in the Investment Advisers (Disclosure) Act 1996 form a useful starting point. At present, the definition of investment advice in that Act includes a recommendation, opinion, or guidance given to a member of the public in relation to buying or selling (or not buying or selling) securities. “Investment adviser” means a person who, in the course of his or her business or employment, gives investment advice. It does not include the issuer, promoter, or a trustee or statutory supervisor of the particular securities to which the advice relates; or a person who only transmits investment advice relating to particular securities given by one of those people.¹⁰⁵
- 7.10 A “financial adviser” could be defined as a person who, in the course of his or her business or employment, gives financial advice. “Financial advice” could be defined as including a recommendation, opinion, or guidance given to a member of the public in relation to buying or selling (or not buying or selling) securities

¹⁰³ Corporations Act 2001 (Aust) ss 941A-F, 942A-E, 943A-F.

¹⁰⁴ Corporations Act 2001 (Aust) ss 946, 947.

¹⁰⁵ Investment Advisers (Disclosure) Act 1996, s 2.

or insurance of any kind. The Investment Advisers (Disclosure) Act 1996 excludes journalists from the definition of investment adviser – the same exclusion could apply to financial advisers.

Regulatory options

- 7.11 The aim of regulating an occupational group is to manage the risk of harm to consumers of the services concerned, and to provide certainty as to the quality of those services. The Ministry of Economic Development has suggested that a key trigger for determining when regulation is necessary is whether there is a possibility that incompetent or reckless acts or omissions by members of the occupational group could result in significant harm to the consumer or a third party.¹⁰⁶
- 7.12 The level of likely benefits from regulation needs to be carefully assessed and weighed against the likely costs. These costs may include government costs (particularly the risk of moral hazard, in appearing to take responsibility for the consequences of a licensed adviser causing loss to a consumer), compliance costs for the occupational group (which may be passed on to the consumer) and economic efficiency costs for consumers and society as a whole, particularly if innovation is reduced.
- 7.13 There are a range of regulatory options for an occupational group, from no regulatory barriers at all, through to requiring a government licence to operate in the market. Options include voluntary standards or codes of practice, self-regulation, co-regulation (where the regulatory role is shared between the Government and an industry body) and licensing.
- 7.14 The Ministry of Economic Development suggest that, in considering a regulatory regime for an occupational group, the following matters should be taken into account:
- the nature of the risk and the significance of any harm that might result from the performance of a member of the occupational group;
 - the costs associated with the risk and nature of any harm;
 - the costs associated with the protection by regulation;
 - the ability of the occupational group to regulate itself;
 - the degree to which quality assurance of services may be provided by other measures;
 - the need to strike a balance between protecting consumers and ensuring that entry to the occupational group is not unduly restricted.¹⁰⁷

Periodic Report Group 2003

- 7.15 In December 2003, the Periodic Report Group 2003 noted that the regulation of financial advisers was a matter of concern in the financial services market generally. While a number of voluntary industry bodies have established codes

¹⁰⁶ Ministry of Economic Development *Review of the Regulatory Regime for the Patent Attorney Profession in New Zealand*, Discussion Paper (Wellington, 2002).

¹⁰⁷ Ministry of Economic Development, above n 106.

of practice, dispute resolution and disciplinary procedures, and training for their members, a significant number of advisers are outside these existing self-regulatory regimes.¹⁰⁸

7.16 The Government has agreed in principle to certain changes to strengthen the Investment Advisors (Disclosure) Act 1996, including:

- removing the present two-tier disclosure provisions of the Act in favour of a mandatory disclosure statement that includes all the information currently required under the two tiers;
- making it an offence to recommend illegal offers of securities;
- increasing the enforcement powers of the Securities Commission in relation to investment advisers.¹⁰⁹

7.17 However, the Periodic Report Group 2003 noted that, even if these changes were enacted, the following concerns about the financial services sector will remain:

- no disputes procedure is available to consumers if the adviser does not belong to a professional body;
- there are no industry-wide codes of conduct or ethics;
- advisers who do not comply with the law cannot easily be excluded from the industry.¹¹⁰

7.18 The Periodic Report Group 2003 recommended that the financial services sector should develop an agreed approach to self-regulation of financial advisers and report to the Government with a comprehensive proposal by the end of 2004. The Financial Planning Industry Association welcomed this recommendation, and describes discussions in this regard as ongoing.

Government Task Force

7.19 The Government has recently announced plans to establish a task force to look into the regulation of financial intermediaries.¹¹¹ The Task Force on the Regulation of Financial Intermediaries will provide the Government with options on the occupational regulation of the sector. The Government hopes to be able to make decisions on progressing reform of the industry by mid-2005.

Recommendation

R36 The development of a new regulatory framework for financial advisers is a top priority, and any new framework should apply to all persons who offer financial advice (including advice on life insurance) to the New Zealand public.

¹⁰⁸ Periodic Report Group 2003 *Retirement Income Report 2003* (Wellington, 2003) 88.

¹⁰⁹ Ministry of Economic Development *Review of Securities Trading Law* (Wellington, 2003), <www.med.govt.nz> (last accessed 16 July 2004).

¹¹⁰ Periodic Report Group 2003, above n 108.

¹¹¹ Hon Margaret Wilson, Minister of Commerce (Speech to Financial Planners and Insurance Advisers Association (Christchurch Branch) 26 August 2004). The members of the Task Force were announced on 8 November 2004. The terms of reference for the Task Force are available on the Ministry of Economic Development's website: <www.med.govt.nz> (last accessed 28 October 2004).

FINANCIAL ANALYSTS

- 7.20 Individual policyholders do not usually have the skills or resources to assess the financial solvency of a life insurer or to understand easily the terms of life policies and their appropriateness to particular circumstances. Most policyholders need financial advisers or other market participants, such as analysts, to help them monitor and understand insurer activities and products. Many financial advisers themselves rely on analysts for their information as to the solvency and products of life insurers.
- 7.21 In some parts of the financial sector (for example, trading in company shares) there are well-established market analysts, who provide potential investors with comparative information about products and issuers. However, in general, this kind of analysis is not readily available in New Zealand in relation to life insurers and life policies. Organisations like the Consumers' Institute of New Zealand Inc (the Consumers' Institute) deliver a valuable service, providing comparative information in relation to particular insurance issues from time to time, however, in general, comprehensive and up-to-date comparative information is not easily available to policyholders or potential policyholders.
- 7.22 We believe that the Government and the life insurance industry should promote and support the establishment of a number of independent and competent life insurance analysts, who could provide public up-to-date comparative information on the solvency, activities, and policies of life insurers operating in New Zealand. If this were done, it could encourage improvements in the transparency and performance pressures within the New Zealand life insurance market.
- 7.23 The information made available by analysts should be published and distributed in ways that are easy for financial advisers and consumers to access, including on the internet, through public libraries and Citizens' Advice Bureaux.
- 7.24 In other sectors, there is precedent for the Government to take steps to "jumpstart" the establishment of independent comparative analysis of performance in consumer markets. Consumers can obtain comparative information about electricity retailers from Consumer Powerswitch, a free online service that compares electricity prices and plans, funded by the Ministry of Consumer Affairs and provided by the Consumers' Institute and the Citizens' Advice Bureaux. The main purpose of the service is to provide information for consumers about which retailer is offering the best prices, or whether there is a plan better suited to the consumer's needs, how to switch retailers, and to help consumers make savings on their electricity bills.
- 7.25 We consider that the "analyst market" in relation to life insurance would benefit from similar promotion and support. The objective would be to encourage analysts to produce easily accessible, comparative information, relating to life policies and life insurer solvency. There are a variety of models that could be adopted. The system might be funded by the Government, an industry levy, voluntary contributions from market participants, or a combination of all three. A consumer organisation such as the Consumers' Institute or a private firm could be contracted to produce and publish this information on the basis of reports and material disclosed and/or filed by life insurers under the Securities Act 1978, the Companies Act 1993 and the Financial Reporting Act 1993.

Recommendation

R37 The Government and the life insurance industry should promote and support the establishment and operation of a number of independent and competent life insurance analysts to provide public comparative information on the solvency, activities and life policies of life insurers operating in New Zealand.

RATINGS

- 7.26 Another way of providing some comparative information about life insurers would be to require them to obtain ratings from approved rating agencies.¹¹² General insurers are required under the Insurance Companies (Ratings and Inspections) Act 1994 to obtain a rating from an approved rating agency. 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. However, many life insurers operating in New Zealand voluntarily obtain a rating from an internationally recognised rating agency.
- 7.27 Ratings are represented by letter, number and/or symbol, and form part of a scale. There are three approved rating agencies, A.M. Best Company, Fitch Ratings and Standard and Poor's. Presently, ratings for the purposes of the Insurance Companies (Ratings and Inspections) Act 1994 are required to show the insurer's ability to pay present and future claims.
- 7.28 In our discussion paper, we outlined the Government's proposal to extend the mandatory ratings requirement to all insurers other than captive and life insurers, and to amend the Act to require the ratings to show "financial strength", rather than claims paying ability.
- 7.29 The Life Insurance Ratings Criteria provided by Standard and Poor's states that the rating is Standard and Poor's opinion of the general creditworthiness of the insurer. In particular, financial strength ratings are prospective evaluations of an insurer's financial security to its policyholders. For a "fully cooperative" rating (as opposed to one based only on publicly available information), the rating process involves meeting with the company, reviewing public and non-public information, coming up with a rating, discussing it with the company, providing an appeals process, then producing a final rating, which the company can accept or decline. Once the rating has been accepted, the company is placed under ongoing surveillance, and the rating will be reviewed annually, or at any time if conditions change.
- 7.30 A financial strength rating looks at a broad range of factors affecting the company's ability to meet its liabilities. The rating methodology used by Standard and Poor's for insurance covers industry risk, business review, management and corporate strategy, operational analysis, investments, capitalisation, liquidity and financial flexibility. Where relevant, the rating agency also looks at the insurer in the context of its group, and at any holding company in the group.
- 7.31 Should financial strength ratings be required for life insurers? Many of the submissions received in response to our discussion paper reflected strong

¹¹² Ratings provide information as to financial standing but do not, for example, provide comparative information on policy terms.

opposition to the extension of mandatory ratings to life insurance and health insurance business. The main concerns raised related to:

- the cost of obtaining a rating, especially for small insurers;
- the perception as to what rating is adequate;
- questions as to the accuracy of external ratings, particularly in relation to small, though financially strong, insurers;
- whether inability to obtain a rating will restrict new entrants to the market and inhibit the development of a vibrant industry;
- whether ratings are appropriate to the health and life insurance industries, particularly given the longer periods over which health and life policies typically operate; and
- whether ratings work to reduce the risk of insolvency, or to assist the existing policyholder, whose ability to act on the rating may be limited.

7.32 We have noted the arguments raised against ratings in the life insurance context, in particular those related to compliance costs. Some submitters expressed concern that there would be no real benefit derived from the costs incurred. However, in our view, in the absence of robust independent comparative analysis of life insurers and life policies being publicly available, a requirement for life insurers to have a financial strength rating from an approved rating agency is an effective and relatively inexpensive way of providing some independent comparative information to assist financial advisers and consumers in making decisions as to life policies. If independent and competent public analysts of New Zealand life insurers and policies do become well established, then we consider the requirement for a rating could be dispensed with.

7.33 Another argument against ratings in a life insurance context is that they are less suited to the long-term nature of life insurance business. But ratings are only one tool for assessing a company's position. We fully accept that they do not provide a complete picture, and that a rating alone is not an adequate means of monitoring a company's solvency. However, we consider that ratings of life insurers will still provide a useful comparative tool for financial advisers and consumers, and the very discipline of the ratings process can itself be beneficial as a method of external review for the insurer.

7.34 We consider that the financial strength rating should not be more than 12 months old and should be published by the life insurer on its website. The life insurer should also be required to publish in the same way, and also in its periodic disclosure (see paragraph 4.35), any negative change in its rating during the past 12 months. There should be no exemptions from this requirement for overseas-incorporated life insurers.

7.35 We also consider that the Government should publish on the internet (and provide hard copies to public libraries and Citizens' Advice Bureaux) a table stating the financial strength rating of every life insurer offering life policies to the New Zealand public, and any negative change in such a rating during the previous 12 months.¹¹³

¹¹³ As is done now by the Insurance and Superannuation Unit of the Ministry of Economic Development in respect of insurers required to obtain a rating under the Insurance Companies (Ratings and Inspections) Act 1994.

Recommendation

R38 Until independent and competent analysts of New Zealand life insurers and policies become well established, every life insurer offering life policies to the public in New Zealand (or that continues to be liable under life policies offered in New Zealand) should be required to have a financial strength rating given by an approved rating agency. The Government should publish a table on the internet (and provide hard copies to public libraries and Citizens' Advice Bureaux) stating the financial strength rating of every life insurer offering life policies to the New Zealand public, and any negative change in such a rating during the previous 12 months.

EDUCATION

- 7.36 In addition to the measures referred to above, we consider that the Government should arrange for a suitable body (for example, the Consumers' Institute) to undertake a public educational role in relation to life insurance, and provide it with sufficient resources to perform this role properly (perhaps with funds provided by an industry levy). Substantial ongoing public education about the purposes and types of life insurance, the need to diversify to minimise risk, and the need to monitor the insurer's performance will likely do more for consumer protection in this area than any law. An individual has a greater incentive than anyone else to protect his or her financial resources, and assisting and encouraging members of the public to acquire the skills and experience needed to avoid bad financial decisions, and to seek advice from qualified advisers, is likely to be the most effective form of protection. The public education could usefully include financial adviser education, education in schools, information for Citizens' Advice Bureaux, and a permanent website where the products of analysts' research and other relevant information are displayed.

Recommendation

R39 The Government should arrange for the Consumers' Institute of New Zealand Inc or another suitable body to have a substantial ongoing public educational role in relation to life insurance.

Insurance Contracts Act

Introduction

- 8.1 **L**IFE INSURANCE and general insurance contracts are governed by common law and statute. Although a few statutes such as the Insurance Law Reform Acts of 1977 and 1985 apply only to insurance contracts, a number of other statutes apply to contracts generally, such as the Contractual Remedies Act 1979, the Contractual Mistakes Act 1977 and the Fair Trading Act 1986.
- 8.2 For close to 100 years, the principal legislation governing the life insurance industry in New Zealand has been the Life Act and its amendments. The Life Act consolidated the Life Assurance Policies Act 1884 and the Life Insurance Companies Act 1873, which was itself modelled on the United Kingdom's Life Assurance Act 1870.
- 8.3 The Life Act was drafted at a time when there was an emphasis on long-term savings policies that required consumer protection measures. Provisions, such as the requirement for a separate fund for life insurance and annuity receipts, were instituted to protect policyholders from the risks of long-term investment. Today, the Life Act contains many provisions that are out of date and require modernising and/or reform.
- 8.4 We recommend that the Life Act be repealed but that Part 2 of the Life Act, which contains provisions relating to life policies, be carried through and incorporated into a new Insurance Contracts Act. The Act would gather together provisions relating to life and general insurance contracts that are currently spread across different statutes, and apply to reinsurance, captive insurance and marine insurance contracts, except where expressly excluded. It also includes provisions reflecting the Law Commission's recommendations in *Report 46: Some Insurance Law Problems* (1998) (Report 46).
- 8.5 The Act would not provide a code of all law relating to insurance contracts. This would require a large-scale review of general insurance law that is beyond the scope of our terms of reference. However, we consider that there may be benefits in expanding this legislation in the future, perhaps along the lines of the Australian Insurance Contracts Act 1984. This would provide a coherent code of laws relating to insurance contracts, and may assist the number of Australian-based insurers that must adhere to different regulatory requirements in Australia and New Zealand.
- 8.6 The Australian Treasury is currently undertaking a review into the operation of the Insurance Contracts Act 1984 (Aust). An initial review was conducted into the operation of section 54 in late 2003,¹¹⁴ and it is expected that recommendations

¹¹⁴ Alan Cameron and Nancy Milne, *Review of the Insurance Contracts Act 1984 (Cth): Report into the Operation of Section 54* (Treasury, Canberra, 2003).

on the Act's other provisions will be released to the public in the near future.¹¹⁵ If a review of general insurance contracts law is to take place in New Zealand, this should occur after the outcomes of the Australian review are known.

- 8.7 Our proposed Act, in Bill form (the Bill), is contained in appendix C.¹¹⁶ In this chapter, we provide a summary of the Bill, and include commentary where existing legislation has been modified or omitted, or where new provisions have been included. We comment also on issues that the Bill could address but presently does not, and on issues that the Bill does address, but which may require further review.

Recommendation

R40 A new Insurance Contracts Act based on the Bill provided in appendix C should be enacted.

SUMMARY OF THE PROPOSED INSURANCE CONTRACTS ACT

Part 1: Preliminary provisions

- 8.8 Part 1 contains preliminary provisions setting out the Bill's purpose and scope.
- 8.9 Clause 3 provides that the purpose of the Bill is to reform and modernise the law relating to certain contracts of insurance to ensure:
- that a fair balance is struck between the interests of insurers, insureds and other members of the public; and
 - that the provisions included in those contracts, and the practices of insurers in relation to those contracts, operate fairly.
- 8.10 Statutory definitions for the purposes of the Bill are contained in clauses 5 and 6.¹¹⁷ Clause 6 sets out a broad definition of "contract of insurance" to include, unless the context requires otherwise, both:
- contracts that would ordinarily be regarded as a contract of insurance but which contain some provisions not relating to insurance; and
 - those that contain some insurance provisions even though they would not ordinarily be regarded as insurance contracts.

Part 2: Mis-statements and disclosure

- 8.11 Part 2 of the Bill deals with mis-statements and disclosure. Clauses 9 to 13 re-enact substantially sections 4 to 7 of the Insurance Law Reform Act 1977 (the ILRA 1977). These provide that contracts of life and general insurance shall not be avoided for reason only of mis-statement, except in specified

¹¹⁵ Once released, the report will be available at <www.icareview.treasury.gov.au>.

¹¹⁶ For the purposes of this report, savings, transitional and consequential provisions have not been included in the Bill. These would, of course, need to be inserted before the Bill is introduced into Parliament.

¹¹⁷ Regarding the definition of "life insurance", see paras 12.11 to 12.20 for discussion about the suggested extension of the term to include quasi-life insurance products such as disability, income protection and trauma insurance.

circumstances. In the case of general insurance, the circumstances are where the mis-statement is substantially incorrect and material (as defined in clause 11). In the case of life policies, the mis-statement must be both substantially incorrect and material, and made either fraudulently,¹¹⁸ or within three years of the date on which the policy is sought to be avoided, or the death of the life insured, whichever is earlier.

- 8.12 Clauses 12 and 13 provide that a life policy may not be avoided by reason only of mis-statement of age, but may be varied to reflect the true age of the insured. Clause 13 is new and substitutes the statutory formula for variation contained in subsections 7(2) and (3) of the ILRA 1977 with that contained in section 30 of the Insurance Contracts Act 1984 (Aust). The formula achieves the same outcome but is considered by industry participants to be easier to use. We also see benefits in having a formula that is consistent with Australia and familiar for Australian-based insurers.
- 8.13 Clauses 14 and 15 are new provisions that limit the insurer's common law right to avoid a contract (that is, terminate the contract with retrospective effect where the insured has failed to disclose a material fact) in accordance with the Law Commission's recommendations in Report 46. Discussion of this proposed reform, and a comparison with the equivalent provisions in the Insurance Contracts Act 1984 (Aust), is set out in paragraphs 8.26 to 8.40.

Part 3: Terms of insurance contracts

- 8.14 Part 3 of the Bill relates to the terms of insurance contracts. It includes provisions contained in the Insurance Law Reform Acts of 1977 and 1985, the Law Reform Act 1936, and some new provisions.
- 8.15 The provisions that the Bill simply brings forward and re-enacts in a modernised form include:
- arbitration clauses (clause 16);
 - pro rata conditions of average (clauses 21-22);
 - insurable interest (clauses 23-24);
 - the sale of land (clauses 25-30).
- 8.16 Clauses 17, 18 and 20 largely re-enact sections 9 and 11 of the ILRA 1977, but with some significant amendments. These sections restrict the operation of contractual terms that prescribe time limits or certain increased risk exclusions under contracts of insurance. For discussion of the reforms see paragraphs 8.41 to 8.60.
- 8.17 Clauses 31 to 39 relate to third-party claims. These re-enact sections 9 and 9A of the Law Reform Act 1936 with amendments. For a discussion of the reform see paragraphs 8.61 to 8.65.
- 8.18 Clauses 40 to 43 have been taken from section 562A of the Australian Corporations Act 2001. For a discussion of this reform see paragraphs 8.66 to 8.68 below.

¹¹⁸ The term "fraudulent" is defined to include cases where the person makes the statement knowing it to be incorrect or without belief in its correctness, or where he or she makes the statement recklessly: cl 10(2).

Part 4: Life insurance contracts

- 8.19 Part 4 of the Bill re-enacts most of the provisions contained in Part 2 of the Life Act in modern form. These relate to:
- interest payable under policies (clauses 44–46);
 - assignment of policies (clauses 47–54);
 - mortgages of policies (clauses 55–69);
 - registration of policies (clauses 70–78);
 - surrender values (clauses 79–80);
 - life insurance of minors (clauses 81–96);
 - insurances by spouses or de facto partners (clauses 97–102);
 - offence for non-compliance (clause 103).
- 8.20 Where provisions taken from Part 2 of the Life Act referred to dollar amounts (such as clauses 87 and 100, for example) these have been replaced by prescribed amounts to allow them to be set by regulation and adjusted from time to time.
- 8.21 Clauses 44 to 46 define the interest payable under life policies and amend section 41A of the Life Act, which requires insurers to pay interest on claims paid after 90 days of the insured’s death. Section 41A(3) of the Life Act provides that the insurer shall pay interest at a rate stipulated in the life policy or prescribed from time to time for the purposes of the Judicature Act 1908, whichever is higher. This may provide an incentive for insureds to delay notifying claims. Clause 46 endeavours to remove this incentive by providing that the rate of interest payable is the Reserve Bank of New Zealand 90-day bank bill rate.
- 8.22 Clauses 90 and 103 provide penalties for non-compliance with Part 4 of the Bill. These penalties have been updated to provide fines of up to \$1000 and \$10 000 respectively. The seven-day grace period and the reference to continuing offences in section 80 of the Life Act are not included in clause 103 in accordance with the LAC guidelines.¹¹⁹ However, we consider the penalties regime needs further review.

Part 5: Miscellaneous provisions

- 8.23 Part 5 includes miscellaneous provisions concerning the scope of the proposed legislation, regulations and repeals.
- 8.24 Clause 110 repeals in its application to New Zealand section 83 of the Fires Prevention (Metropolis) Act 1774 (Imp) (preserved in force in New Zealand by section 3(1) of the Imperial Laws Application Act 1988). This section:
- entitles insurers to elect to reinstate property rather than pay out cash claims for property damaged by fire where they suspect arson; and
 - requires that insurers reinstate where a person with an interest in the property (such as an owner, a mortgagor or mortgagee, a lessor or lessee and so on) so requests.

¹¹⁹ Continuing penalties are generally considered to be undesirable in legislation because they introduce large and indeterminate fines. See Legislation Advisory Committee above n 86, para 12.6.2.

- 8.25 The repeal of the application of this section accords with the Law Commission’s recommendation in Report 46. There, the Law Commission noted that:
- the insurer’s right to elect to reinstate is commonly included in insurance contracts anyway;
 - an insurer is unlikely to elect to reinstate property if the insured has only a limited interest and the cost of reinstatement will exceed the insured’s entitlement to indemnity; and
 - a third party’s right to require reinstatement arguably does little to achieve the purpose of the Act, which is to deter arson by owners with limited interests in property.¹²⁰

COMMENTARY ON ASPECTS OF THE PROPOSED INSURANCE CONTRACTS ACT

The insured’s duty of disclosure

- 8.26 At common law, an insured has a duty to disclose all material circumstances to the insurer prior to entering into the contract. Where an insured fails to discharge this duty, the insurer may avoid the contract (that is, terminate the contract with retrospective effect). A circumstance is “material” if it would influence the judgement of the prudent insurer in determining whether to accept the risk and on what terms.
- 8.27 Part 2 of the Bill contains two new clauses that modify the insurer’s common law right to avoid a contract for non-disclosure. Clauses 14 and 15 restrict this right to cases where:
- the insurer seeks to avoid the contract within ten working days of the risk attaching; or
 - the contract is for reinsurance; or
 - the insured failed to disclose a fact that he or she either knew, or that, in the circumstances, a reasonable person would have known, would have influenced the judgement of a prudent insurer in fixing the premium or in determining whether to take on the risk on substantially the same terms; or
 - the insured answered a question expressly asked by the insurer in a way that is substantially incorrect,¹²¹ because of the failure to disclose a fact.
- 8.28 The reform reflects the Law Commission’s recommendations in Report 46.¹²² There, the Law Commission was concerned that the insurer’s common law

¹²⁰ We note that s 86 of the Fires Prevention (Metropolis) Act 1774 (Imp) is the only other section to remain in force in New Zealand. This section provides a statutory defence against nuisance proceedings in tort where a fire begins accidentally on a person’s property, without negligence, and escapes causing damage. This section is outside the scope of this report, but may be better incorporated into another Act and the Fires Prevention (Metropolis) 1774 (Imp) Act completely repealed in its application to New Zealand.

¹²¹ Clause 15 defines an answer as “substantially incorrect” for the purpose of the section if the difference between what is stated and what is actually correct would have been considered material by a prudent insurer.

¹²² See Report 46, paras 1–32. See generally Neil Campbell’s discussion of the Law Commission’s recommendations on remedies for non-disclosure: “Insurance” [1999] NZ Law Review 191, 204–209.

right to avoid a contract can have disproportionately harsh consequences for the insured, given the difficulty for the insured in assessing what a prudent insurer would consider “material” and because at common law:

- the insured’s duty to disclose is unmitigated by ignorance or the fact that he or she was not warned of the nature or extent of the duty; and
- the insured is not excused from volunteering matters that he or she is under a duty to disclose, even if the insurer has asked specific questions relating to other matters on the proposal form.¹²³

8.29 The Law Commission recommended retaining the insurer’s right to avoid a contract retrospectively on the grounds noted in paragraph 8.27 on the basis that:

- the ten-day limit would provide insurers with time to ask the appropriate questions and would not discourage insurers from offering interim insurance before agreeing to the substantive contract;
- insurers should have the ability to discharge the duty of disclosure in cases of reinsurance; and
- insurers should have the right to avoid a contract where the non-disclosure was blameworthy, or where the insured gives a substantially incorrect answer to a question expressly asked by the insurer, because of the failure to disclose a fact (if the difference between the answer and what is actually correct would be considered material by a prudent insurer).

8.30 The Law Commission also recommended that:

- any existing right to cancel a concluded contract prospectively on grounds of non-disclosure should be unaffected;
- the words “risk first attaching” should be defined to exclude risk that attaches under a policy replacing interim cover, or on the reinstatement or renewal of a policy (to prevent insurers from prolonging their right to avoid the contract indefinitely); and
- the provision should have effect, notwithstanding a declaration by the insured that his or her disclosure obligation has been complied with, to prevent the reform being undone by a contractual warranty.

8.31 These recommendations have been incorporated into clauses 14 and 15 of the Bill. Clauses 14 and 15 aim to ease the burden on the insured by shifting the onus onto insurers to ask specific questions in order to obtain information, rather than requiring the insured to volunteer all information necessary for the insurer’s assessment of risk.

8.32 Insurers have been generally wary of this reform, which will require them to take more proactive steps than they do currently in obtaining information from the insured prior to entering into the contract. Some argue that they will have to develop lengthy health and lifestyle questionnaires, which will lead to increased costs and delay in the underwriting process.

8.33 Part 4 of the Insurance Contracts Act 1984 (Aust) provides a complete code of the laws relating to non-disclosure and misrepresentation in insurance contracts.

¹²³ *Misirlakis v NZ Insurance Co Ltd* (1985) 3 ANZ Ins Cas 78,893 (CA).

It limits the insurer's right to avoid a contract of general insurance to cases where the non-disclosure or misrepresentation was fraudulent.¹²⁴

- 8.34 In all other cases, or if the insurer elects not to avoid the contract, the insurer may reduce its liability by the amount that would place it in a position it would have been in had the matter been disclosed or the misrepresentation not made.¹²⁵ Thus:
- if it would have refused to have entered into the contract on any terms, it may refuse to pay the claim;
 - if it would have entered into the contract but for a higher premium, it may reduce its liability by the difference between the actual and notional premiums;
 - if it would have entered into the contract but on different terms, it may reduce its liability by the difference between its liabilities under the actual and notional contracts.¹²⁶
- 8.35 In contracts of life insurance, the insurer may avoid the contract only if the non-disclosure or misrepresentation was fraudulent;¹²⁷ or:
- the insurer would have refused to enter into the contract on any terms had the duty of disclosure been complied with or the misrepresentation not been made; and
 - the insurer seeks to avoid the contract within three years of the contract being entered into.¹²⁸
- 8.36 If the insurer elects not to avoid the contract, it may vary the sum insured in accordance with a statutory formula, provided it gives notice in writing to the insured within the three-year period.¹²⁹
- 8.37 A separate statutory formula applies where the misrepresentation relates to the age or ages of the insured(s).¹³⁰
- 8.38 In Report 46, the Law Commission considered the Australian approach but concluded that:
- the extent of the insured's disclosure duty would still be uncertain; and
 - the formula would involve difficult assessments as to the insurer's likely response had the insured disclosed the information.¹³¹

¹²⁴ Section 28(2). However, (i) the insurer has no remedy if it would have entered into the insurance contract on the same terms if full disclosure had been made by the insured (s 28(1)); and (ii) the court may disregard the insurer's right to avoid a contract retrospectively for fraudulent non-disclosure or misrepresentation if avoidance would be harsh and the insurer has not been significantly prejudiced by the non-disclosure (Insurance Contracts Act 1984 (Aust), s 31).

¹²⁵ Insurance Contracts Act 1984 (Aust), s 28(3).

¹²⁶ See Law Commission *Some Insurance Law Problems* (NZLC R46, Wellington, 1998) 10.

¹²⁷ Insurance Contracts Act 1984 (Aust), s 29(2). But the insurer has no remedy if it would have entered into the insurance contract if full disclosure had been made by the insured – s 29(1)(c).

¹²⁸ Insurance Contracts Act 1984 (Aust), s 29(3).

¹²⁹ Insurance Contracts Act 1984 (Aust), s 29(4).

¹³⁰ Insurance Contracts Act 1984 (Aust), s 29(1)(d), s 30.

¹³¹ Law Commission, above n 126, para 23.

- 8.39 The Law Commission took the view that limiting the right to avoid the contract to the circumstances listed would strike the best balance between the interests of the insurer and the insured. The ten-day grace period would enable insurers to go on risk immediately until they have had time to ask all the questions necessary to assess the risk fully.¹³² The right to avoid the contract where there has been a failure to disclose information that ought reasonably to have been disclosed was intended to limit the need for lengthy pre-contractual questionnaires.
- 8.40 We view clauses 14 and 15 as provisional measures aimed at providing redress for an insured that can be affected disproportionately by the insurer's remedy of avoidance for non-disclosure. There may be some merit in reviewing the Australian approach at a later date if the law governing insurance contracts is to be better aligned with Australia. If such a review is to occur this should be after the Australian Treasury's review of the Insurance Contracts Act 1984 (Aust) is completed.¹³³

“Claims made” and “claims made and notified” policies

- 8.41 Clauses 17 and 18 of the Bill re-enact section 9 of the ILRA 1977. They provide some protection for an insured who fails to comply with contractual provisions that prescribe the manner or time in which a notice of claim or a suit or action must be lodged. Section 9 provides that the insured shall not be bound by these terms where the contract is for life insurance and the claim relates to the death of the insured, or in any other case unless the court considers that:
- the insurer has been prejudiced by the insured's failure to comply with the provision; and
 - it would be inequitable for the provision not to bind the insured.
- 8.42 Clause 19 of the Bill is a new provision that limits the application of clause 17 in certain cases involving “claims made” or “claims made and notified” policies. This accords with the Law Commission's recommendation in Report 46 that section 9 of the ILRA 1977 should not apply to a provision of a “claims made” policy that defines the period within which claims made against the insured, or claims arising out of circumstances notified to the insurer, are within the risk accepted by the insurer under the policy.¹³⁴
- 8.43 “Claims made” policies, unlike traditional “occurrence-based” policies, require only that a claim be made against the insured during the period of the cover, not that the act or omission giving rise to the claim occur during that time.¹³⁵ This approach has the advantage of enabling insurers to assess the limits of their liability, particularly in the context of professional indemnity insurance, where the act or

¹³² Law Commission, above n 126, 16.

¹³³ Above n 115. The Australian Treasury is currently reviewing the operation of Part 4 as part of its general review of the Insurance Contracts Act 1984 (Aust). The review will focus on the nature of the insured's duty of disclosure; the insurer's duty to warn insureds of the duty; and the role of insurance brokers and agents in providing information to insureds on behalf of insurers.

¹³⁴ However, it will still be possible for the insured to invoke clause 17 in limited circumstances. See Law Commission, above n 126, para 41.

¹³⁵ Where a policy is for “claims made and notified”, the insured will be required, in addition, to notify the insurer of the claim during the period of cover in order to receive indemnity.

omission giving rise to the claim may have occurred years earlier, or where it may be difficult to pinpoint exactly when the act or omission occurred.

- 8.44 In Report 46, the Law Commission noted the difficulties that arise for insurers where section 9 is applied to extension provisions in “claims made” policies. Extension provisions (termed “deeming provisions” in Australia) operate to extend indemnity in situations where the insured notifies the insurer of a possible future third-party claim within a specified time, even if the claim is not actually brought until after the contract expires. Such policies protect an insured who would be otherwise ineligible for indemnity under the expired contract, but who would be unlikely to obtain new cover from another insurer if the likelihood of the future claim had to be disclosed.
- 8.45 The issue with section 9 is that it operates to excuse an insured who fails to notify the insurer of possible future claims within the time prescribed by the extension clause, unless the insurer suffers prejudice. This means that insurers are unable to assess accurately the limits of their exposure in these types of circumstances and must set aside large reserves for future claims.
- 8.46 As one commentator has noted, this blurs the distinction between these policies and “occurrence-based” policies, where insurers are obliged to indemnify the insured for claims notified after the policy expires.¹³⁶

Australia

- 8.47 This issue was considered as part of the Australian Treasury’s current review of the Insurance Contracts Act 1984 (Aust). A preliminary review was conducted into the operation of section 54 of that Act in late 2003, after ministerial concern that the courts’ interpretation of the section in the context of “claims made” and “claims made and notified” policies had reduced the availability of certain classes of indemnity insurance in Australia and increased premiums.
- 8.48 Broadly, section 54 applies to prevent insurers from refusing to pay claims on the basis of non-compliance with a contractual term (such as a time limit) if the insured’s non-complying act or omission did not cause or contribute to the loss. If the non-compliance did cause or contribute to the loss, the insurer may only reduce its liability by the extent that its interests were adversely affected.
- 8.49 In its final report, the team conducting the review recommended that section 54 continue to provide relief in relation to traditional “occurrence-based” policies, but that the section be amended to exclude situations where the insured is required to notify facts or circumstances that might give rise to a claim (that is, deeming provisions).
- 8.50 The review team saw no issue with section 54 continuing to provide relief for the late notification of *claims*, but was of the view that the section was not intended to apply in respect of the late notification of *facts or circumstances* that give rise to claims after the cover expires.
- 8.51 It also recommended that:
- insurers should be required to inform an insured of the importance of notifying facts and circumstances that might give rise to a later claim, not

¹³⁶ Campbell above n 122, 209; see also Cameron and Milne above n 114, 10–11.

earlier than one month and no later than seven working days prior to the policy expiring, unless the insurer knows that the insured has been advised by an insurance broker; and

- there should be an extended reporting period of 45 days for facts or circumstances that might give rise to a claim from the date on which the policy expires.

Comment

- 8.52 As it is currently drafted, clause 19 of the Bill goes some way towards dealing with the problems that arise in the context of “claims made” and “claims made and notified” policies for insurers. However, the clause goes further than the proposed amendments to section 54 of the Insurance Contracts Act 1984 (Aust), by excluding protection in all cases. We consider that there might be merit in adopting the proposed Australian approach in limiting the exclusion to cases where the insured fails to comply with the time limits imposed by the contractual extension provision.¹³⁷
- 8.53 It may also be advantageous to adopt the proposed Australian approach in allowing for an extended notification period for circumstances that might give rise to a claim, and requiring insurers to warn the insured of the consequences of non-compliance. This could provide the insured with some protection in cases of non-compliance, while still retaining the benefits of increased predictability for insurers under “claims made” policies.

Increased risk exclusions

- 8.54 Clause 20 of the Bill re-enacts section 11 of the ILRA 1977 with amendments. It provides that an insurer may not refuse to pay a claim by reason only of breach of an exclusion clause (termed an “increased risk exclusion”),¹³⁸ if the insured proves, on the balance of probabilities, that the loss was not caused or contributed to by that breach.
- 8.55 However, clause 20(3) of the Bill amends significantly the operation of section 11 of the ILRA 1977, by removing the following types of exclusions from the operation of the section:
- the age, identity, qualifications, or experience of a driver of a vehicle, a pilot of an aircraft, an operator of goods or a master or pilot of a ship; or
 - the geographical area in which the loss must occur; or
 - the purposes for which the vehicle, aircraft, goods or ship are to be used.
- 8.56 Clause 20(3) accords with the Law Commission’s recommendations in Report 46 that section 11 of the ILRA 1977 be amended to account for the extent to

¹³⁷ Note that insurers are less concerned about the failure by insureds to notify claims made against them during the currency of the policy, because the time lapse between the claim being made and the claim being notified to the insurer will rarely be long.

¹³⁸ In broad terms, “increased risk exclusions” are defined in cl 20(2) as those provisions in the insurance contract that limit the liability of the insurer to indemnify the insured where events or circumstances occur that, in the view of the insurer, were likely to increase the risk of loss occurring.

which insurers frame exclusion provisions having regard to the statistical likelihood of loss occurring in these situations.

- 8.57 The Law Commission noted that the current drafting of section 11 prevents insurers from relying on exclusion clauses where the events or circumstances have, by their nature, no loss-causing potential. For example, if a car is damaged while being driven by an unlicensed driver in breach of the insurance contract, the insurer is still required to indemnify the insured if they establish that the driver's lack of licence was not a cause or contributing factor to the loss.

The Australian approach

- 8.58 The application of increased risk exclusion clauses in Australian insurance is covered by section 54 of the Insurance Contracts Act 1984 (Aust).¹³⁹ As outlined in paragraph 8.48, this section may provide proportionate relief to the insurer where the insured fails to comply with a contractual clause.
- 8.59 Unlike the proposed amendments under clause 20(3) of the Bill, which remove certain classes of exclusion clauses completely from the operation of clause 20, section 54 distinguishes between circumstances that have loss-causing potential and those that do not. Thus, an insurer may rely on an exclusion clause to the extent only that the loss was caused or contributed to by the insured's act or omission. If the insured establishes on the balance of probabilities that no part of the loss was caused by the breach, the insurer may not refuse to pay the claim.
- 8.60 The Law Commission rejected the Australian model in 1998 on the basis that it might lead to increased litigation and difficulties in apportioning the causes of loss. However, if the approach of section 54 is adopted with respect to extension clauses to "claims made" policies (see paragraphs 8.47–8.53), the Australian approach may also be appropriate in New Zealand in respect of increased risk exclusions.

Third-party claims

- 8.61 Clauses 31 to 39 of the Bill govern the circumstances in which a third party may bring a claim against an insurer directly for monies payable under a contract of liability insurance, where the insured is deceased, insolvent or cannot be found.
- 8.62 The clauses amend substantially sections 9 and 9A of the Law Reform Act 1936, in line with the Law Commission's recommendations in Report 46. Sections 9 and 9A provide that a third party may be entitled to a charge over insurance monies where an insured is insolvent (section 9) or dead and where no-one has been granted administration of the insured's estate (section 9A). This charge has priority over claims by the insured's other creditors.
- 8.63 In Report 46, the Law Commission considered whether the priority afforded third parties over other creditors should be continued and, if so, by what means. It took the view that there was a community expectation that a third party's loss would be met by insurance monies in these circumstances,¹⁴⁰ and that this

¹³⁹ See paras 8.47–8.51 for commentary on the application of s 54 to time limits prescribed in "claims made" and "claims made and notified" policies.

¹⁴⁰ Law Commission, above n 126, 46.

right should apply to both “occurrence-based” and “claims made” insurance contracts.¹⁴¹ However, the Commission recommended that this money should be recoverable by way of extending privity of contract to third parties under section 4 of the Contracts (Privity) Act 1984, rather than by way of a charge.¹⁴²

8.64 The Law Commission also recommended extending the circumstances in which a third party could recover money payable to the insured to cases where a corporate insured is removed from the Companies Register or has been dissolved or ceases to exist, or where the insured cannot be found after reasonable enquiry.¹⁴³

8.65 These recommendations have been reflected in clause 32 of the Bill. Clauses 33 to 39 embody the Law Commission’s other recommendations, which were aimed at improving the operation of the regime. Broadly, these provisions limit the liability of the insurer in paying third-party claims where:

- the total amount claimed by a third party exceeds the amount for which the insurer is liable to pay the insured under the insurance contract;
- there is more than one third-party claim but insufficient insurance money;
- the insurer makes payment to a third party without actual knowledge of other possible claims by third parties; or
- the insurer makes payment to the insured without actual knowledge that the insured is insolvent.

They also:

- define the circumstances in which payment by the insurer under the insurance contract constitutes a valid discharge of the insurer’s liability;
- impose a duty on insurers, the insured, and other persons to disclose information that may be required by third parties to bring a claim;
- set out the circumstances in which a third party may proceed directly against an insurer without first obtaining leave of the court; and
- provide that, where an insured has commenced an action against the insurer within the statutory limitation period under section 4 of the Limitation Act 1950, no time limit shall be placed on subsequent actions against the insurer.

8.66 Clauses 40 to 43 of the Bill have been taken from section 562A Corporations Act 2001 (Aust). They govern how the proceeds of a contract of reinsurance contract are to be dealt with and provide a statutory exception to the general

¹⁴¹ In Report 46, para 102, the Law Commission noted that there had been some uncertainty as to whether ss 9 and 9A of the Law Reform Act 1936 extended to certain types of policies, such as “claims made” policies. “Claims made” policies were not common until around 1960 and do not sit comfortably in the drafting of s 9(1), which refers to a charge attaching “on the happening of the event giving rise to the claim”. Under “claims made” policies, the insured is indemnified only if the third party makes the claim during the period of cover. It is not necessary for the act or omission giving rise to the claim to have occurred during that time. See Law Commission, above n 126, 40.

¹⁴² This was on the basis that charges are usually granted over property rather than securities, and may be challenged under the voidable preference or transaction provisions in ss 56–57 of the Insolvency Act 1967, the voidable security/charge provisions in ss 292–293 of the Companies Act 1993, or by any defence that an insurer would otherwise have against an action by the insured. See Law Commission, above n 126, 47–48.

¹⁴³ Law Commission, above n 126, 49.

principle that the property of an insolvent company shall be applied equally in discharging its liabilities.¹⁴⁴

- 8.67 Broadly, clause 41 applies where the liquidator of an insolvent insurer receives reinsurance proceeds in respect of a liability of the insolvent insurer under a contract or contracts of insurance. The amount received is payable pro rata, according to the specified formula, to creditors under the insurance contracts to which the reinsurance proceeds relate, in priority to all payments in respect of expenses, fees and claims mentioned in section 312 of the Companies Act 1993.
- 8.68 The court also has the discretion under clause 42 to make an order that clause 41 not apply, but that the reinsurance money be applied by the liquidator in the manner the court considers to be just and equitable in the circumstances.

Transfers of life policies by life insurers

- 8.69 In the discussion paper, we raised the issue of policyholder protection in cases where life insurers transfer their obligations under life policies to other insurers. At present, when transferring their obligations, life insurers need only comply with the New Zealand statutory requirements discussed below.
- 8.70 The provisions regarding directors' duties in sections 135 and 136 of the Companies Act 1993 apply if the life insurer is a New Zealand incorporated company. These protect creditors by prohibiting directors from:
- agreeing, causing or allowing a company to carry on business if this might create a substantial risk of serious loss to the company's creditors; or
 - agreeing to the company incurring an obligation unless he or she believes that the company will be able to perform the obligation when required to do so.
- 8.71 Section CM18 of the Income Tax Act 1994 may also apply in certain cases. This requires the Government Actuary to report to the Commissioner of Inland Revenue and confirm that no policyholder will be unduly disadvantaged where business is transferred from one life insurer to another where:
- both insurers are members of the same wholly owned group of companies in the year of transfer; and
 - the life insurer's entire life business is being transferred to the other insurer.¹⁴⁵
- 8.72 Generally, life insurers transfer their obligations under life policies in one of two ways. The original contract between the policyholder and the original insurer (the transferor) is either "novated" – that is, replaced by a second policy on identical terms between the policyholder and the second insurer (the transferee) – or a policy or portfolio of policies is transferred informally by way of an agreement between the transferor and the transferee.
- 8.73 Unlike a portfolio transfer, a novation extinguishes the transferor's liability to indemnify the insured under the original policy. However, it requires the consent

¹⁴⁴ For further discussion of s 562A Corporations Act 2001 (Aust) see Andrew R Keay *McPherson: The Law of Company Liquidation* (4 ed, LBC Information Services, Pymont (NSW), 1999) 584–585; *Butterell v The Douglas Group Pty Ltd* [2000] NSWSC 942.

¹⁴⁵ Where the transferor is not resident in New Zealand, it need only transfer all life business offered or entered into in New Zealand for the section to apply: Income Tax Act 1994, s CM 18(2).

of all three parties to the arrangement. It is unclear whether the policyholder's consent could be implied in the absence of his or her express written agreement.¹⁴⁶

- 8.74 In the case of a portfolio transfer, the two insurers will enter into an agreement whereby the transferee agrees to indemnify the insured for loss in return for the benefit of the insured's premiums. This would not serve to extinguish the original policy, meaning the transferor would remain liable to the insured, although it would obtain an indemnity from the transferee against this liability.
- 8.75 A number of submissions endorsed the suggestion in the discussion paper that additional measures be put in place to protect policyholder interests where life insurers transfer policies (see paragraphs 11.45 to 11.52 of the discussion paper). These arrangements have the potential to prejudice policyholders if the companies have unequal asset-backing, particularly where long-term savings policies are concerned.
- 8.76 A number of submitters recommended that life insurers be required to gain the approval of the court, Government Actuary or other regulator to transfer life policies. A requirement that insurers seek prior independent actuarial advice as to the effect of the transfer on policyholders was also favoured, especially if someone (such as a prudential supervisor) reviewed this on behalf of policyholders. All submitters saw individual policyholder approval as impracticable in all but the rarest of cases.
- 8.77 In Australia, life insurers are required to obtain the approval of the court for all proposed transfers, except in limited circumstances.¹⁴⁷ Under section 190 of the Life Insurance Act 1995 (Aust), insurers must provide the court with a scheme of transfer that sets out:
- the terms of the agreement or deed under which the proposed transfer is to be carried out; and
 - the particulars of any other arrangements necessary to give effect to the scheme.
- 8.78 Prior to applying to the court, the insurer must:
- provide APRA with a copy of the scheme and any actuarial report on which the scheme is based;¹⁴⁸ and
 - publish notice of its intention to make the application; and
 - provide every affected policy owner with an approved summary of the scheme.
- 8.79 In addition, a copy of the scheme must be provided on request to each policy owner free-of-charge.
- 8.80 The court may then confirm, refuse to confirm, or modify the scheme of transfer on application, as it thinks appropriate.¹⁴⁹

¹⁴⁶ It might be argued that the policyholder's consent can be implied if he or she continues to pay the premiums to the new insurer. However, there is authority that consent in these circumstances without something more (such as a specific request for consent) is insufficient. See *Karangahape Road International Village Ltd v Holloway* [1989] 1 NZLR 83, 101.

¹⁴⁷ "Court" in this context means the Federal Court of Australia.

¹⁴⁸ Under s 192 of the Life Insurance Act 1995 (Aust) APRA may arrange for an independent actuarial report to be provided on the scheme at the applicant's expense.

¹⁴⁹ Life Insurance Act 1995 (Aust), s 194.

- 8.81 Although we consider that prior court approval in every case would lead to unnecessary cost and delay, we agree that additional measures should be in place to protect policyholders where life policies held by members of the New Zealand public are transferred between insurers.
- 8.82 We consider that the Insurance Contracts Bill should include a clause that provides that the transferor's liability under a life policy will only be extinguished, and another policy between the policyholder and transferee deemed to be created, if either:
- the express, signed approval of the policyholder is obtained; or
 - the High Court approves the transfer having had regard to the interests of the policyholder.
- 8.83 The Bill should also provide, before any transfer of life policies occurs (whether by novation or portfolio transfer) that:
- both insurers must provide notice of the intended transfer to their prudential supervisors, whether this be a government monitor or private sector policyholder agent;¹⁵⁰
 - the prudential supervisor is authorised to commission an independent actuarial report on the proposed transfer, at its insurer's expense;
 - both insurers must provide the independent actuary with any information reasonably sought by the actuary.
- 8.84 The Bill should provide that either of the insurers or any policyholder or prudential supervisor may apply to the High Court to approve, prohibit, or amend the proposed transfer, and the High Court may do so after having regard to the policyholders' interests.
- 8.85 If the High Court approves the transfer proposal, the effect of the approval would be to cancel the original policies issued by the transferor and create identical new policies between the transferee and the policyholders.¹⁵¹
- 8.86 Where individual policyholder or High Court approval to a proposed transfer is not obtained, the transferor may still enter into an arrangement with the transferee as mentioned above (provided they comply with the requirements referred to in paragraph 8.83 and subject to any court order to the contrary), although they would remain liable to the policyholders under the original policies. Each prudential supervisor would continue thereafter to monitor its insurer in respect of the life policies issued by that insurer.

Recommendation

R41 In relation to transfers by life insurers of life policies held by members of the New Zealand public, provisions should be included in the Insurance Contracts Bill as suggested in paragraphs 8.82 to 8.86.

¹⁵⁰ For discussion on the role and nature of the prudential supervisor see chapter 6.

¹⁵¹ This would mean that the transferee would be required to comply with the disclosure requirements for new securities in the Securities Act 1978, although we would expect the Securities Commission to issue an exemption in these circumstances.

Outdated policies

- 8.87 A life insurer can encounter administrative problems where old life policies have become outdated or policies have been acquired from other insurers. The insurer may have a lack of institutional knowledge about the policies or lack the computer software required to administer them efficiently.
- 8.88 There was support in submissions for processes to update life policies to bring them in line with current practice. The Investment Savings and Insurance Association agreed that there should be a process for modernising or updating old policy terms, but that any change should not be detrimental in any material way to policyholders and that the permitted changes should be limited to those that are desirable to simplify administration.
- 8.89 We suggest that the Insurance Contracts Bill contain a clause that provides that a life insurer may apply to the High Court to have a policy term or terms amended, provided the life insurer has given notice of the application to:
- every policyholder at their last known address; and
 - the prudential supervisor (whether this be a government monitor or private sector policyholder agent).¹⁵²
- 8.90 The Bill should also provide that:
- once notified of such an application, the prudential supervisor is entitled to obtain legal, actuarial, and other advice on the effect of the proposed amendments on policyholders, at the insurer's expense;
 - any policyholder and the prudential supervisor may appear before the High Court to support or oppose the application; and
 - the High Court may approve an application to have term(s) modified only if satisfied that the amendments:
 - are necessary for administrative purposes; and
 - will not materially disadvantage any policyholder.
- 8.91 Where the High Court approves an application, the policies would be deemed to be amended. The life insurer should then be required to notify every policyholder and the prudential supervisor of the amendments.

Recommendation

R42 The Insurance Contracts Bill should include a process for life insurers to have policy terms amended by the High Court for administrative reasons, so long as notice is given to policyholders and the prudential supervisor who may oppose such an amendment.

¹⁵² For discussion on the nature and role of the prudential supervisor see chapter 6.

Reinsurance

Introduction

- 9.1 **R**EINSURANCE ARRANGEMENTS form a key part of the risk management strategy of life insurers. All of the reinsurers offering life reinsurance in New Zealand are overseas based. Most operate through an Australian company, because the Australian life insurance regime requires reinsurers to incorporate in Australia in order to offer reinsurance there. All are ultimately based elsewhere (for example, in Europe or the United States of America). None is incorporated in New Zealand.¹⁵³
- 9.2 A reinsurer which is liable under a 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) is a “company” for the purposes of Part 1 of the Life Act. Part 1 requires companies to prepare an annual financial condition report, and to deposit certain financial information with the Ministry of Economic Development. In addition, some information must be available to policyholders, such as a list of shareholders and a copy of the constituting documents. Before “doing business in New Zealand”, a general agent must be appointed in New Zealand on whom lawful processes may be served, and contracts issued to persons resident in New Zealand must state that the foreign company will abide by the decision of the High Court. If the reinsurer is carrying on in New Zealand the business of reinsurance in respect of policies of insurance upon human life (or the grant of annuities), a deposit is required to be made with the Public Trust.
- 9.3 We recommend the repeal of the Life Act, with the effect that the principal legislation regulating life reinsurers will be the Financial Reporting Act 1993 and the Companies Act 1993.¹⁵⁴

Overseas reinsurers

- 9.4 Reinsurers that are overseas companies “carrying on business” in New Zealand are currently subject to the Companies Act 1993 (they must register as overseas companies and provide annual returns) and the Financial Reporting Act 1993 (audited financial statements must be registered, which comply with generally accepted accounting practice, or with the requirements of the law of the country of incorporation, if substantially the same).

¹⁵³ This excludes captive reinsurers that only provide life reinsurance to insurers in the same company group.

¹⁵⁴ Life reinsurers are not subject to the Securities Act 1978 requirements because they are not issuing to the public.

- 9.5 We recommend the continuation of the Companies Act 1993 requirements that apply to reinsurers which are carrying on business in New Zealand.

Recommendation

R43 Overseas life reinsurers that are carrying on business in New Zealand, offering reinsurance in respect of the issue to the New Zealand public of life insurance, should continue to be subject to the requirements of the Companies Act 1993 that apply to overseas companies carrying on business in New Zealand.

- 9.6 The Ministry of Economic Development is currently reviewing the requirements of the Financial Reporting Act 1993, in particular how the Act should apply to overseas companies. We consider that overseas life reinsurers offering reinsurance in respect of publicly offered life policies in New Zealand that are carrying on business in New Zealand should continue to be covered by the Act's requirements to prepare, audit and register financial statements. This should assist life insurers, auditors, audit actuaries, policyholders, prudential supervisors and other monitors (such as market analysts and rating agencies) to assess and monitor life reinsurer solvency. Financial statements would have to be prepared in accordance with the relevant New Zealand standard, or the reporting standard of the home jurisdiction, if "substantially the same" (Financial Reporting Act 1993, section 11(3)). We recommend in chapter 5 that the financial reporting standards that apply to life insurers be reviewed and consideration be given to improving the solvency disclosures. This also applies to the financial disclosures required to be made by life reinsurers.
- 9.7 The financial statements of life reinsurers registered under the Financial Reporting Act 1993 should also have to be independently actuarially audited. The Securities Commission should have the power to grant an exemption from this requirement on the basis of defined criteria set out in the legislation. Those criteria would be designed to ensure that the actuarial requirements of the home jurisdiction are sufficiently robust to make additional independent assessment unnecessary.

Recommendation

R44 Overseas reinsurers carrying on the business in New Zealand of reinsuring liabilities under life policies offered to the New Zealand public should be required by the Financial Reporting Act 1993 to register audited financial statements under that Act that comply with the relevant financial reporting standards, and the actuarial information in them should be required to be actuarially audited, unless an exemption has been granted by the Securities Commission.

- 9.8 We do not propose that overseas reinsurers be required to incorporate in New Zealand. The reasons for requiring this of overseas life insurers do not apply to reinsurers. Overseas life insurers should be incorporated here to ensure that policyholders are able to access the protections provided by the Companies Act 1993. Policyholders have no direct contractual relationship with reinsurers, and there is little justification for providing these protections for life insurers

(that are the direct contracting party) because life insurers should have the resources and expertise to protect themselves.

- 9.9 There are potential problems with enforceability in relation to contracts with overseas reinsurers. In chapter 10 we discuss enforceability issues in relation to overseas life insurers. Apart from the requirement to have an agent for service in New Zealand for reinsurers carrying on business in New Zealand, we do not propose any special rules for overseas reinsurers in this regard (for example, that contracts be subject to New Zealand law). However, we consider that these issues (such as the law of the contract, accessibility of records, what liquidation procedures are available and so on) should be relevant to any assessment by a life insurer's actuary, the auditors and the audit actuary of the reinsurance arrangements a life insurer has. We suggest consideration be given to the inclusion in the relevant actuarial standard (during the standard approval process) of more detail as to the type and level of investigation into reinsurance arrangements that is required, so that all these matters become relevant (see paragraph 9.13).

New Zealand-established reinsurers

- 9.10 We consider that, if any New Zealand-established life reinsurers commence business in the future in relation to life policies offered to the New Zealand public, they should be subject to the Financial Reporting Act 1993 requirements to register audited financial statements in accordance with the relevant financial reporting standard. This may require the creation of a specific category in the Financial Reporting Act 1993 (because they will not be "issuers"). These reinsurers should also be required to have the actuarial information in their financial statements independently actuarially audited.

Recommendation

R45 New Zealand-established reinsurers that reinsure life policies offered to the New Zealand public should be required by the Financial Reporting Act 1993 to register audited financial statements under that Act that comply with the relevant financial reporting standard, and the actuarial information in those statements should be required to be actuarially audited.

Monitors of reinsurers

- 9.11 We do not advocate a system of direct supervision of reinsurers. In addition to the difficulties of supervising offshore entities, this would be inconsistent with our proposed regime for life insurers, which is based on providing additional protection for members of the public. Reinsurers do not contract with members of the public, and life insurers (with whom they do contract) should be able to look after themselves.
- 9.12 Nor do we propose a prudential supervisor for reinsurers (overseas or New Zealand incorporated). The primary monitor of the reinsurers is the life insurers with whom they contract, assisted by the monitors of the publicly disclosed financial information, such as the auditors and the audit actuary. We do not propose that a current financial strength rating be required of reinsurers. However, the existence of any rating that has been obtained will

be relevant to the assessment of the strength of the reinsurance by the life insurer's actuary and audit actuary.

Effect of reinsurance on life insurer solvency

- 9.13 The appropriateness of reinsurance arrangements, including the quality of the reinsurer, will be an important part of the solvency assessment of a life insurer under the actuarial standard that provides the framework for solvency disclosures in the financial reporting standard. At present, under GN5, the actuary may reduce policy liabilities of a life insurer by taking into account reinsurance where reinsurance is through companies that maintain prudential reserves in accordance with GN5, or in accordance with legislative requirements in the European Union, the United States of America, Australia or Canada, or where the reinsurer has been assigned an "investment grade credit rating" by one of three named credit rating agencies. This provision should be carried forward into an approved actuarial solvency standard for life insurers, and consideration given to requiring the actuary to take into account other matters relevant to the security of the reinsurance arrangements and solvency of the reinsurer, as well as any enforceability issues in respect of the reinsurance.

Recommendation

R46 The actuarial solvency standard for life insurers should be reviewed to ascertain whether closer scrutiny of reinsurance arrangements and reinsurers is required.

- 9.14 We also consider it desirable that more disclosure of the nature of a life insurer's reinsurance arrangements be required in the life insurer's financial statements, under the relevant reporting standard. Reinsurance is such an important part of the risk management strategy of any life insurer that we consider it desirable that any monitor of the life insurer should have access to some information about the life insurer's reinsurance arrangements. We recommend that there be a requirement to disclose the names of the reinsurers and a brief description of the reinsurance arrangements, at least in relation to arrangements that constitute material assets.
- 9.15 An alternative approach (to meet concerns expressed about confidentiality in relation to reinsurance arrangements) could be the development of an accounting and/or actuarial standard on how reinsurance arrangements are to be valued for the purposes of financial reporting.

Recommendation

R47 Life insurers should be required by the relevant reporting standard to disclose the name of the reinsurer and a brief description of any reinsurance arrangement that constitutes a material asset of the life insurer.

Cross border issues

Introduction

- 10.1 **T**HE NEW ZEALAND life insurance industry is dominated by overseas based or owned life insurers. In particular, Australian life insurers have a major presence here. Some of these overseas entities operate via a New Zealand incorporated subsidiary, but two Australian and most of the American life insurers operate in New Zealand via branches.
- 10.2 There exists between New Zealand and Australia the Australia New Zealand Closer Economic Relations Trade Agreement (CER), and the Memorandum of Understanding on Co-ordination of Business Law (see further paragraphs 9.21 to 9.26 of our discussion paper). The commitment under the Memorandum of Understanding is to find ways of dealing with differences in our business laws so that they do not create barriers to trade and investment. The New Zealand and Australian governments have agreed to focus on reducing transaction costs, lessening compliance costs and uncertainty, and increasing competition.
- 10.3 The Ministry of Economic Development released recently a discussion paper proposing a regime for coordination and recognition of securities offerings in Australia and New Zealand.¹⁵⁵ This regime would allow an issuer to extend an offer that is being lawfully made in the issuer's home country to investors in the other country without having to comply with most of the substantive requirements of the other country's fund-raising laws that apply to domestic offers. The current proposal is not intended to extend to life insurance offers, but could do so in the future.
- 10.4 There have been recent high-level discussions about the desirability of having a single economic market between Australia and New Zealand and, in particular, concerning the integration of prudential supervision of banks.

Compliance by overseas life insurers with our proposals

- 10.5 An important issue is the extent to which overseas life insurers will be required to comply with the proposals contained in this report. We discuss this in relation to the following proposals:
- requirement to incorporate in New Zealand;
 - product disclosure;

¹⁵⁵ *Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests* can be obtained from: <www.med.govt.nz> (last accessed 28 October 2004).

- financial reporting;
- prudential supervision;
- requirement to obtain financial strength rating.

Requirement to incorporate in New Zealand

- 10.6 As discussed in paragraphs 3.9 to 3.16, we recommend that all life insurers offering life policies to the public in New Zealand be required to incorporate in New Zealand. This would apply to overseas as well as New Zealand-based life insurers (that would otherwise choose another form of legal entity). The reason for this is not an attempt to “ring-fence” the New Zealand business. It is to access those mechanisms of the Companies Act 1993 that provide some protection for policyholders, in particular, directors’ duties, prohibition of defaulting directors, amalgamation procedures, liquidation procedures and the proposed new voluntary administration regime (see paragraph 6.16).
- 10.7 We propose that the Securities Commission have the power to exempt overseas-based life insurers (as well as New Zealand-based) from this requirement if it is satisfied that the overseas insurer is subject to provisions in its home country that give at least as good protections for policyholders including New Zealand policyholders, as the Companies Act 1993. The criteria on which an exemption could be granted should be set out in the Securities Act 1978. If, for example, there was something in the law of the home country that gave New Zealand policyholders a lower priority on winding up than the home-based policyholders (as is the case, for example, with Australian general insurance and banking law) this would preclude an exemption being given. We propose that the Securities Commission would have the power to impose conditions attaching to the exemption, for example, that life policies offered in New Zealand be governed by New Zealand law.

Recommendation

R48 Overseas life insurers offering life policies to the public in New Zealand should be required to incorporate in New Zealand, subject to an exemption regime operated by the Securities Commission.

Product disclosure

- 10.8 Overseas-based life insurers that offer life policies to the public in New Zealand are required to comply with our Securities Act 1978 disclosure regime, subject to any exemption granted by the Securities Commission under section 5(5) of that Act. New Zealand life insurers that offer life policies to persons outside New Zealand only are not subject to the Securities Act 1978. We consider that these requirements are appropriate (subject to the changes suggested in chapter 4). The Securities Commission has granted a considerable number of exemptions from the Securities Act 1978 to overseas-based life insurers.
- 10.9 While the proposed trans-Tasman mutual recognition of securities offerings regime does not apply to life insurance, the possibility of that regime being extended to life insurance should be considered. In that event, Australian-based

life insurers¹⁵⁶ would not be required to comply with our Securities Act 1978, as long as the equivalent disclosure requirements in Australia are met, certain entry requirements for the regime are satisfied, and the life insurer complies with the ongoing requirements of that regime.¹⁵⁷ Part 5 of the Securities Act 1978, which relates to mutual recognition regimes, contemplates that the Act's requirements can be applied to offers made to persons outside New Zealand under such a regime.

Financial reporting

- 10.10 Any entity that is an “issuer” under the Securities Act 1978, and overseas companies carrying on business in New Zealand, must comply with the Financial Reporting Act 1993 requirements, to prepare, audit and register annual financial statements (see chapter 5). We have proposed a number of amendments to that Act in chapter 5, in particular, extension to risk only policies.
- 10.11 Under section 11 of the Financial Reporting Act 1993, financial statements must comply with generally accepted accounting practice. Under section 11(3), if the Registrar of Companies is satisfied, in relation to an overseas company, that the financial statements of that company comply with the requirements of the law in force in the country of incorporation of that company, and that those requirements are substantially the same as the Financial Reporting Act 1993 requirements, those financial statements shall be taken to comply with the Financial Reporting Act 1993. We propose that this exemption power be transferred to the Securities Commission. In our view, it is more appropriate that this power be vested in a body of persons rather than a single individual. The Securities Commission consists of five to ten members with experience of financial markets, it already has a role in relation to savings policies, and it is independent of the Government and life insurers.

Recommendation

R49 The power of the Registrar of Companies under section 11(3) of the Financial Reporting Act 1993 to exempt a reporting entity incorporated outside New Zealand from the requirement to prepare financial statements that comply with New Zealand financial reporting standards (and to comply instead with the reporting standards of the entity's home country) should be transferred to the Securities Commission.

- 10.12 Overseas-based life insurers offering life policies to the public in New Zealand should continue to be required to comply with the Financial Reporting Act 1993 and, in particular, should be required to comply with our proposed requirement that the actuarial aspects of the financial statements be independently actuarially audited by an actuary approved for this purpose by the Securities Commission (with the Commission having the power to approve overseas-based

¹⁵⁶ The Ministry of Economic Development discussion document states that the offeror could be incorporated in Australia, have an established place of business there, or be registered there as an overseas company (above n 155). The key point is that the offer must be subject to the home country's regulatory regime.

¹⁵⁷ It is possible that such a regime would have the effect of changing the nature of life products on offer in New Zealand, because the offeror would be able to extend directly to New Zealanders offers made in the home country.

actuaries – see paragraph 5.32). We consider that the Securities Commission should have power to exempt an overseas-based life insurer from this requirement on the basis of statutory criteria, to the general effect that the quality of actuarial input to the insurer’s financial statements is of a comparable standard.¹⁵⁸

Recommendation

R50 Overseas life insurers offering life policies to the public in New Zealand should be required to comply with the Financial Reporting Act 1993 to prepare, audit and register financial statements, and to have those statements independently actuarially audited, subject to an exemption regime (in relation to the actuarial audit) to be operated by the Securities Commission.

Prudential supervisor

10.13 We propose that all overseas life insurers offering life policies to the public in New Zealand, whether via a subsidiary or branch operation or otherwise, be required to appoint a private sector policyholder agent, if that is the method of supervision chosen for life insurers (see chapter 6). If prudential supervision is to be done by a government monitor, that government monitor will supervise overseas life insurers as well. The Securities Commission should have the power to exempt an overseas life insurer from the prudential supervision requirement (whether government or private sector is chosen), if it is satisfied, based on defined criteria (which we propose would be set out in legislation) that equivalent protections for New Zealand policyholders exist in the insurer’s home country. In relation to Australian life insurers, for example (whether operating by branch or subsidiary), an exemption could be applied for on the basis that APRA carries out an equivalent prudential supervision role. Before any exemption was granted the Securities Commission would have to be satisfied that the body that carried out prudential supervision in the home country of the insurer (for example, APRA) would:

- look after the interests of the New Zealand policyholders to no less a standard than a New Zealand prudential supervisor would;
- have no less a level of competence and trustworthiness than a New Zealand prudential supervisor would;
- give New Zealand policyholders’ interests equal priority with those of home-country policyholders, on an ongoing basis and in a voluntary administration or liquidation situation.

¹⁵⁸ We note the Ministry of Economic Development is proposing to review the application of the Financial Reporting Act 1993 to overseas companies, and subsidiaries of overseas companies. We recommend that overseas-incorporated life insurers continue to be subject to the Act’s requirements to prepare, audit and register financial statements, and to obtain an independent actuarial audit (subject to the exemption regime described above). New Zealand incorporated subsidiaries of overseas life insurers should also be covered by the Act. Both of these types of entities will be “issuers” under the Securities Act 1978 (and so caught by the Financial Reporting Act 1993) in any event. During consultations it was suggested that the requirement that overseas companies register New Zealand branch accounts in addition to full accounts (section 8(2)) may need to be reviewed and the usefulness of these accounts reconsidered. It was also suggested that there are good reasons to retain section 9A(3) of the Financial Reporting Act 1993, notwithstanding that we do not propose that life business must be conducted through a statutory fund.

Recommendation

R51 Overseas life insurers offering life insurance to the public in New Zealand should be required to appoint a policyholder agent (if that is the method of prudential supervision chosen for life insurers). The Securities Commission should have the power to exempt overseas life insurers from the prudential supervision requirement on certain criteria.

10.14 In the event of a serious decline in the financial health of an overseas life insurer operating in New Zealand, to whom such an exemption had been given, the Registrar of Companies would retain its powers of inspection and intervention under the Corporations (Investigation and Management) Act 1989, and the Securities Commission would have some powers of investigation under the Securities Act 1978. The Corporations (Investigation and Management) Act 1989 should be amended to clarify that “creditors” in section 4 of that Act, includes contingent and prospective creditors (such as policyholders).

Recommendation

R52 The Corporations (Investigation and Management) Act 1989 should be amended to clarify that “creditors” in section 4 includes contingent and prospective creditors.

Requirement to obtain financial strength rating

10.15 Overseas insurers offering life policies to the public in New Zealand should be required to obtain a current financial strength rating, for the reasons given in chapter 7.

Enforcement by creditors

10.16 New Zealand policyholders may face considerable difficulties in enforcing their contractual rights against overseas life insurers that operate here by subsidiary or branch (for example, if day-to-day records are not kept in New Zealand.) There are a number of legal mechanisms that can be used to mitigate these difficulties. They are discussed under the following headings:

- agent for service in New Zealand;
- contracts to be subject to New Zealand law;
- accessibility of records;
- enforcement of judgments offshore;
- obtaining evidence offshore;
- cross border insolvencies.

Agent for service in New Zealand

10.17 Under Part 18 of the Companies Act 1993, all life insurers carrying on business in New Zealand that are overseas companies (that is, bodies corporate incorporated outside New Zealand) must register under the Companies Act 1993 as overseas companies and, as part of that registration process, provide

the name and address of a person resident or incorporated in New Zealand who is authorised to accept service in New Zealand of documents on behalf of the overseas company. This is similar to the requirements of section 34 of the Life Act (which we propose be repealed). Section 334 of the Companies Act 1993 provides penalties for failure to register.¹⁵⁹

- 10.18 We recommend that all life insurers that offer life policies to the New Zealand public be required to incorporate in New Zealand (see chapter 3). However, an exemption may be granted from that requirement by the Securities Commission, and, in that event, the overseas insurer would generally be required to register as an overseas company under Part 18 of the Companies Act 1993.
- 10.19 The phrase “carrying on business in New Zealand” is not exhaustively defined. It is possible that an overseas life insurer could offer policies to the New Zealand public without having any presence in New Zealand. In order that all life insurers offering to the public in New Zealand become subject to the Companies Act 1993 and the Financial Reporting Act 1993, we recommend that all overseas life insurers that have been exempted by the Securities Commission from the requirement to incorporate as a company in New Zealand, be required to register as an overseas company under the Companies Act 1993.

Recommendation

R53 Overseas life insurers offering life policies to the public in New Zealand (or remaining liable under such policies) that are exempted by the Securities Commission from the requirement to incorporate as a company in New Zealand should be required to register as overseas companies under the Companies Act 1993.

Contracts to be subject to New Zealand law

- 10.20 Under section 35 of the Life Act, life policies issued by “foreign companies” (namely companies incorporated outside New Zealand) to persons resident in New Zealand must state that the company will abide by the decision of the High Court. This provision will be repealed on the repeal of the Life Act, but we recommend that a general provision to this effect be inserted into the Securities Act 1978, with application to all life insurers that offer life policies to the public in New Zealand.¹⁶⁰ In addition, we recommend a provision be inserted into the Securities Act 1978 requiring all life insurers to specify in their offer documents to the New Zealand public that the contract will be subject to New Zealand law, with a power for the Securities Commission to grant an exemption, if it is satisfied that the law that would otherwise apply offers equivalent (or better) protections to New Zealand policyholders. Alternatively, the Securities Commission could impose, as a condition of the exemption from local incorporation, that life policies issued by an overseas life insurer specify these matters.

¹⁵⁹ Section 34 of the Life Act has been the subject of case law in which it was argued that the section has been implicitly repealed by section 336 of the Companies Act 1993. It was held that compliance with the Companies Act 1993 requirements was effective compliance with section 34 – see *Colonial Mutual Life Assurance Society Ltd v Lindale Financial Services Ltd* (11 November 1996) High Court CP22/96 Master Thomson.

¹⁶⁰ This requirement (and the requirement that contracts be subject to New Zealand law) should have equal application to overseas-based life insurers, New Zealand subsidiaries of overseas life insurers and locally owned life insurers.

Recommendation

R54 The Securities Act 1978 should require all life policies issued by life insurers that offer to the public to provide that the insurer will abide by a decision of the High Court of New Zealand, and that the policy will be governed by New Zealand law (subject to an exemption regime to be operated by the Securities Commission in relation to the requirement for a policy to be governed by New Zealand law).

Accessibility of records

- 10.21 It is important that every overseas life insurer, whether operating via a branch or subsidiary (as well as every New Zealand life insurer), either maintains records relevant to the New Zealand business in New Zealand, or has access to those records within a reasonable timeframe. This is required not only so that policyholders (and the prudential supervisor) can take effective legal action directly, but also for the prudential supervisor in exercising the inspection powers we propose for it, for the Securities Commission in exercising its powers of inspection under Part 3 of the Securities Act 1978, and the Registrar of Companies in exercising his powers of investigation under the Corporations (Investigation and Management) Act 1989.
- 10.22 Section 53 of the Securities Act 1978 requires issuers of securities offered to the public to keep certain accounting records. Under section 53A, those records may be kept at a place outside New Zealand only if there is kept at a place in New Zealand such documents in respect of the business dealt with in the accounting records as will disclose with reasonable accuracy the financial position of the business at intervals not exceeding six months, and will enable the financial statements to be prepared.
- 10.23 On the basis that the coverage of the Securities Act 1978 is extended to all life insurance issuers, as recommended in chapter 4, we conclude that these record-keeping requirements of the Securities Act 1978 are sufficient.

Enforcement of judgments offshore

- 10.24 Under the international regime of reciprocal enforcement of judgments, it is possible to register some judgments made in New Zealand, in other countries (being a country that has an equivalent reciprocal enforcement of judgments enactment) and to enforce that decision in that country. The law in New Zealand is set out in the Reciprocal Enforcement of Judgments Act 1934. Under that Act, it is possible to register a foreign judgment in New Zealand. The Act generally applies to money judgments of superior foreign courts, but its application can be extended by Order in Council to certain other types of judgments. It relies on other countries having equivalent legislation in respect of New Zealand judgments, and the Governor-General has the power to make foreign money judgments unenforceable in New Zealand if it appears that the treatment of New Zealand judgments in the foreign court is substantially less favourable than that accorded by New Zealand courts.
- 10.25 The Act extends to the United Kingdom and other countries specified by Order in Council. An Order in Council can only be made if substantial reciprocity of treatment will be assured regarding enforcement in the foreign country of money

judgments given in the superior courts of New Zealand. Orders in Council have been made in respect of a number of countries, including Australia and France.

- 10.26 It would be desirable to extend the application of the Reciprocal Enforcement of Judgments Act 1934 to the home countries of all overseas insurers offering life policies in New Zealand not already covered by an Order in Council (notably, the United States of America).

Obtaining evidence offshore

- 10.27 The Securities Commission has reciprocal arrangements to obtain information offshore in relation to its powers and functions under the Securities Act 1978. Under section 69F of the Act, the Commission may act on the request of an overseas regulator to inquire into any matter related to the functions of that overseas regulator, and may obtain information, documents or evidence likely to assist in complying with that request. The Securities Commission is a signatory to a multilateral memorandum of understanding issued by an international organisation of securities commissions concerning consultation, cooperation and exchange of information. As regards arrangements with Australia, the Australian Securities and Investments Commission (ASIC) is authorised to release information requested by our Securities Commission, under the Corporations Act 2001 (Aust), on certain grounds. If ASIC does not already hold information requested, it can exercise certain powers to obtain the information.

- 10.28 If the Reserve Bank of New Zealand was to be the prudential supervisor, it should have similar powers and arrangements to obtain evidence offshore. At present, it has an arrangement with APRA under a memorandum of understanding that gives rise to a presumption of cooperation between the two that information and assistance will be provided if requested, and there are also understandings with other offshore supervisors that result in cooperation with regard to information sharing.

Cross border insolvencies

- 10.29 Complications can arise when an overseas insurer operating in New Zealand through a branch gets into serious financial difficulties and liquidation procedures are commenced. Our concern is that the interests of New Zealand policyholders in such circumstances should be fairly protected in a liquidation of that insurer.

- 10.30 The United Nations Commission on International Trade Law (UNCITRAL) has developed a Model Law on cross border insolvencies, and, as mentioned in the discussion paper (in paragraph 9.26), Australia and New Zealand officials have been working on adoption of this Model Law between Australia and New Zealand. The Model Law is designed to assist states to equip their insolvency laws with a modern, harmonised and fair framework to address more effectively instances of cross border insolvency.

- 10.31 The Insolvency Law Reform Bill includes, as Part 9, provisions intended to implement the UNCITRAL Model Law (as amended and supplemented in order to apply to New Zealand), and provide a framework for facilitating insolvency proceedings when a person is subject to insolvency administration in one country

but has assets or debts in another, or more than one solvency administration has commenced in more than one country in relation to a person.¹⁶¹

10.32 Schedule 5 of the Bill sets out the rules applying to cross border insolvency proceedings. The preamble to that schedule states that the purpose of the schedule is to provide effective mechanisms for dealing with cases of cross border insolvency so as to promote the objectives of:

- cooperation between the courts and other competent authorities of New Zealand and foreign states involved in cases of cross border insolvency;
- greater legal certainty for trade and investment;
- fair and efficient administration of cross border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;
- protection and maximisation of the value of the debtor's assets; and
- facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

10.33 Schedule 5 applies where:

- assistance is sought in New Zealand by a foreign court or a foreign representative in connection with a foreign proceeding; or
- assistance is sought in a foreign state in connection with a New Zealand insolvency proceeding; or
- a foreign proceeding and a New Zealand insolvency proceeding in respect of the same debtor are taking place concurrently; or
- creditors or other interested persons in a foreign state have an interest in requesting the commencement of, or participation in, a New Zealand insolvency proceeding.¹⁶²

Internet issues

10.34 Particular issues arise where an overseas life insurer has no business presence in New Zealand but offers life insurance policies to the New Zealand public, for example, over the internet. Such life insurers are "issuers" for the purposes of the Securities Act 1978. Section 7 of that Act provides that Part 2 (which includes the disclosure rules) applies to securities offered to the public in New Zealand regardless of where the issuer is resident or carries on business, as long as the offer is received by a person in New Zealand (unless the offeror can demonstrate that it took all reasonable steps to ensure that members of the public in New Zealand may not accept the offer). However, there are problems of enforcement of the provisions of that and other applicable Acts (such as the Companies Act 1993 and Financial Reporting Act 1993, because it could be argued that the offeror was carrying on business in New Zealand), as well as detection problems, in a situation where the offer is made over the internet,

¹⁶¹ Insolvency Law Reform Bill, clause 449. The Bill can be obtained from the Ministry of Economic Development website: <www.med.govt.nz> (last accessed 28 October 2004).

¹⁶² The closing date for submissions on the Insolvency Bill and the accompanying discussion document on insolvency issues was 11 June 2004.

and there is no other advertising. The IAIS Principles mention this problem, and suggest it be a function of the “supervisory authority” to give information to the public about whether and how local legislation applies to cross border offers of this nature, and to issue warnings to consumers when necessary in order to avoid transactions with unsupervised entities.¹⁶³ We consider that the Securities Commission is the appropriate body to perform this role. The Securities Commission has the function under section 10(d) of the Securities Act 1978 of promoting public understanding of the law and practice relating to securities, and this could well include education in relation to internet offers of securities in general and life insurance in particular.

10.35 There are also problems with offshore investment advisers soliciting for business in New Zealand. We note that the Investment Advisers (Disclosure) Act 1996 does not contain a provision equivalent to section 7 of the Securities Act 1978, extending the territorial application of the former Act to advice from offshore. This matter is addressed in a Cabinet paper on the Review of Securities Trading Law.¹⁶⁴ An amendment to the Act in this regard is proposed.

Recommendation

R55 The Securities Commission should provide information to the public on internet offers of life insurance from offshore entities in the course of performing its function under section 10(d) of the Securities Act 1978, including guidance on what laws are applicable, and issue warnings as appropriate. This information should also extend to guidance about solicitations from offshore financial intermediaries.

¹⁶³ International Association of Insurance Supervisors Insurance Core Principles, ICP 25, advanced criteria.

¹⁶⁴ Ministry of Economic Development *Review of Securities Trading Law: Overview and Application Issues* (Wellington, 2003) <www.med.govt.nz> (last accessed 28 October 2004).

Assessment of costs and benefits

- 11.1 **A**S NOTED IN CHAPTER 1, the primary role of financial markets is to enable the efficient aggregation of capital. Consumers invest in securities with a view to growing the value of their capital. They purchase insurance with a view to avoiding possible losses in the value of their capital. Both activities are part of the spectrum of maintaining and enhancing consumers' wealth.
- 11.2 As noted in chapter 2 of our discussion paper, it is widely accepted that free and competitive markets generally help to provide an efficient allocation of resources. The key concern of public policy in this context is to ensure that securities and insurance markets operate within a regulatory framework that promotes both economic efficiency and fairness for consumers.¹⁶⁵
- 11.3 Economic efficiency is characterised by strong and sustained pressure on providers to reduce costs, by prices for products and services that closely reflect costs, and by constant innovation from providers continually seeking to offer products and services that better meet consumers' demands.¹⁶⁶ These are outcomes that public policy should aim to promote in the securities and insurance markets.
- 11.4 The two main drivers of a well-functioning market are effective competition among providers to satisfy consumer demands, and consumers' incentives and capacity to protect and enhance their own interests. The pressures on providers created by informed consumer choice are powerful and fundamental.

Our proposals

- 11.5 In chapter 1 (paragraph 1.23) we identified the key issues to be addressed by life insurance regulation, namely:
- consumers cannot always readily understand the products offered;
 - consumers have difficulty monitoring the performance of insurers; and
 - consumers have difficulty enforcing their rights as policyholders.

¹⁶⁵ Refer to paragraph 1.17 of this report.

¹⁶⁶ Economic efficiency is where goods and services are produced in the least costly manner and distributed to those who value them most. This requires three component efficiencies: productive, allocative and dynamic. Productive efficiency is where firms meet demand at minimum cost *and* the industry's activities are distributed among firms so that industry-wide costs are minimised to meet demand. Allocative efficiency is where goods and services are consumed by those who most value them *and* no alternative combination of goods and services could better meet demand. Dynamic efficiency is where resources are used to deliver the greatest possible value to consumers over time, particularly through innovation and creating new opportunities. This is the orthodox (Kaldor-Hicks/Pareto-based) definition of economic efficiency.

- 11.6 Our approach to the first problem is centred on disclosure and includes other measures to improve the quality of financial advice.¹⁶⁷ Our approach to the second and third issues can be categorised as the “co-regulatory” solution described in paragraph 1.24.
- 11.7 In chapter 2, we identify a number of problems with the present regulatory regime for life insurance. Our proposals responding to these problems are outlined in chapter 3. Briefly these include:
- The repeal of the Life Act and the introduction of an Insurance Contracts Bill that would re-enact provisions from Part 2 of the Life Act, and bring together and amend various (but not all) provisions relating to insurance contracts from other legislation.¹⁶⁸
 - A requirement for life insurers to incorporate as companies, unless exempted by the Securities Commission on certain criteria.¹⁶⁹
 - The extension of the Securities Act 1978 regime to cover risk only policies as well as savings policies that are already covered by that regime.¹⁷⁰
 - The Financial Reporting Act 1993 requirements to prepare, audit and register annual financial statements should apply to all life insurers and life reinsurers carrying on business in New Zealand. Related recommendations include a review of the financial standard applicable to life insurers to ensure that there is sufficient solvency and reinsurance disclosure, the development of approved actuarial standards and the augmentation of the ASRB by the inclusion of actuarial representation.¹⁷¹
 - A requirement for the actuarial aspects of the life insurer’s or life reinsurer’s financial statements to be independently actuarially audited, unless exempted by the Securities Commission.¹⁷²
 - The requirement for there to be a prudential supervisor for each life insurer.¹⁷³ The method we recommend is by private sector policyholder agents contractually appointed by each life insurer, rather than by a government monitor.¹⁷⁴ The policyholder agent would receive regular financial reports and would have powers to request further information, to conduct investigations and to apply for voluntary administration or liquidation.¹⁷⁵ Overseas life insurers would be able to obtain an exemption from the prudential supervision requirement if certain criteria are satisfied.¹⁷⁶

¹⁶⁷ We have recommended changes to the disclosure regime under the Securities Act 1978 to improve the quality of disclosure in the context of life insurance.

¹⁶⁸ Recommendations R1, R40.

¹⁶⁹ Recommendations R2, R48. Overseas life insurers that are exempted would be required to register as overseas companies under the New Zealand Companies Act 1993, recommendation R53.

¹⁷⁰ Recommendation R3, see also recommendations R4–R15.

¹⁷¹ Recommendations R16–R19, R44, R45, R50.

¹⁷² Recommendations R20, R44, R50.

¹⁷³ See paras 6.1 to 6.5 and footnote 83 for detail of the recommended method of supervision.

¹⁷⁴ Recommendation 35. The costs of the policyholder agent would be negotiated with the life insurer and met by the life insurer (and ultimately by consumers). If the prudential supervisor is to be a government entity instead of a private sector policyholder agent, the costs of the government monitor should be met by industry levies, recommendation R28.

¹⁷⁵ Recommendations R23, R27, R30, R35.

¹⁷⁶ Recommendation 51.

- Until the analyst market is better established, every life insurer would be required to obtain a financial strength rating from an approved rating agency.¹⁷⁷
- 11.8 We make a number of other recommendations relating to financial advisers (the need for a new regulatory framework),¹⁷⁸ analysts (the need to promote the development of an analyst market to provide comparative information to consumers),¹⁷⁹ and cross border issues.¹⁸⁰
- 11.9 In summary, our proposals aim to bring all life insurance under the current securities and financial disclosure framework in New Zealand and extend the existing disclosure requirements to include an independent actuarial report. In addition, our proposals provide for a policyholder agent to act as a monitor for policyholders, similar to the trustee's role for debt securities and the statutory supervisor's role for participatory securities under the Securities Act 1978.
- 11.10 The regulatory model we propose is largely based on disclosure. As noted in chapter 4,¹⁸¹ we believe that disclosure is likely to be more cost effective than imposing a more prescriptive or merit-based regime. While compliance costs for insurers may increase under our proposals, we expect that overall costs for insurers under a more prescriptive regime would be significantly higher.¹⁸²
- 11.11 For a market to work well, consumers (and their advisers) need to be adequately informed. The main objective of disclosure is therefore to ensure adequate, useful and timely disclosure to enable this interplay between providers and consumers (or their advisers) to take place.¹⁸³ However, if the costs of disclosure are too high, potential providers could be deterred from entering the market or existing providers could be deterred from expanding, resulting in less competition, and thus less innovation and efficiency in the market.
- 11.12 The aim of our proposals is to facilitate an efficient exchange of business between life insurers and consumers (and their advisers), with particular focus on empowering consumers so that they are able to pressure insurers to perform. A consumer's risks, particularly in relation to choosing the right product and insurer failure, remain with the consumer, although the consumer is assisted in relation to solvency monitoring and enforcement by the policyholder agent.

Comparison of costs and benefits of our proposals with existing New Zealand life insurance regime

- 11.13 The main benefits of our proposals relative to the status quo for life insurance companies carrying on business in New Zealand are as follows:

¹⁷⁷ Recommendation R38.

¹⁷⁸ Recommendation R36.

¹⁷⁹ Recommendation R37.

¹⁸⁰ Recommendations R48 to R55.

¹⁸¹ See paragraph 4.2.

¹⁸² Overall costs could include, for example, levies to fund the central regulator, management time dealing with the regulator, and the likely cost of capital issues from imposition of additional solvency requirements.

¹⁸³ A cost effective set of minimum disclosure rules helps (i) to reduce search costs that consumers would otherwise face in obtaining relevant and reliable information from providers and comparing it across like investment alternatives and (ii) to mitigate the otherwise weak negotiating position of fragmented individual investors relative to the providers in obtaining the information.

- Applying the Securities Act 1978 disclosure regime to risk only policies enhances consumers' ability to select products that are appropriate for their needs and preferences and promotes more effective competition as a result of consumers (and their advisers) comparing alternative products more readily.¹⁸⁴
- Applying the disclosure regime to risk only policies also imposes a more formal discipline on insurers to address each product and corporate matter requiring disclosure.¹⁸⁵
- The regulatory framework, both within the life insurance market and across securities and life insurance markets, will be more consistent. In particular, the extension of the Securities Act 1978 and Financial Reporting Act 1993 requirements to all life insurers selling life insurance to the public will reduce the risk of "regulatory arbitrage", where products and arrangements are structured to avoid the burdens of one set of rules, or to gain the advantages of another. We consider this regulatory neutrality to be a significant gain.
- The potential for improved accountability from life insurers to consumers (and their advisers) by strengthening the quality and usefulness of information, aiding consumer choice of product and insurer and empowering policyholders to use their enforcement remedies more effectively through a "policyholder agent".¹⁸⁶
- Satisfying the Financial Reporting Act 1993, supplemented by an independent actuarial audit and regular reporting to a policyholder agent, will require all life insurers to ensure, on a more systematic basis, that their affairs are in order to support the obligations they undertake to members of the public.
- Consistency and reliability in the information provided by life insurers will be improved. This is achieved in part by requiring the actuarial aspects of a life insurer's financial statements to be audited by an independent actuary (approved by the Securities Commission), that would apply standards approved by an augmented ASRB. This is in addition to a life insurer's normal annual audit. Neither the independent actuarial audit nor the approval of actuarial standards by the ASRB are currently required.
- The repeal of the outdated and confusing Life Insurance Act 1908 and the re-enactment (with some amendments) in clearer and more modern form of statutory provisions relating to life and non-life insurance contracts. Specific cost savings for insurers flowing from repeal of the Life Insurance Act 1908 include the removal of requirements to lodge a \$500 000 deposit with the Public Trust,¹⁸⁷ to maintain a separate fund for life receipts¹⁸⁸ and to comply with the reporting requirements of the Act.¹⁸⁹ Some regulatory duplication

¹⁸⁴ Over time, more competition pressures poorer performing insurers either to exit or become more efficient, which leads to a better allocation of economic resources.

¹⁸⁵ Stronger internal disciplines should lead to the earlier detection of any financial difficulty on the part of the insurer, reduce the risk of insurer failure, increase the financial security of policyholders, reduce overall risk in the insurance and investment markets and increase participation in those markets.

¹⁸⁶ For this disclosure approach to work properly, a considerably more robust advisory and analytical market must be developed.

¹⁸⁷ Life Insurance Act 1908, s 3.

¹⁸⁸ Life Insurance Act 1908, s 15.

¹⁸⁹ Life Insurance Act 1908, Part 1.

is removed for those insurers currently complying with the financial reporting provisions of the Life Act and the Financial Reporting Act 1993.

- 11.14 The main cost of our proposals is the additional compliance cost for life insurers of meeting the relevant Securities Act 1978¹⁹⁰ and Financial Reporting Act 1993 disclosure requirements, together with the costs of the independent actuarial audit,¹⁹¹ the costs of obtaining and publishing the financial strength rating, and the costs of the policyholder agent.¹⁹² We have not quantified these costs on a net present value basis, however, we would not expect the net cost to be unreasonable relative to a life insurer's current regulatory compliance costs (especially for those life insurers who offer savings policies to the public and therefore are already subject to the Securities Act 1978 and Financial Reporting Act 1993).¹⁹³
- 11.15 One or two smaller life insurers (and a number of smaller health insurers) have made submissions that the cost of obtaining a financial strength rating would be excessive relative to their small market share. Some submitters also expressed concern that ratings will be an additional cost for little real benefit. We believe that in the absence of robust independent comparative analysis of life insurers being publicly available, ratings are a relatively inexpensive way of providing some independent comparative information to assist financial advisers and consumers in making decisions about life insurance. We do not consider it unreasonable to require a life insurer that has contractual obligations to members of the public to provide consumers with a rating. Under our proposals, this rating requirement could be relaxed if and when the market for advisory and analytical services becomes sufficiently developed.
- 11.16 The costs to be considered in relation to the proposed solvency monitoring and exercise of enforcement powers by a policyholder agent include:
- The fees and costs of the policyholder agent.¹⁹⁴
 - The costs to insurers of ongoing reporting to the policyholder agent.¹⁹⁵
 - An increase in audit costs flowing from the recommendation that auditors of life insurers have obligations to report to the policyholder agent.¹⁹⁶

¹⁹⁰ These costs will include legal and accounting costs in preparing documents required under the Securities Act 1978, including the prospectus. We note at para 2.9 that the prospectus regime is unduly costly and in need of general review.

¹⁹¹ In relation to the costs of the independent actuarial audit, these can be offset to a small extent by the repeal of the independent actuarial role of the Government Actuary under the Life Insurance Act 1908 (refer to the last bullet point of para 2.12).

¹⁹² These costs will either be absorbed by providers (and therefore reduce returns for the insurer's owners) and/or passed on through increased product prices, depending on the level of competition in the market.

¹⁹³ Our assessment does not include consideration of the taxation implications of our proposals.

¹⁹⁴ These can be offset to some extent against the monitoring and enforcement costs that each policyholder would incur individually. Another offset would be the repeal of the provisions in Part 2 of the Insurance Companies (Ratings and Inspections) Act 1994 authorising the Registrar of Companies to require further information. This would become a power of the policyholder agent. See recommendations R30 and R31.

¹⁹⁵ Recommendations R11, R23.

¹⁹⁶ See recommendation R25.

- This form of regulation may introduce some market uncertainty as to when and whether the policyholder agent would take action in response to a life insurer’s solvency problems.¹⁹⁷ A related issue is additional cost to the market should the policyholder agent take action either too quickly or too late in response to a life insurer’s solvency difficulties.
- The “moral hazard” issues with directors and consumers becoming unduly complacent about managing their own risk if the policyholder agent’s role is introduced. This cost is difficult to quantify but we note that it is likely to be higher if a government entity were to perform the prudential supervision role or if there was a central regulator, as discussed.

11.17 In paragraph 3.11 we note that some submitters were concerned that the requirement for life insurers to be incorporated in New Zealand would create significant additional costs and compliance issues.¹⁹⁸ We have recommended that an exemption regime would operate on a case-by-case basis to enable insurers that operate under equivalent regulatory requirements to be exempted from the requirement to incorporate in New Zealand. However, for those life insurers that are not already New Zealand incorporated companies and that are not exempted by the Securities Commission from this requirement, there will be one-off costs associated with establishing a company in New Zealand. There will also be the minor cost of registering as an overseas company under the New Zealand Companies Act 1993 for overseas life insurers that are exempted from the incorporation requirement.¹⁹⁹

11.18 The major advantage of requiring local incorporation as a company is that this triggers the operation of the Companies Act 1993 and avoids the need to create special regimes to set equivalent requirements in relation to life insurers that are not locally incorporated companies. We expect that the administrative and regulatory costs of administering the Companies Act 1993 (with exemptions) would be lower than administering a number of different regimes.

11.19 We have also recommended that the Securities Act 1978 require that:

- all life policies offered to the New Zealand public to be governed by New Zealand law (subject to an exemption regime to operate where another law would offer equivalent or better protections to New Zealand policyholders); and
- insurers abide by decisions of the High Court of New Zealand.²⁰⁰

11.20 There may be some additional cost for overseas insurers in submitting their New Zealand business to New Zealand law or in obtaining an exemption from this requirement. We consider that the protections afforded to New Zealand policyholders by New Zealand law warrants any additional cost to overseas insurers in this regard.

¹⁹⁷ While the policyholder agent and life insurer would agree on financial covenants, solvency triggers may leave some room for interpretation.

¹⁹⁸ Recommendations R2, R48.

¹⁹⁹ Recommendation R53. This cost is currently incurred by overseas life insurers “carrying on business in New Zealand” as defined in section 332 of the Companies Act 1993.

²⁰⁰ Recommendation R54. The second requirement is an existing requirement under section 35 of the Life Act that would be shifted to the Securities Act 1978.

11.21 We consider that the proposed Insurance Contracts Bill is largely neutral from a cost/benefit perspective. We expect that initiating the process of drawing together provisions currently scattered throughout various Acts and modernising existing provisions will be of benefit to the insurance industry in improving the ease with which the legislation can be applied and interpreted.

- In relation to reform of the insured’s duty to disclose,²⁰¹ we expect this will benefit policyholders. We note that some insurers have argued that this will lead to increased costs and delays in the underwriting process. Nevertheless, we view this reform as a better balance of the interests of the insurer and insured, as discussed in chapter 8.
- In relation to “claims made” and “claims made and notified” policies,²⁰² as noted in paragraph 8.52, clause 19 of the Bill goes some way towards dealing with the problems that arise for insurers in relation to these policies, and we expect this will be of benefit to insurers.
- In relation to increased risk exclusions,²⁰³ we expect that the modification proposed in the Bill will provide increased certainty to insurers in this area by taking account of the extent to which insurers frame exclusion provisions having regard to the statistical likelihood of loss.
- In relation to third party claims,²⁰⁴ we expect that the proposed reforms will provide increased clarity and efficiency of process to insurers and third parties in circumstances where third parties have a claim on insurance proceeds. New provisions have also been proposed to provide increased certainty about the application of the proceeds of reinsurance contracts where the insurer becomes insolvent.
- In relation to the payment of interest on the proceeds of life policies, we expect that clause 16 will benefit insurers by removing an incentive for insureds to delay notifying claims.²⁰⁵
- In relation to penalties for non-compliance, these have been updated to provide for fines of up to \$1000 and \$10 000, although we consider that the penalties regime generally needs further review.²⁰⁶
- In relation to transfers of life policies,²⁰⁷ we consider that the benefits of the additional measures designed to protect policyholder interests, warrant the additional costs to the insurer (the costs of seeking policyholder approval and/or High Court approval and the costs of notifying the policyholder agent(s) and providing an independent actuarial report on the proposed transfer if required).
- In relation to administrative changes to policies,²⁰⁸ this is of benefit to insurers because there is no practicable means by which they can do this at

²⁰¹ See cls 14 and 15 of the Insurance Contracts Bill.

²⁰² See cls 17–19 of the Insurance Contracts Bill.

²⁰³ See cl 20 of the Insurance Contracts Bill.

²⁰⁴ See cls 31 to 39 of the Insurance Contracts Bill.

²⁰⁵ Clause 46 of the Insurance Contracts Bill.

²⁰⁶ Clauses 90 and 103 of the Insurance Contracts Bill.

²⁰⁷ See paras 8.69 to 8.86 and recommendation R41.

²⁰⁸ See paras 8.87 to 8.91 and recommendation R42.

present. This benefit outweighs the costs of this process for insurers (the costs of notification to policyholders and the policyholder agent, the costs of the policyholder agent obtaining advice on the proposed changes, and the costs of obtaining High Court approval).

11.22 In relation to amalgamations involving life insurers, we consider that the benefits of the proposed process (by amendment to Part 13 of the Companies Act 1993) in protecting the interests of policyholders warrant the additional costs to insurers (the costs of notification to the policyholder agent, providing an independent actuarial report if required, and the costs of seeking High Court approval if sought by the policyholder agent or any policyholder).²⁰⁹

11.23 Other recommended changes include:

- amendments to the Securities Act 1978 to clarify required disclosures relating to surrender values, benefit projections and allocation of profits²¹⁰ and amendments to reporting standards to require disclosure of principles relating to the valuation and distribution of profits;²¹¹
- implementation of the periodic disclosure regime under the Securities Act 1978;²¹²
- improvements to the Financial Reporting Act 1993, financial reporting standards relating to financial, solvency and other disclosures²¹³ and actuarial standards relating to solvency²¹⁴ and prudential capital requirements;²¹⁵
- relatively minor amendments to the Companies Act 1993 and the Insolvency Law Reform Bill to recognise the role of the policyholder agent in amalgamations, liquidations and the proposed voluntary administration regime, and to re-enact sections 30, 30A and 31 of the Life Act relating the liquidations of life insurers;²¹⁶
- amending section 383 of the Companies Act 1993 to include persistent failure to comply with the Financial Reporting Act 1993 as a ground for disqualification as a director;²¹⁷ and
- amending the Corporations (Investigation and Management) Act 1989 to clarify that policyholders are creditors for the purposes of that Act.²¹⁸

11.24 We expect that these amendments would largely be cost neutral or add relatively minor costs in the overall scheme of the disclosure regime.

11.25 For completeness, we note that additional administrative costs would be incurred:

²⁰⁹ Recommendation R34.

²¹⁰ Recommendations R12, R13, R14, R15.

²¹¹ Recommendation R22.

²¹² Recommendation R9, Securities Act 1978, s 54A.

²¹³ Recommendation R17, R22, R47.

²¹⁴ Recommendation R46.

²¹⁵ Recommendation R19.

²¹⁶ Recommendations R32, R33.

²¹⁷ Recommendation R26.

²¹⁸ Recommendation R52.

- by the Securities Commission in administering the expanded Securities Act 1978²¹⁹ and granting exemptions from that Act and the Financial Reporting Act 1993,²²⁰ in approving firms to act as independent actuarial auditors,²²¹ in approving and monitoring policyholder agents²²² and in providing information on internet offers of life insurance from offshore entities;²²³
- by the Securities Commission or another agency in reviewing the Securities Act 1978 prospectus regime;²²⁴
- by the ASRB in developing and approving actuarial standards and revising accounting standards as may be necessary;²²⁵
- by the Registrar of Companies in administering the expanded Financial Reporting Act 1993;²²⁶ and
- by other government agencies in administering the rating requirement for life insurers,²²⁷ in promoting and supporting independent life insurance analysts to become well established,²²⁸ in facilitating internet publication of a table of insurer financial strength ratings²²⁹ and in arranging for ongoing public education in relation to life insurance.²³⁰

Central regulator

- 11.26 An alternative approach to a policyholder agent or government monitor would be for the Government to establish a central regulator that would administer a detailed and extensive set of powers and rules, including licensing, minimum capital requirements, and requirements to approve certain insurer activities. This approach is followed in Australia by APRA.²³¹
- 11.27 We comment on some of the powers and mechanisms used under this central regulator approach in appendices A and B.

²¹⁹ Recommendation R3.

²²⁰ Recommendations R2, R6, R20, R27, R44, R48, R49, R50, R51 and R54.

²²¹ Recommendation R21.

²²² Recommendation R29.

²²³ Recommendation R55.

²²⁴ Recommendation R7.

²²⁵ Recommendations R17–R19.

²²⁶ Recommendation R16.

²²⁷ Insurance rating information is currently administered by the Insurance and Superannuation Unit of the Ministry of Economic Development in respect of general and disaster insurers, and other insurers electing to be rated under the Insurance Companies (Ratings and Inspection) Act 1994.

²²⁸ Recommendation R37.

²²⁹ Recommendation R38.

²³⁰ Recommendation R39.

²³¹ Australia also has ASIC, which administers the disclosure requirements. There is no equivalent of APRA in New Zealand. In relation to the regulation of banks, the Reserve Bank of New Zealand is charged with monitoring and supervising registered banks for the purposes of promoting the soundness and efficiency of the financial system. Banking supervision is based on disclosure and market discipline, employing limited prudential requirements, with no active on-site role for supervisors. From International Monetary Fund *New Zealand – Financial System Stability Assessment* (Washington, DC, 2004) available at <www.imf.org> (last accessed 28 October 2004).

11.28 The question of whether New Zealand should move to a central regulator approach raises broader questions, in particular:

- The nature of the policy objective – is it to prevent insurers failing, or to facilitate an efficient market (which may involve intermittent insurer failure) based on effective competition and consumer pressures?
- If it is the former, whether close supervision by a government agency with wide powers is likely to be effective in achieving the objective of avoiding insurer failure.
- If so, whether the economic benefits are likely to outweigh the economic costs.

11.29 It is easy to over-estimate the capacity of a central regulator to deliver on stated objectives. In its submission on our discussion paper, the Institute of Chartered Accountants of New Zealand (ICANZ) noted a study undertaken by the International Monetary Fund (IMF)²³² that reviewed financial failures across most of the IMF member countries (133 countries, from 181 members) in the period 1980–1996. The study showed that in countries with powerful central regulators, key financial institutions still failed. The HIH Insurance Group collapse in Australia is an example.

11.30 It is clearly not possible to reduce to zero the risk of a life insurer failing. Nor is it sensible to seek to do so. The process of exiting a failing insurer in a timely manner and allowing for an efficient reallocation of resources is an essential part of a well-functioning market and achieving optimal economic growth.

11.31 The main benefits of a central regulator as compared with our recommended method of more limited prudential supervision by a policyholder agent may be:

- possibly reducing the risk of some insurers failing through increased regulatory intervention;
- for a period, an enhanced perception of increased safety among consumers and therefore a higher level of participation in the market;
- possibly a perception of fairer treatment of policyholders by insurers because of increased regulatory intervention and therefore a higher level of participation in the market; and
- an enhanced standing of the New Zealand life insurance market with overseas regulators (for providing in New Zealand increased consistency with their regulatory arrangements).²³³

11.32 The main costs of a central regulator approach as compared with our recommended method of more limited supervision by a policyholder agent include:

- adverse impacts on allocative, productive and dynamic efficiency,²³⁴ in particular, significantly weakened incentives for product providers to innovate over time;

²³² C Lindgren, G Garcia, and MI Saal *Bank Soundness and Macro-economic Policy* (International Monetary Fund, Washington, DC, 1996).

²³³ This is not strictly an economic benefit, however, it is a factor raised by a range of interested parties.

²³⁴ As defined in footnote 166 above.

- an incremental expansion of regulation over time, as the regulator seeks to fill in perceived gaps, correct defects in existing regulation and respond to new situations;
- moral hazard problems as consumers and the industry become more complacent in managing risks, perceiving that the regulator will take care of the risks, and increased risk of an implicit government guarantee of insurer performance;
- higher compliance costs for market participants in meeting regulatory requirements;
- “gaming” the regulator by exploiting inevitable information asymmetries. This can result in the regulated entities “capturing” the regulator (to varying degrees), which can, among other things, reduce competition if the regulator imposes barriers to new entry and higher costs, making it harder for smaller firms to compete; and
- a reduction in the competitiveness of New Zealand life insurers²³⁵ relative to foreign insurers.

11.33 The costs of reduced economic efficiency, increased moral hazard, “regulator capture”, “regulatory creep” and reduced competitiveness tend to be less visible than the bare costs of compliance and administration, but they are generally more significant over time.²³⁶

11.34 In our view, it is not necessary to adopt a central regulator approach in the New Zealand life insurance market. On balance, we consider the costs are likely to outweigh the benefits significantly.²³⁷

Conclusion

11.35 In chapter 2 (paragraph 2.23) of our discussion paper, we noted that 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 regulation.

11.36 We consider the net benefits of our proposals are likely to exceed the net costs in a reasonably optimal fashion. We have been careful to structure our proposals flexibly so that exemptions will be available from key requirements where insurers can demonstrate equivalent compliance. This will minimise unnecessary regulation and compliance costs and will target those insurers requiring an upgrade of regulatory standards.

²³⁵ Particularly for those not carrying on business in Australia, which do not currently have to meet APRA requirements.

²³⁶ A study by JR Franks, SM Schaefer and MD Staunton “The Direct and Compliance Costs of Financial Regulation” (1998) 21 *Journal of Banking & Finance* 1547–1572 estimates that the indirect costs of regulation (of major sectors of the UK financial services industry) are around four times the direct costs.

²³⁷ This is based on a qualitative assessment. Quantitative values could be modelled, making broad assumptions about likely impacts on the behaviour and incentives of market participants. However, that analysis is beyond the scope and resources of this project. It also tends to be highly sensitive to changes in assumptions.

Application to non-life insurance

Introduction

- 12.1 **T**HE TERMS OF REFERENCE require us 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.
- 12.2 In the regime we propose for life insurance, we advocate the use and expansion of existing regulatory instruments (Companies Act 1993, Securities Act 1978, Financial Reporting Act 1993). In particular, we recommend the extension of the Securities Act 1978 and Financial Reporting Act 1993 to risk only policies. Issues peculiar to insurance, such as the actuarial aspects and the interests of policyholders, are addressed by expanding the existing regulatory regime, such as the creation of the roles of policyholder agent (or government monitor) and audit actuary.
- 12.3 The regulatory regime proposed for life insurance emphasises:
- that it applies only to life policies offered to the public;
 - consistent requirements for life insurers in the areas of corporate governance, amalgamations and liquidations, by requiring insurers to incorporate under the Companies Act 1993 (exemptions to be available where insurers are subject to comparable requirements under foreign or other New Zealand law);
 - disclosure of product and corporate information under the Securities Act 1978 by life insurers not already subject to that regime;
 - disclosure of financial information in accordance with the maximum requirements of the Financial Reporting Act 1993 by life insurers not already subject to it or subject to lesser requirements of that regime;
 - the need for improvements to auditing and actuarial requirements;
 - until independent, comparative analytical information on life insurers is available and easily accessible to the public in New Zealand, the desirability of a financial strength rating from an independent rating agency; and
 - strengthening of policyholder rights by the introduction of the role of the policyholder agent to act on behalf of policyholders to monitor the financial disclosures made by the life insurer and to exercise powers of enforcement against the life insurer if required or by giving monitoring powers to a government monitor.²³⁸

²³⁸ Note that the prudential supervisor we envisage, while it could potentially be a government entity, is not a central regulator. Its role is a narrowly defined one, see para 6.4.

None of the components of this regulatory regime is tailored exclusively for life insurance, but together they comprise a regulatory package designed to enable policyholders to identify and deal with issues and problems that may arise in relation to their life insurer or life policy.

- 12.4 The implication of this generic approach to the regulation of life insurers and life insurance products is that if the framework is implemented and regulatory standards are upgraded for life insurance, comparisons with non-life insurance will likely be drawn and the adequacy of regulation of non-life insurance will come under scrutiny. The questions are:
- Do the same sorts of issues and problems exist in the non-life insurance market (or different problems and issues) that indicate that the framework is also needed in that context?
 - If so, could the framework be readily implemented for non-life insurance?
- 12.5 In this chapter we suggest that the proposed regulatory regime for life insurance could be extended to non-life insurance that is offered to the public.²³⁹ Suggestions we make in this chapter are not firm recommendations. This topic requires its own thorough review and an opportunity for market participants to consider specific proposals and make detailed submissions. Nevertheless, we believe that many of the issues considered in relation to life insurance also arise in the context of non-life insurance and that the major tenets of the proposed regulatory model are relevant to non-life insurance.
- 12.6 We have not recommended that any special regulatory measures be imposed on reinsurers of life insurance companies other than the usual requirements for overseas companies carrying on business in New Zealand, although we recommend that these companies and New Zealand reinsurers register audited and actuarially audited financial statements under the Financial Reporting Act 1993 (unless exempted in relation to the actuarial audit by the Securities Commission).²⁴⁰ Given that reinsurance arrangements are a key issue in assessing insurer solvency, our focus on reinsurance has centred on appropriate disclosure of reinsurance arrangements by the life insurer. Similarly, we expect that direct regulation of non-life reinsurers would not be needed, as long as financial standards require sufficient disclosure of reinsurance arrangements by the insurer to enable assessment of the reinsurance risk to which the insurer is exposed by the prudential supervisor, analysts and other readers of the financial statements.
- 12.7 It was submitted to us that reform of the life insurance industry should include examination of the superannuation industry. Ideally, superannuation would also be brought under the same regulatory framework. However, we have concluded that while there are issues common to life insurance and

²³⁹ We are primarily concerned with personal insurance and so limit our comments to those types of non-life insurance specifically mentioned in this chapter. Our comments are not intended to apply to commercial insurance such as aviation or marine insurance. In the context of general insurance, which includes both personal and commercial insurance, we do not draw a firm line delineating which policy types should be subject to the proposed regime and note that analysis would need to be undertaken to determine its precise parameters in relation to general insurance.

²⁴⁰ We received submissions expressing concern that increased regulation of reinsurance may create a disincentive to reinsurers offering reinsurance in New Zealand that could be problematic for the insurance market. Further, our area of concern has been the regulation of insurance offered to members of the public. See chapter 9 for discussion of reinsurance in relation to life insurance.

superannuation, the regulation of superannuation schemes is significantly different, involving many additional issues, including government policy and tax issues, which takes superannuation outside the practical scope of this review.

THE ISSUES

12.8 Given the terms of reference for this report, we have not conducted a thorough review of the range of issues relating to non-life insurance. However, we anticipate that a review would highlight many of the issues that have been raised in relation to life insurance, namely:

- a lack of policyholder understanding of policy terms and mechanics and policyholder obligations;²⁴¹
- a lack of market information as a result of:
 - a lack of rigour and consistency in relation to product and financial disclosures (including solvency disclosures) by insurers to the market; and
 - an absence of independent comparative analysis of insurers that is easily accessible to the public;
- a lack of practical policyholder enforcement powers against a financially troubled insurer.

12.9 If the same problem areas exist in non-life insurance markets, components of our regulatory regime for life insurance may be beneficial to the interests of non-life policyholders and the public.

12.10 We have considered three areas of non-life insurance that may benefit from the application of our proposed regulatory regime:

- quasi-life insurance such as disability, income protection and trauma insurance;
- health insurance; and
- general insurance.

Quasi-life insurance

12.11 Policies such as disability, income protection and trauma/critical illness currently fall outside the current regulatory regime for life insurance.

12.12 These policies effectively represent the development of the life insurance product to meet a demand for specific and tailored personal financial insurance. But the statutory definition of life insurance, which acts as a threshold trigger to the regulatory regime for life insurance, has not changed to encompass product development in this area.

12.13 These policies are generally (but not exclusively) written by life insurers. There are common characteristics between policies in this category and life insurance, including:

²⁴¹ Especially in relation to the policyholder's duty of disclosure.

- their long-term nature (renewal generally at the obligation of the insurer and at the discretion of the policyholder);²⁴²
- the personal risk covered falls in the same general category as the risk insured by life insurance;
- policyholder interests in understanding the product they have purchased, in monitoring the financial health and solvency of their insurer, and in being able to enforce their rights against their insurer should the need arise, coincide with the interests of life insurance policyholders.

12.14 The OECD *Glossary of Insurance Policy Terms*²⁴³ includes two definitions of life insurance. The narrower definition is comparable with the statutory definition in the Insurance Companies (Ratings and Inspections) Act 1994 where payment is contingent on whether the life insured is dead (or alive).²⁴⁴ But in a broader sense, life insurance is described as extending to “any form of insurance whose payment is contingent on the insured’s health”. In this broad sense, life insurance includes insurance that pays benefits on a person’s:

- death;
- living a certain period (endowments, annuities and pensions);
- disability; and
- injury or incurring a disease (health insurance).

12.15 The issue is: has the line delineating whether a product is life insurance or non-life insurance become too arbitrary? Submitters were generally agreed that long-term policies such as disability, income protection and trauma insurance should be treated for regulatory purposes in a similar fashion to life insurance.

12.16 We note that, in effect, disability insurance, income protection insurance and trauma insurance have been included in the Australian life insurance regime, subject to certain qualifications.²⁴⁵

12.17 We consider that a regulatory alignment of the long-term policies in this category with life insurance would be logical, straightforward and we anticipate would be largely non-contentious. We suggest that further consideration be given to treating these products as “life insurance” for regulatory purposes.²⁴⁶

²⁴² Although some policies are annually renewable and cancellable by the insurer and are therefore “short-term” policies.

²⁴³ Organisation for Economic Co-operation and Development (Paris, 1999) 41.

²⁴⁴ This definition does not include disability, income protection or trauma/critical illness policies unless there is also a life insurance component. See further above n 2.

²⁴⁵ Paragraph 17.29 of the discussion paper.

²⁴⁶ The definition of “continuous disability policy” in s 9A of the Life Act 1995 (Aust) may be a useful starting point. A “continuous disability policy” is one type of policy that is treated as a “life policy” for purposes of s 9 of that Act.

The Insurance Contracts Bill uses definitions of “life insurance” and “continuous disability insurance contract” from the Insurance Companies (Ratings and Inspections) Act 1994. The definition of “continuous disability insurance contract” is limited to contracts of insurance providing a benefit on death by accident or other specified cause or injury or disability as the result of accident or sickness, where the contract forms part of a life policy and is for a term of not less than a year. Stand-alone income protection or disability policies without the life insurance component do not fall within the current definition of “continuous disability insurance contract”.

- 12.18 The practical implication of treating these policies as life insurance for regulatory purposes is that all statutory provisions specific to life insurance would extend to these “quasi-life” policies, for example, statutory provisions relating to the legal transfer²⁴⁷ and mortgage²⁴⁸ of life policies.²⁴⁹
- 12.19 In addition, the following clauses of the Insurance Contracts Bill would extend to “quasi-life” policies if the definition of “life insurance” is broadened:
- clauses 10 to 13 (mis-statements in relation to life policies);²⁵⁰
 - clauses 23 and 24 (insurable interest not required for life policies);
 - clauses 44 to 46 (provisions relating to the payment of interest on life insurance money);
 - clauses 70 to 78 (registration of ownership of life policy acquired by bankruptcy or under will, intestacy, or writ of execution);
 - clauses 81 to 96 (life insurance of minors);²⁵¹ and
 - clauses 97 to 102 (creation of trust by life insured).
- 12.20 Otherwise, we do not anticipate that the implications of treating these policies as life insurance for regulatory purposes would be significant for life insurers. For non-life insurers writing these policies, it may be appropriate to provide a lead-in period before compliance with life insurance regulation is required.²⁵²

Health insurance

- 12.21 Health insurance shares some characteristics with life insurance (personal health risk covered) and with general insurance (annual renewable policies with potentially multiple claims). How does health insurance compare with life insurance?
- As with life insurance, policyholders are effectively “locked into” their health policies. As people age, there is an increased likelihood that they will develop medical conditions that their existing health insurer will continue to cover but which another health insurer will be unlikely to cover on the same terms. For this reason, people do not have the same freedom to change their health insurers as they may have with other types of insurance cover.²⁵³

²⁴⁷ Section 43 of the Life Insurance Act 1908, see also Insurance Contracts Bill cls 47–54.

²⁴⁸ Sections 44–51, 53 of the Life Insurance Act 1908, see also Insurance Contracts Bill cls 55–69.

²⁴⁹ The extension of these provisions to “quasi-life” policies would clarify the current uncertainty about how the provisions apply to “bundled” policies (that is, whether the statutory provisions apply in respect of the whole policy or just to the life component).

²⁵⁰ If defined as “life insurance”, the “quasi-life” policies would no longer fall under cl 9 (mis-statements in general contracts of insurance). Instead, the stricter cl 10 would apply, as well as the prohibition in cl 12 on an insurer avoiding a life policy for mis-statement of the age of the life insured.

²⁵¹ Consideration would need to be given to the appropriate limitations for “quasi-life” policies where the life insured is under the age of ten for purposes of cl 87 of the Insurance Contracts Bill or under the age of 16 for purposes of cl 88 of the Insurance Contracts Bill.

²⁵² If the same regime is to be considered for general insurance, as we suggest, then it may make sense for changes to the regime affecting non-life insurers to be coordinated.

²⁵³ Health Funds Association of New Zealand Inc *The Need for Self Regulation: The New Zealand Health Insurance Industry* (Wellington, February 2001) 7.

- Unlike life insurance, diversification is not an option in health insurance. Health insurance in practice cannot be split between insurers.
- Claims under health insurance policies are for medical and hospital expenses and are generally smaller than under life insurance policies, although claims in aggregate over the term of a health policy may be significant.
- The New Zealand health insurance market is made up of one major health insurer (Southern Cross Healthcare) and a mix of small not-for-profit and corporate niche health insurers.

12.22 As highlighted in the discussion paper, the health insurance industry in New Zealand is largely unregulated in comparison with other jurisdictions. There is currently no dedicated regulatory regime for health insurance. Current regulation of health insurers includes:

- the statute governing the health insurer;²⁵⁴
- the Insurance Companies' Deposits Act 1953 that requires health insurers to lodge a deposit with the Public Trust;
- the potential application of the inspection provisions of the Corporations (Investigation and Management) Act 1989 and the Insurance Companies (Ratings and Inspections) Act 1994;²⁵⁵
- consumer legislation such as the Fair Trading Act 1986 and the Consumer Guarantees Act 1993;
- voluntary industry standards under the Health Funds Association of New Zealand Inc (HFANZ).

12.23 Following a review of the Insurance Companies (Ratings and Inspections) Act 1994 and Insurance Companies' Deposits Act 1953 by the Ministry for Economic Development, the Government has proposed some changes to the regime for non-life insurance, including health insurers.²⁵⁶

12.24 The regulation of health insurance currently falls between two stools, being outside the life insurance regime and outside the ratings regime for disaster and general insurance. We consider the lack of consistent standard regulatory requirements for health insurers to be of concern. Issues of disclosure, corporate governance and solvency are as important to health insurers as they are to life insurers, and consistent regulatory standards in these areas should be applied to health insurers. The implications of the failure of a health insurer are likely to be financially significant to its policyholders.

12.25 The industry itself is aware of the inadequacies of the current regulatory regime as it applies to health insurance and is taking steps towards self-regulation. The Health Funds Association of New Zealand Inc and NZSA are close to completing a health insurance solvency standard similar to that of the Australian Private Health Insurance Administration Council. The solvency standard is likely to be adopted by the HFANZ with a requirement that members comply with the

²⁵⁴ Companies Act 1993, Friendly Societies and Credit Unions Act 1982, Industrial and Provident Societies Act 1908 or Incorporated Societies Act 1908.

²⁵⁵ The ratings requirements of the Insurance Companies (Ratings and Inspections) Act 1994 are not compulsory for health insurers. Section 9 allows health insurers to elect not to be rated.

²⁵⁶ As summarised in para 17.13 of the discussion paper. See also para 17.19 of the discussion paper.

standard. This is a useful step in the absence of mandatory regulation. However, the longer-term aim should be to bring health insurance within the same regulatory umbrella as life insurance.

General insurance

12.26 “General insurance” covers both personal and commercial property and liability insurance.²⁵⁷ As well as providing personal property insurance to families and individuals, general insurers provide the insurance cover necessary to facilitate commercial activity, such as insurance cover for commercial property, businesses, livestock, agriculture and horticulture, as well as public and product liability insurance, directors’ and officers’ liability insurance, and professional indemnity insurance. General insurers provide disaster cover against flood and earthquake and other natural disasters under which the occurrence of one event may give rise to a multitude of claims against insurers.²⁵⁸

12.27 Unlike life insurance, general insurance is usually short term (12 months). Policies generally insure multiple risks and events against the risk of partial or total loss. The policyholder keeps some of the risk (through paying an excess and any loss over the policy limit).

12.28 The short-term nature of the policy means that policyholders are not “locked into” their policies in the same way that policyholders of life insurance are. For most types of cover, it is relatively straightforward for the policyholder to change insurer and to obtain alternative insurance with another insurer on similar terms. But it is more difficult in the general insurance market than in the life insurance market for policyholders to diversify their risk by insuring different portions of risk with different insurers, unless the property to be insured is very large.

12.29 The regulatory regime to which general insurers are currently subject is summarised in chapter 17 of the discussion paper. Briefly, the regime comprises the following:

- financial strength rating under the Insurance Companies (Ratings and Inspections) Act 1994;
- deposit under the Insurance Companies’ Deposits Act 1953;
- compliance with New Zealand company law²⁵⁹ and the Financial Reporting Act 1993;²⁶⁰
- potential inspection under the Insurance Companies (Ratings and Inspections) Act 1994 and the Corporations (Investigation and Management) Act 1989;

²⁵⁷ We note that insurance for death by accident can be covered by a general insurance policy such as motor vehicle insurance. This does not convert the policy into a life insurance policy.

²⁵⁸ The Earthquake Commission Act 1993 provides limited insurance cover against earthquakes and other natural disasters in respect of residential buildings, personal belongings and the land the buildings are on: *Laws of New Zealand*, Insurance, para 584. Otherwise cover against these risks is provided by private insurers.

²⁵⁹ The Companies Act 1993 or the Co-operative Companies Act 1996 for corporate insurers (or the relevant governing statute for insurers not covered by the Companies Act 1993, for example, the Mutual Insurance Act 1955).

²⁶⁰ General insurers that are not publicly listed companies are not currently “issuers” under the Financial Reporting Act 1993 and so are not required to register their financial statements or have them audited under that Act.

- compliance with New Zealand consumer law;²⁶¹
- voluntary compliance with the Insurance Council of New Zealand (ICNZ) Fair Insurance Code including the ICNZ's solvency ratio and participation in the Insurance and Savings Ombudsman Scheme (for ICNZ members).

12.30 The nub of the regulatory regime for general insurers is the rating requirement and the deposit requirement (although the deposit requirement is generally regarded as inadequate). The rating requirement was introduced following the reduction of earthquake insurance provided by the Earthquake and War Damage Commission for commercial property (and the increase in this cover provided by private insurers) in accordance with the recommendations of the Brash/McLean Report.²⁶²

12.31 The philosophy behind the recommendations made in that report was acknowledged to be similar to that lying behind the Securities Act 1978, namely that the Government does not guarantee the safety of investments made by private citizens, but does insist that investors be well informed. The justification for ratings in the general insurance context was that something considerably more than ordinary "Securities Act" disclosure is required, as the contingent nature of the liabilities of a general insurer reduces the usefulness of the financial information disclosed. It was felt that the mandatory rating requirement would fill this information gap.

12.32 Following a review of the Insurance Companies (Ratings and Inspections) Act 1994 and Insurance Companies' Deposits Act 1953 by the Ministry for Economic Development, the Government has proposed some changes to the regime for general insurers including the retention of the rating requirement and the removal of the deposit requirement.²⁶³

12.33 We received submissions from general insurers that short-term insurance does not require the same level of regulation as life insurance. We also received submissions that the current regime for general insurers is not effective and requires review,²⁶⁴ although submitters generally felt that the regulatory regime for general insurance should be lighter than that imposed on life and other long-term insurance.

²⁶¹ Including the Fair Trading Act 1986, the Consumer Guarantees Act 1993 and the Commerce Act 1986.

²⁶² DT Brash and I MacLean *A Prudential Regime for Insurance Companies* (Office of the Minister of Justice, Wellington, 1993). The report considered several possible mechanisms for the regulation and prudential supervision of general insurance companies but did not favour a prudential regime such as a supervisory body because this could encourage public expectation of government support for financially troubled insurers. Instead, the report endorsed the rating mechanism as providing much better information to consumers and reducing the Government's role in the supervisory process.

A precedent for prudential supervision in the general insurance area, as noted in para 3.37 of the discussion paper, was the Accident Insurance Act 1998 (repealed 1 April 2002) that provided for a system of prudential supervision of insurers providing personal injury cover.

²⁶³ As summarised in para 17.13 of the discussion paper.

²⁶⁴ It was submitted to us that key areas where further regulation would be beneficial would be in:

- regular and prompt financial reporting;
- solvency reporting;
- more detailed rating disclosures;
- reinsurance analysis and rating.

- 12.34 We note that general insurance covers a wide range of products from the relatively minor to the highly significant. At the top end, general insurance covers major assets including homes, businesses and livelihoods (in the form of professional indemnity cover). The protection of these assets could be as financially significant for policyholders as life insurance or even more so in certain circumstances.
- 12.35 We believe the proposals relating to life insurance warrant consideration with regard to their application to general insurers given the potentially serious consequences should a general insurer fail. Members of the public and the business community are dependent on the underlying solvency and financial robustness of general insurers. The industry's financial soundness is important not only for the protection of individuals but also for stability and confidence in the wider economy.²⁶⁵
- 12.36 We do not accept that the short-term nature of general insurance justifies a different approach from long-term insurance. The short-term nature of New Zealand general insurance means that the contingent liability of insurers to meet potential claims generally does not extend beyond the short term. Thus, it is argued that adequacy of reserving is not such a critical issue for short-term insurers that are less vulnerable to under-reserving (failing to provide adequately for future claims) than long-term insurers.
- 12.37 Nevertheless, many general insurance policies have a material long-tail component, for example, public liability policies, where an event occurring within the term of the policy may not be notified to the insurer until damage or liability actually arises, which in some cases may be outside the term of the insurance policy.²⁶⁶
- 12.38 In addition, even short-term liabilities, that are contingent on some unpredictable happening, require adequate reserving.²⁶⁷ Further, an accurate actuarial assessment of expected claims and expenses is crucial to the solvency of general insurers.
- 12.39 Policyholders require similar disclosures from general insurers in order to be in a position to make informed decisions about their general insurance, most importantly whether their general insurer is likely to be able to pay any claim and whether they should renew their policy with the same insurer.
- 12.40 We do not accept that our proposed regime for life insurance would be overly onerous if extended to general insurers. A more heavy-handed prescriptive

²⁶⁵ Prudential Reform of Australian General Insurance, APRA website: <www.apra.gov.au> (last accessed 28 October 2004). The *Australian Royal Commission on the Failure of HIH Insurance* report, April 2003, details individual cases of personal hardship experienced from the collapse of the general insurer as well as significant consequences for the public <www.hihroyalcom.gov.au/final-report> (last accessed 28 October 2004).

²⁶⁶ In other jurisdictions, such as Australia, the bulk of long-tail risks concern personal injury, for example, arising from asbestosis and toxic mould. In New Zealand, the existence of the statutory no-fault accident compensation scheme has resulted in a much smaller personal accident insurance market, although there is still a demand for personal insurance: *Laws of New Zealand*, Insurance, para 451. Specific examples of long-tail risks in New Zealand include public liability insurance and employer's liability insurance.

²⁶⁷ The Australian Royal Commission on the failure of HIH Insurance, above n 265, concluded that as a result of mismanagement, under-reserving was the primary reason for the HIH Insurance Group failing and not only failing but doing so in such an egregious way.

approach to the regulation of life insurance may not have been entirely appropriate for short-term insurance. The regime we propose for life insurance continues a trend in New Zealand in favour of a relatively light-handed pragmatic approach and is a suitable option to consider for non-life insurance.

EXTENSION OF LIFE INSURANCE REGIME TO NON-LIFE INSURANCE

12.41 We consider that the current regulatory framework for non-life insurance requires attention and that the regulatory regime proposed for life insurance provides a useful template that could readily be extended to non-life insurance.

12.42 We comment below on the suggested extension of our proposed regime to non-life insurance in the following areas:

- product and corporate disclosures under the Securities Act 1978;
- financial disclosures and related issues:
 - financial strength rating from an approved rating agency;
 - application of the Financial Reporting Act 1993 to non-life insurers as “top-tier” reporting entities under appropriate financial reporting standards;
 - independent actuarial audit;
- appointment of a policyholder agent to monitor the financial health of the insurer and to take action on behalf of policyholders as required, or monitoring by a government monitor;
- mandatory incorporation under the Companies Act 1993, subject to the operation of an exemption regime;²⁶⁸
- application of the regime to non-life overseas insurers.

Product and corporate disclosure under the Securities Act 1978

12.43 Chapter 4 describes how the Securities Act 1978 disclosure regime applies already to life policies that are savings policies and could be extended to cover risk only life policies, on the basis that risk only life policies have a similar economic function.

12.44 We suggest that consideration be given to extending the Securities Act 1978 disclosure regime to non-life insurance products as well as risk only life policies. Non-life insurance also has an economic function of spreading risk with a view to mitigating possible losses of financial resources. Application of the Securities Act 1978 to non-life insurance would provide an appropriate baseline disclosure standard for non-life insurance.

12.45 In suggesting the Securities Act 1978 as the appropriate vehicle for product and corporate disclosures, we consider that the principles underlying that Act are broad enough to encompass the extension of the Act’s operation to non-life insurance products. The technical provisions of the Securities Act 1978 would require amendment for its operation to extend to non-life insurance.

²⁶⁸ We recommend that exemptions would be available where standards equivalent to or better than those set by the Companies Act 1993 in key areas apply to the insurer (whether under foreign or New Zealand law), see suggested criteria in para 3.12.

12.46 One important technical issue is how the concept of “offerings to the public” (that triggers application of the Securities Act 1978 in the case of offerings of securities) would apply in the context of non-life insurance.²⁶⁹ Section 3(2) of the Securities Act 1978 provides guidance by excluding certain categories of person as members of the public for this purpose. The provision is currently oriented towards investors and would need to be adapted to policyholders.

12.47 The main consequences of bringing non-life insurance within the ambit of the Securities Act 1978 would include:

- The application of product disclosure and prospectus requirements.
- As an “issuer” under the Securities Act 1978, an insurer would be subject to the full requirements of the Financial Reporting Act 1993 (discussed below in relation to financial reporting).²⁷⁰
- The application of sanctions to insurers issuing insurance policies where requirements of the Securities Act 1978 are not complied with.²⁷¹
- Civil and criminal liability on directors²⁷² of insurers who fail to comply with requirements of the Securities Act 1978. Promoters and experts are also potentially liable for breaches.²⁷³
- Requirements as to the keeping of accounting records.²⁷⁴
- The keeping of a securities (policies) register that must be audited annually.²⁷⁵

12.48 If applied to non-life insurers, key Securities Act 1978 requirements should include the following:²⁷⁶

- the product disclosure provisions²⁷⁷ (we recommend in chapter 4 that in the insurance context the investment statement would be renamed the “product disclosure statement”);²⁷⁸

²⁶⁹ This issue is not significant for life insurance where policyholders can generally be regarded as consumers within the ambit of the Securities Act 1978, although some group life policies may be excepted (see above n 28). But non-life insurance covers both personal insurance and commercial insurance and so not all policyholders will necessarily require the protections afforded by the Securities Act 1978.

²⁷⁰ Financial Reporting Act 1993, s 4(1)(a).

²⁷¹ Securities Act 1978, ss 55–65.

²⁷² “Director” is defined in s 2(1) of the Securities Act 1978 to include any person occupying a position in a body corporate or unincorporate, that is comparable with that of a director of a company.

²⁷³ Securities Act 1978, s 56(1)(d), s 59(1)(c) in relation to promoters and s 57 in relation to experts. Insurance brokers may need to consider their potential liability as “promoters”, and actuaries may need to consider their potential liability as “experts”.

²⁷⁴ Securities Act 1978, ss 53–53F.

²⁷⁵ Securities Act 1978, s 51.

²⁷⁶ Refer to chapter 4 for a fuller discussion of these provisions.

²⁷⁷ Securities Act 1978, ss 38C–38F.

²⁷⁸ Concern was expressed in submissions that additional disclosure requirements may be counterproductive if voluminous paperwork has to be sent to policyholders. We agree that disclosure needs to be clear and concise in order to be meaningful for policyholders. Rather than necessitating voluminous paperwork or prescribing a standard form of disclosure, we expect that product disclosure requirements would provide a checklist of matters to be included in existing policyholder materials. As noted in chapter 4, the product disclosure statement could be set out within the policy document as an alternative to producing a stand-alone document.

- the prospectus regime or its replacement;²⁷⁹
 - the advertising provisions;²⁸⁰
 - the request disclosure provisions;²⁸¹
 - once implemented, periodic disclosure,²⁸² to require that, on an annual basis, policyholders receive:
 - notice of any change in the rating of the insurer since the last such notice;
 - information to help the policyholder monitor his or her policy, such as information for both the last year and the next year in relation to:
 - (a) the right to make request disclosure;
 - (b) the amount of premiums paid or payable; and
 - (c) fees and charges deducted or deductible;
- subject to an appropriate exemption regime;
- for new insurers, disclosure documents should include forecast financial statements for the first year of operation, audited by an auditor and an audit actuary;
 - a material adverse change in an insurer’s solvency position should be notified to the prudential supervisor as soon as the insurer is aware, or should reasonably be aware, of the change; and the prudential supervisor should be empowered to require the insurer to notify all policyholders of the change.

Measures in relation to financial disclosures and related issues

Financial strength rating

12.49 General insurers are currently required by the Insurance Companies (Ratings and Inspections) Act 1994 to obtain a rating from an approved rating agency. A recent review of that Act has resulted in government proposals to require all insurers, other than captive and life insurers, to obtain a rating.

12.50 In the absence of an active analyst market covering insurance, we see ratings as having a valuable role in informing the market of the comparative financial strength of insurers.²⁸³ The rating should be from an approved credit rating

²⁷⁹ Securities Act 1978, ss 39–44, Securities Regulations 1983, Part 1. As noted in chapter 4, the prospectus regime is due for review. We expect that this review would need to be carried out before the regime could be applied to non-life insurance. The Securities Commission noted in its submission that the disclosure provisions of the Securities Act 1978 may not be ideal for short-term risk policies. It would be desirable for the review of the prospectus regime to anticipate the potential extension of the regime to non-life insurance.

²⁸⁰ Securities Act 1978, ss 38–38B, Securities Regulations 1983, Part 2.

²⁸¹ Securities Act 1978, s 54B, Securities Regulations 1983, reg 23A. Refer to para 4.28 for information to be disclosed by issuers upon request.

²⁸² Securities Act 1978, s 54A. We expect that an exemption regime for renewals and variations would be available, similar to that currently provided by the Securities Act (Renewals and Variations) Exemption Notice 2002, but that insurers would be required to make periodic disclosure.

²⁸³ In chapter 7 we recommend that life insurers be required to have a financial strength rating from an approved rating agency.

agency and not more than 12 months old. The insurer should be required to publish the rating in its product disclosure statement under the Securities Act 1978 and on its website.²⁸⁴ Any negative change in the rating should also be published by these means and be notified to the prudential supervisor.²⁸⁵

12.51 The Government's proposed extension of the ratings regime from general insurers to health and other non-life insurers is discussed in the discussion paper,²⁸⁶ including the opposition to this proposal from the health insurance industry. In paragraph 7.31 of this report we note the main concerns highlighted in submissions to the extension of the mandatory ratings regime to life and health insurers. Smaller niche health insurers are particularly concerned with the proposal because they feel that the ratings method will unfairly penalise them based on their size and small market share. The Health Funds Association of New Zealand Inc advocates a separate health insurance industry ratings model to address some of the main concerns about mandatory ratings.

12.52 Public information (pi) ratings²⁸⁷ are an alternative to full interactive ratings that can be assigned at the discretion of the ratings agency to assist brokers or other interested third parties where there may be a gap in market information.²⁸⁸ This may be an avenue that could be pursued with the ratings agencies to establish the new ratings regime for health insurers.

12.53 We consider that the disadvantages to insurers in obtaining a rating are outweighed by the interests of consumers. While ratings offer no guarantee of insurer soundness, they help to rectify partially the information asymmetry between insurance buyers (who are often not well informed about insurers' financial condition) and sellers (who know their own true financial condition but might tend to minimise any adverse information).²⁸⁹ Comment has been made elsewhere about the difficulty for consumers in analysing financial information produced by insurers. Ratings provide an alternative source of readily understandable comparative financial information for the consumer market and are necessary for advisers to be able to perform a meaningful role in advising consumers.

²⁸⁴ See our suggestion at para 12.43 and following as to the suggested application of the Securities Act 1978 to general insurers.

²⁸⁵ See para 12.62 and following.

²⁸⁶ See para 17.26 and following of the discussion paper.

²⁸⁷ Standard & Poor's uses two approaches when rating the financial strength of insurers: interactive ratings and "pi" ratings. Interactive ratings are provided by contract between the ratings agency and the insurer for a fee. "Pi" ratings, denoted with a "pi" subscript, are Insurer Financial Strength Ratings allocated by the ratings agency at its discretion for the benefit of the market and are based on an analysis of an insurer's published financial information and additional information in the public domain. They do not reflect in-depth meetings with an insurer's management and are therefore based on less comprehensive information than ratings without a "pi" subscript. "Pi" ratings are reviewed annually based on a new year's financial statements, but may be reviewed on an interim basis if a major event that may affect an insurer's financial security occurs. Ratings with a "pi" subscript are not subject to potential CreditWatch listings. From *Rating Definitions*, Standard & Poor's Insurance Criteria Books.

²⁸⁸ The Standard & Poor's *Australian Health Insurance Report 2004* analyses the largest 14 health insurers in the Australian market and assigns pi ratings to 11 of these insurers that do not have interactive ratings.

²⁸⁹ Organisation for Economic Co-operation and Development, above n 243, 69.

Non-life insurers as “issuers” for purposes of the Financial Reporting Act 1993

- 12.54 We suggest that the Financial Reporting Act 1993 should apply to all non-life insurers to its full extent (preparation, auditing and registration of financial statements).²⁹⁰ It is fundamentally important to policyholders and to the efficient operation of insurance markets that all insurers provide full public disclosure as to their financial state. It is also important that insurers are subject to common disclosure requirements for analysis purposes. The Financial Reporting Act 1993 sets baseline standards for financial disclosure that should apply to insurers across the board.
- 12.55 The Financial Reporting Act 1993 is currently the subject of a review by the Ministry of Economic Development.²⁹¹ Under consideration are the tiers of reporting entity (each tier having differing reporting levels), along with audit and filing requirements, entity neutrality and sector neutrality. We consider that the interests of policyholders necessitate full financial reporting and that all insurers should be fully reporting entities (tier one), regardless of whether the insurer is a company, mutual insurance association, friendly society, industrial and provident society or otherwise, and regardless of the size of the insurer.
- 12.56 Under the Financial Reporting Act 1993, the financial statements of insurers would have to comply with generally accepted accounting principles, including applicable reporting standards, the relevant reporting standard being FRS 35: Financial Reporting of Insurance Activities.²⁹²
- 12.57 The Financial Reporting Standards for non-life insurers would need to be reviewed to ensure that they are up to the task of setting sufficiently high standards of financial disclosure, in particular, sufficient disclosure on solvency matters and reinsurance to enable the audit actuary and the prudential supervisor to have a clear picture of the insurer’s financial state.²⁹³
- 12.58 Several submissions suggested the development of solvency standards for general insurers and that returns should be required under FRS 35.²⁹⁴

²⁹⁰ The suggested extension of the Securities Act 1978 disclosure regime to non-life insurers would make them “issuers” as defined in the Securities Act and the Financial Reporting Act 1993 that would trigger maximum compliance under the Financial Reporting Act 1993. But in the absence of Securities Act 1978 coverage, the Financial Reporting Act 1993 could require full compliance from insurers as a particular class of reporting entity.

²⁹¹ Ministry of Economic Development *Review of the Financial Reporting Act 1993 Part 1: the Financial Reporting Structure*, Discussion Document (Wellington, 2004). A further discussion document is to be released.

²⁹² The ASRB has decided to adopt International Financial Reporting Standards for New Zealand reporting entities for reporting periods commencing on or after 1 January 2007, with the option to adopt earlier from 2005. The Financial Reporting Standards Board of the ICANZ issued discussion papers on International Accounting Standards Board (IASB) Exposure Draft 5 Insurance Contracts (September 2003) and Exposure Draft FRS 35A: Financial Reporting of Insurance Activities (October 2003) with the intention that these will replace the current FRS 35.

²⁹³ Rather than a highly prescriptive regulatory model for insurers, we advocate a model based largely on disclosure as the key tool to promote market transparency and efficiency. This has the advantage of avoiding unnecessary compliance costs and the lack of flexibility that a more prescriptive method of regulation would entail. But regulation based on disclosure requires clear and comprehensive disclosure standards against which reporting is to be made and relies heavily on the quality of disclosures made.

²⁹⁴ Following a review of the Insurance Companies’ Deposits Act 1953 by the Ministry of Economic Development, the Government has proposed that financial reporting obligations under that Act be replaced by an obligation to file annual audited returns under FRS 35.

12.59 In paragraph 5.26, we recommend review of the solvency standard for life insurance (GN5) to ensure that the level of prudential capital requirements for life insurers is appropriate. In chapter 9 (paragraph 9.13), we recommend that this actuarial solvency standard should be reviewed to ascertain whether closer scrutiny of reinsurance arrangements is required. We also recommend that actuarial standards such as GN5 be given increased standing by a formal approval process operated by an augmented Accounting Standards Review Board.²⁹⁵

12.60 As noted, solvency is of critical concern across the insurance market and is not limited to life insurance. We recommend that consideration be given to the development and adoption of formal actuarial solvency standards for non-life insurers that, in particular, require adequate disclosure of reinsurance arrangements.

Audit and actuarial issues

12.61 In chapter 5, we make recommendations in relation to audit and actuarial issues for life insurers, including:

- the independent actuarial audit of the actuarial aspects of financial statements (subject to an exemption regime for overseas insurers); and
- the whistle-blowing responsibilities of auditors and audit actuaries under the Securities Act 1978 (comparable with the responsibilities of auditors of debt and participatory securities).

These requirements could usefully be applied to non-life insurers.

Policyholder agent/government monitor

12.62 The concept of a private sector policyholder agent or government monitor is discussed in chapter 6 in relation to life insurers. The rationale for the creation of either role is to provide policyholders with a mechanism to protect their interests where financial unsoundness of the insurer becomes apparent.

12.63 Whichever option is adopted, we suggest that the role extend to non-life insurers as well as to life insurers.²⁹⁶ The key function would be to assess the insurer's financial information and take further action if issues of financial unsoundness arise. The policyholder agent or government monitor would have powers to request further information from the insurer, to conduct investigations, to monitor and contest amalgamations of insurers²⁹⁷ and transfers of policies between insurers,²⁹⁸ and to apply for voluntary administration²⁹⁹ or liquidation.³⁰⁰

²⁹⁵ See paras 5.17–5.23.

²⁹⁶ This requirement would be subject to an exemption regime for overseas insurers; see para 10.13.

²⁹⁷ See paras 6.20–6.27.

²⁹⁸ See paras 8.69–8.86.

²⁹⁹ If the proposed voluntary administration provisions (currently contained in Part 15A of the Insolvency Law Reform Bill) are not introduced, we recommend in para 6.18 the enactment of a regime similar to judicial management that allows the prudential supervisor and any policyholder to apply to the High Court for appointment of an administrator of a financially troubled life insurer.

³⁰⁰ See also paras 8.87–8.91 relating to the recommended High Court process for changing policy terms and the potential involvement of the prudential supervisor in this process.

Incorporation under the Companies Act 1993

- 12.64 In chapter 3, we recommend that the Securities Act 1978 require life insurers that offer life policies to the New Zealand public, or that remain liable under such policies, to be companies incorporated under the Companies Act 1993, subject to an exemption regime operated by the Securities Commission.³⁰¹
- 12.65 The aim is to ensure that such life insurers are subject to minimum standards of operation in key areas such as directors' duties, prohibited directors, amalgamations, liquidations and (potentially) voluntary administration and, in the case of overseas insurers, that New Zealand policyholders are treated equally with policyholders in the insurer's home jurisdiction.³⁰² The Companies Act 1993 sets benchmark standards in these areas for companies. We have recommended that, as a rule, life insurers should be subject to these standards, either by incorporating under the Companies Act 1993, or by being subject to other foreign or New Zealand legislation or obligations that impose these or better standards.
- 12.66 We consider that these standards are equally necessary for non-life insurers. Many local non-life insurers are incorporated under the Companies Act 1993. But some non-life insurers are, or could in future be, organised as friendly societies, industrial and provident societies, incorporated societies or mutual insurance associations. The provisions of the Companies Act 1993 do not apply to these bodies³⁰³ and where there are comparable provisions, these are generally not as stringent as the Companies Act 1993 requirements. We suggest that consideration be given to imposing the same New Zealand incorporation requirement on non-life insurers, subject to a similar exemption being available, based on certain criteria.³⁰⁴
- 12.67 Submissions received from insurers not covered by the Companies Act 1993 indicated concern about any requirement to incorporate under that Act because of consequential issues that could arise, including a change of structure, non-profit status (if applicable) and tax issues.

³⁰¹ See para 3.9 and following.

³⁰² As noted in the discussion paper, para 6.74, s 116(3) of the Insurance Act 1973 (Aust) provides that in the winding up of an Australian general insurer, its Australian assets may only be applied in discharge of its Australian liabilities (unless it has no Australian liabilities). The predecessor to this section was judicially considered in *New Cap Reinsurance v Faraday Underwriting* [2003] NSWSC 842 Windeyer J (and on appeal in *AssetInsure Pty Limited (formerly Gerling Global Reinsurance Company of Australia Pty Limited) v New Cap Reinsurance Corporation Limited (InLiq) & 3Ors* [2004] NSWCA 225 (6 Oct 2004)) where, on the winding up of a reinsurer based in Australia with no foreign offices, the court found that certain reinsurance contracts issued by the reinsurer to parties offshore gave rise to liabilities in Australia. The operation of this section and its effect on New Zealand policyholders would need to be considered in framing criteria for the availability of an exemption from the incorporation requirement.

³⁰³ Although in some instances, the relevant statute provides for Companies Act 1993 processes to apply, for example, the liquidation provisions of the Act apply to incorporated societies by virtue of s 26(3) of the Incorporated Societies Act 1908, can apply to friendly societies by virtue of s 90(1) of the Friendly Societies and Credit Unions Act 1982, apply to industrial and provident societies by virtue of s 15(a) of the Industrial and Provident Societies Act 1908 and apply to mutual insurance associations by virtue of s 43 of the Mutual Insurance Act 1955. Section 38(2) of the Mutual Insurance Act 1955 provides that ss 196–207 of the Companies Act 1993, that deal with the appointment and function of auditors, apply to mutual insurance associations as if they were companies.

³⁰⁴ As for life insurers, the requirement could be inserted in the Securities Act 1978 and exemptions granted by the Securities Commission.

12.68 These concerns could be addressed by changes to applicable statutes³⁰⁵ as they apply to insurers,³⁰⁶ so that insurers not covered by the Companies Act 1993 would be eligible for an exemption from the requirement to incorporate under the Companies Act 1993.³⁰⁷ This step would preserve the variety of corporate forms currently available to insurers. However, we consider that the Companies Act 1993 provisions should be regarded as the applicable baseline.

Overseas insurers

12.69 In chapter 10 we make a number of recommendations in relation to overseas-based life insurers that offer life policies to the public in New Zealand. Requirements include:

- New Zealand operations to be through a New Zealand incorporated company, subject to an exemption regime to be operated by the Securities Commission. If exempted, the insurer would be required to register as an overseas company.
- Compliance with New Zealand law regarding product disclosure.
- Compliance with the Financial Reporting Act 1993 (preparation, audit and registration of financial statements) and independent actuarial audit of financial statements, subject to an exemption regime to be operated by the Securities Commission.
- Prudential supervision by the Government monitor, if there is a government entity tasked with the role, or by the appointment of a private sector policyholder agent, subject in either case to an exemption regime to be operated by the Securities Commission.³⁰⁸
- Financial strength rating from an approved credit rating agency.

12.70 If the proposed regime for life insurers is extended to non-life insurers, these requirements could readily be extended to overseas non-life insurers.

Other cross border issues

12.71 In chapter 10, we discuss a number of other cross border issues that arise when overseas insurers offer life insurance to the New Zealand public, such as:

- jurisdiction of the New Zealand courts and the governing law of the contract (we recommend that the Securities Act 1978 require that the High Court of New Zealand have jurisdiction and New Zealand law apply to the contract);
- accessibility of records (we conclude that the Securities Act 1978 requirements are sufficient);

³⁰⁵ The Friendly Societies and Credit Unions Act 1982, the Industrial and Provident Societies Act 1908, the Incorporated Societies Act 1908 and the Mutual Insurance Act 1955.

³⁰⁶ Or a statute such as the Securities Act 1978 or Companies Act 1993 could provide that the critical Companies Act provisions apply to certain entities such as insurers or entities that are subject to the Securities Act, regardless of other statutory provisions.

³⁰⁷ An exemption would only relieve the insurer from the requirement to incorporate under the Companies Act 1993. The insurer, as an “issuer” would still be required to comply with the Securities Act 1978 and the full provisions of the Financial Reporting Act 1993.

³⁰⁸ See para 3.39 (fifth bullet point) for the suggested criteria for the exemption regime.

- enforcement of judgments (we note the desirability of extending the application of the Reciprocal Enforcement of Judgments Act 1934);
- the ability of the Securities Commission to exchange information with overseas regulators;
- cross border insolvencies (we note that the Insolvency Law Reform Bill is intended to provide a framework for cross border insolvencies);
- internet issues (we recommend that the Securities Commission provide information and warnings).

These issues are equally relevant to non-life overseas insurers.

12.72 In the context of life insurance, some of these issues can be addressed via the Securities Act 1978. Extension of that Act to non-life insurance would mean that these issues could also be covered for non-life insurance.³⁰⁹

OTHER ISSUES RELATING TO NON-LIFE INSURERS

Insurance Contracts Act

12.73 Chapter 8 contains a commentary on the proposed Insurance Contracts Bill attached in appendix C. If passed, the Bill would re-enact aspects of the Life Act. In addition, the Bill would gather together various (but not all) provisions relating to life and general insurance contracts across different statutes³¹⁰ and enact some new provisions.³¹¹

12.74 Briefly, the Bill:

- defines “contracts of insurance”;³¹²
- re-enacts statutory provisions relating to mis-statements and the insurer’s ability to avoid the insurance policy³¹³ (a distinction is made here between general insurance and life policies, with additional criteria applying to the avoidance of life policies for mis-statement);
- provides that a life policy may not be cancelled by reason only of mis-statement of age but may be varied, replacing the statutory formula for variation in section 7(2) and (3) of the Insurance Law Reform Act 1977 with that contained in section 30 of the Insurance Contracts Act 1984 (Aust);³¹⁴
- limits the insurer’s common law right to avoid a policy retrospectively for failure to disclose;³¹⁵

³⁰⁹ Although cross border issues specific to non-life insurance would need to be addressed. See for example above n 302.

³¹⁰ Including provisions from the Insurance Law Reform Acts of 1977 and 1985 and the Law Reform Act 1936.

³¹¹ Many of the new provisions contained in the Bill were previously recommended by the Law Commission in *Report 46: Some Insurance Law Problems*, above n 126.

³¹² Clause 6.

³¹³ Clauses 9 to 11 re-enact ss 4–7 of the Insurance Law Reform Act 1977.

³¹⁴ Clauses 12 and 13.

³¹⁵ Clauses 14 and 15, in accordance with the Law Commission’s recommendations in Report 46.

- restricts the ability of insurers to rely on time limits and other conditions for notifying claims, except for “claims made” policies and “claims made and notified” policies;³¹⁶
- limits the ability of the insurer to decline a claim for breach of an exclusion clause if the loss was not caused or contributed to by that breach, but allows the insurer to rely on certain exclusions;³¹⁷
- re-enacts statutory provisions dealing with arbitration,³¹⁸ pro-rata conditions of average,³¹⁹ insurable interest³²⁰ and the sale of land;³²¹
- revises the regime applicable to third-party claims in certain circumstances;³²²
- re-enacts the provisions of Part 2 of the Life Act in modern form;³²³
- re-enacts miscellaneous provisions relating to insurer representatives, High Court proceedings, regulations, conflict with the Marine Insurance Act 1908, prohibiting any attempt to contract out, and repeals of other enactments.³²⁴

12.75 In chapter 8, we recommend that further provisions be included in the Insurance Contracts Bill:

- setting out how transfers of life policies between insurers should be effected with policyholder or High Court approval and notice to the relevant prudential supervisor, who is authorised to commission an independent actuarial report on the proposed transfer, at the insurer’s expense;³²⁵ and
- allowing a life insurer to apply to the High Court to have policy terms amended if notice has been given to policyholders and the relevant prudential supervisor, who is authorised to obtain legal, actuarial and other advice on the effect of the proposed amendments on policyholders, at the insurer’s expense.³²⁶

It may be appropriate for these provisions to apply generally to all contracts of insurance.

³¹⁶ Clauses 17–19 largely re-enact s 9 of the Insurance Law Reform Act 1977, but with significant amendments.

³¹⁷ Clause 20 re-enacts s 11 of the Insurance Law Reform Act 1977 with significant amendments.

³¹⁸ Clause 16.

³¹⁹ Clauses 21 and 22.

³²⁰ Clauses 23 and 24.

³²¹ Clauses 25–30.

³²² Clauses 31–39, substantially amending ss 9 and 9A of the Law Reform Act 1936, in accordance with the Law Commission’s recommendations in Report 46. In addition, cls 40–43 have been inserted from s 562A of the Corporations Act 2001 (Aust) in relation to reinsurance.

³²³ Part 4 of the Insurance Contracts Bill, covering interest payable by the insurer on life insurance money, assignments and mortgages of life policies, registration of ownership of life policy acquired by bankruptcy or under will, intestacy or writ of execution, application of surrender values of life policies by insurer, life insurance of minors, and life insurance on trust for the benefit of family members.

³²⁴ Clauses 104–110.

³²⁵ See paras 8.69–8.86.

³²⁶ See paras 8.87–8.91.

Human Rights Act 1993 and genetic testing

12.76 Issues raised in the discussion paper relating to the Human Rights Act 1993 and genetic testing are discussed in Part 2 of appendix A.

Financial advisers and brokers

12.77 In chapter 7 we discuss issues relating to financial advisers. Our recommendation is that the development of a new regulatory framework for financial advisers is a top priority and that the framework should include all advisers, brokers and other intermediaries for all financial products offered to the public, including securities and insurance.

12.78 In chapter 7 we note the Government announcement of a Task Force on the Regulation of Financial Intermediaries to provide the Government with options on the occupational regulation of the sector.³²⁷ The task force is to report in time for decisions to be made in this area by mid 2005.

CONCLUSION

12.79 Traditionally, insurance has been categorised by policy type. Insurers offering different types of insurance are regulated by different statutory regimes.³²⁸

12.80 Currently, insurers may fall under either or both of the life and non-life regimes, depending on the range of products offered. The non-life regime of ratings and deposits applies fully to disaster and general insurers (which are subject to the rating requirement) and only partially to other non-life insurers (which can elect not to be rated).

12.81 The question is whether the regulatory distinction between “life” and “non-life” insurance ought to be continued or whether these products ought to be subject to largely common requirements.

12.82 In the interests of consistency, simplicity and product neutrality,³²⁹ we believe that the presumption should be in favour of a common regulatory regime, modified for particular products as may be necessary or can be justified.

12.83 It is clear that the traditional classification of insurance is no longer useful or determinative when considering the regulation of insurance. Many submissions highlighted that the most fundamental distinction between insurance products is the distinction between long-term and short-term products, rather than the distinction between “life” and “non-life” insurance.

³²⁷ Above n 111.

³²⁸ According to an Ontario Law Reform Commission Study Paper “... [a] disintegration of insurance law has occurred for a number of historical reasons including the division of the industry between property and casualty insurers, on the one hand, and life and health insurers, on the other. Throughout most of the industry’s history there were in effect two separate industries with separate organizations and different marketing and underwriting concerns. This division in the industry has diminished and many insurers now operate in both fields. Moreover, many academic commentators and public officials have recognized the need for greater harmonization of various types of insurance law”. Study Paper on the Legal Aspects of Long-Term Disability Insurance, Ontario Law Reform Commission, 1996.

³²⁹ The continuation of a regulatory demarcation between life and non-life insurance may inhibit the development of integrated or packaged financial products (that cover risks on both sides of the boundary) that would benefit consumers.

- 12.84 The adoption of a common regulatory framework for both life and non-life insurance would make the categorisation of insurers and products generally less important for regulatory purposes. Insurers would be subject to common requirements under the Securities Act 1978 and the Financial Reporting Act 1993. The distinction between life and non-life insurance would remain relevant under financial reporting standards and actuarial guidance notes.
- 12.85 Further work would need to be done in this area to consult with market participants, assess feasibility, conduct a cost/benefit analysis and to make specific recommendations on the application of the regulatory model to non-life insurance, including the setting of parameters for the regime, given that, unlike life insurance, non-life insurance covers commercial as well as consumer interests. Further analysis of international regulatory models and trans-Tasman issues would also need to be considered.
- 12.86 From submissions we received, it is clear that the regulation of non-life insurance requires attention. We believe that the objective should be a consistent regulatory regime for life and non-life insurance.
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APPENDIX A

Other issues raised in
the discussion paper

PART ONE – FINANCIAL SAFETY MEASURES NOT
RECOMMENDED

Introduction

A1 IN CHAPTER 13 of our discussion paper we raised various options for “financial safety” regulation. Some of these, like the policyholder agent proposal, the audit actuary concept, public filing of the financial condition report, incorporation in New Zealand and setting of prudential standards, are discussed in the main body of this report. Issues associated with giving the prudential supervision role to a central regulator are discussed in chapter 11. We cover here the measures that require further comment:

- statutory funds;
- registration and “fit and proper” testing;
- prohibition on carrying on other types of business;
- bonds;
- minimum paid-up capital;
- rules on related party transactions;
- corporate governance standards;
- appointed actuary regime;
- whistle blowing;
- policy-only liability insurance; and
- guarantee funds.

Statutory funds

A2 In principle, we consider businesses should be able to organise their affairs however they wish, and that artificial constraints should not be imposed unless there is a clear benefit. It is not possible to ring-fence fully the life insurance business of an entity, nor is it necessarily desirable. A raft of supporting rules will be required, such as restrictions on related party transactions. With life insurance becoming increasingly a part of other financial products, the requirement for a statutory fund creates an artificial structure and will require “unbundling”, which is an additional and unnecessary compliance measure.

- A3 Reliance can be placed on the financial disclosures under the Financial Reporting Act 1993 and, in particular, the solvency disclosures (as actuarially audited) to assess the health of the life insurance business of an insurer. We have recommended that FRS 34 be reviewed, and, in particular, that sufficient disclosures on solvency be required to enable the various monitors of life insurers to assess the insurer's financial condition. We also recommend that GN5 be reviewed and an approved solvency standard be produced. It may be that in the course of these reviews the implications for these standards of not requiring a separate statutory fund also needs to be considered, as it may be necessary for disclosures to be made concerning the other businesses carried on by the insurer, or the actuary may need guidance on how to factor in the existence of other businesses in the solvency assessment.

Registration and “fit and proper” testing

- A4 We see little benefit in registration of life insurers. The Securities Act 1978 requires registration of an annual prospectus, and the Financial Reporting Act 1993 requires the annual registration of audited financial statements. We have recommended that all life insurers be required to incorporate in New Zealand, subject to an exemption regime. This is primarily to ensure that life insurers will be subject, and have access, to various procedural and other measures in the Companies Act 1993, notably voluntary administration, amalgamation and liquidation procedures, and various provisions relating to directors. Overseas life insurers that are exempted from this requirement should have to register as overseas companies under Part 18 of the Companies Act 1993. We have not been persuaded that there is justification for additional registration requirements.
- A5 It is not realistic to assume that incompetent directors or management can be weeded out in advance. It is better to have a system of prohibitions on who can act as a director and an ability for the court to prohibit persons from acting as directors in the event of unacceptable acts or omissions, as exists under the Companies Act 1993. The disqualification provisions in section 383 of the Companies Act 1993 refer to failure to comply with the Securities Act 1978, and we have recommended that persistent failure to comply with the Financial Reporting Act 1993 should also be a ground for disqualification under that legislation.

Prohibition on carrying on other types of business

- A6 This is another constraint on the ability of businesses to organise their affairs as they wish, which should only be imposed where there is a demonstrable need. The justification commonly given is that the life business should be “insulated” from the risks of the other businesses of the life insurer. But those other businesses may well be beneficial to the life business (they may be financially more sound). There are no similar constraints for other types of financial products. Life insurance is increasingly mixed with other types of financial products. The financial statements registered under the Financial Reporting Act 1993, and the auditor's and audit actuary's reports, should take into account exposures to other types of businesses carried on, and, in our view, nothing further is justified.

Bonds

- A7 The amount of bond required to be deposited by life insurers under the Life Act (\$500 000) does not offer any significant financial security for policyholders. Our consultations have revealed that the bond as it presently exists has proven to be useful only for the purpose of providing an amount to pay the liquidator's fees. In order to constitute a real degree of financial security, the amount of the bond would have to be increased significantly, to, for example, \$10 million. We think it would be difficult to prescribe an amount that would be appropriate to suit all life insurers, because the size of life insurance companies differs markedly. Imposition of a bond requirement is an additional cost, which in our view is not justifiable. The financial statements registered under the Financial Reporting Act 1993, in particular the solvency information, will be a much better indicator of an insurer's financial health. For new life insurers, see our recommendation in chapter 4 regarding forecast financial statements.

Minimum paid-up capital

- A8 In some other jurisdictions, in particular Australia, there is a requirement for a new life insurer to have a minimum amount of paid-up capital in order to be registered and to commence business. The protection provided by such a requirement can be illusory in the absence of restrictions on what can be done with the capital that has been paid in. The requirement of a specified amount of unpaid capital may perhaps be better security (depending upon the financial strength of the guarantor). In our view, it is better to place reliance on the solvency standard. Capital requirements will be an integral part of such a standard. With regard to new life insurers, our proposed amendments to the Securities Act 1978 discussed in chapter 4 will require audited forecast financial information to be provided in the first prospectus.

Rules on related party transactions

- A9 The imposition of rules relating to the ability of a life insurer to enter into transactions with related parties is another constraint on the manner in which it may conduct its business. We are not in favour of imposing constraints on businesses unless there is a good reason for doing so. We envisage that the solvency standard, which the audit actuary will report on, will require full account to be taken of related party exposures, and that FRS 34 could also require disclosures on these matters (see chapter 5).

Corporate governance standards

- A10 Corporate governance standards provide useful guidelines for management of all types of businesses, not just life insurers, and we endorse the existence of such standards. The Securities Commission has recently released a set of principles and guidelines for corporate governance in New Zealand.³³⁰ They focus strongly on reporting and disclosure of corporate governance structures

³³⁰ Securities Commission *Corporate Governance in New Zealand: Principles and Guidelines* (Wellington, February 2004) <www.sec-com.govt.nz> (last accessed 28 October 2004).

and processes, as well as on reporting of financial and other matters. Some of the principles are of particular relevance to life insurers, such as Principle 6 – the board should regularly verify that the entity has appropriate processes that identify and manage potential and relevant risks. We have not identified a need for specific additional corporate governance standards for life insurers alone.

Appointed actuary regime

- A11 The concept of “appointed actuary” contemplates an actuary, usually the life insurer’s own, acting as both the actuary for the life insurer (as an officer, employee or contractor) and, at the same time, acting as an agent of the regulator. This places conflicting duties on the actuary that are difficult for that person to reconcile and, in practice, probably do not work. Recent developments in the United Kingdom demonstrate a move away from the appointed actuary regime.³³¹ We envisage that each life insurer would have its own actuary, who would prepare any financial condition report required by the insurer’s directors (as well, no doubt, as carrying out other actuarial duties such as advising on premiums), but we do not propose that the appointment or role of such actuary be covered by legislation. In addition, the annual financial statements should be required to be audited by an independent actuary. Such an audit actuary would be selected from a list of approved actuaries issued from time to time by the Securities Commission (see chapter 5). The audit actuary would in no sense be an agent of the prudential supervisor, but would be required to provide an independent report that would be publicly disclosed, in the same manner as auditors that are chartered accountants do currently in respect of financial statements of issuers of equity and debt securities.

Whistle blowing

- A12 We do not propose a whistle-blowing obligation on a life insurer’s actuary. The creation of such a role would cause conflict of interest problems that would be difficult to reconcile. We do, however, propose that the audit actuary has a duty to “whistle blow” to the prudential supervisor (government or private sector) in the event that he or she becomes aware of any matter that, in his or her opinion, is relevant to the exercise or performance of the powers or duties of the prudential supervisor. This is the same kind of duty that is imposed on auditors in relation to debt securities, participatory securities and unit trusts, under the Securities Act 1978 (see sections 50 and 50A of that Act). This will be supplemented by the life insurer’s own obligations to amend its prospectus in the event of adverse material change, and give a copy of this to the prudential supervisor (see chapter 5).

Policy-only liability insurance

- A13 We are referring here to the proposal put forward in paragraph 13.45 of our discussion paper. While the idea may provide a creative solution, this type of

³³¹ See chapter 7 of our discussion paper for discussion of the appointed actuary regime in the United Kingdom, including the reforms announced by the Financial Services Authority. We note that the Financial Services Authority reforms originally proposed an independent actuarial audit of certain aspects of an insurer’s financial information, which is very similar to the independent audit actuary function we propose. This function is now to be incorporated into the auditor’s report (see Financial Services Authority Policy Statement 04/16).

insurance imposes additional cost, and leaves unresolved the question of who is monitoring the solvency of the person who provides the insurance to the primary life insurer.

Guarantee funds

- A14 The establishment of a guarantee fund into which all life insurers would have to contribute and that would be available in the event of one of them becoming insolvent, imposes additional cost on life insurers, and creates a situation where sound life insurers are subsidising unsound life insurers. We do not recommend it, at least not in the case of life insurance only. It may be worthy of consideration that there be guarantee funds established (and paid for by customers) for all financial products offered to the public, but this would require a comprehensive review.³³²

PART TWO - OTHER MATTERS RAISED IN DISCUSSION PAPER

Human Rights Act 1993

- A15 The Human Rights Act 1993 generally prohibits discrimination by those who provide goods, facilities and services to the public, on the grounds of age or sex or disability.³³³ However, the provision of insurance necessarily involves the classification of risk, and the tailoring of premiums and policy terms to reflect those risks. The Human Rights Act 1993 has an exception, allowing the providers of insurance policies to discriminate against people on these grounds in specified circumstances.
- A16 To come within the exemption, the differential treatment must be based on actuarial or statistical data, upon which it is reasonable to rely, relating to life expectancy or sickness. In the case of disability, where no such data may be available, any different treatment must be based on reputable actuarial or medical advice or opinion. The Human Rights Commission has a statutory power to get an opinion from the Government Actuary on any justification put forward for different treatment.³³⁴
- A17 The Human Rights Commission has prepared guidelines on health insurance premiums and the Human Rights Act 1993, and on insurance generally, to assist the industry and consumers in understanding the application of that Act.³³⁵ The guidelines represent the Commission's view on how the Act should be interpreted.

³³² Recent comments have been made by the Reserve Bank of New Zealand on bank deposit insurance. Generally, deposit insurance has been rejected by the Reserve Bank as an option for banks operating in New Zealand for the following reasons: the existence of insurance can reduce incentives for banks and depositors to be careful; it tends to work in a way that results in well-run banks subsidising badly run banks; and the Reserve Bank favours using incentives to encourage banks and the public to manage and monitor banks prudently. In addition, the Reserve Bank is looking at ways of enabling depositors to access part of their funds in a bank failure situation. Source: Questions and answers provided to *The Press*, Christchurch, on 8 July 2004.

³³³ Human Rights Act 1993, s 44.

³³⁴ Human Rights Act 1993, s 48.

³³⁵ Human Rights Commission *Insurance Guidelines* (Wellington, April 1997); *Guidelines, Health Insurance Premiums and the Human Rights Act 1993* (Wellington, May 2003).

A18 It was suggested in one submission that section 48 of the Human Rights Act 1993 should be redrafted to allow more flexibility in targeting products at particular segments of the insurance market. We suggest that the Government should continue to monitor developments in this area.

Genetic information issues

A19 Health insurers in New Zealand routinely request the results of all medical tests, including genetic tests, as part of the information gathered on application for a health insurance policy in order to assess pre-existing conditions. The results of genetic tests, like other medical tests, are then used to assess the likelihood of future medical costs and to set the premiums.

A20 Genetic testing raises a number of issues in the insurance context. Should a proposed insured be obliged to provide the insurer with the results of genetic tests that have already been performed? Should the insurer be able to require the proposed insured to undergo genetic testing before entering into an insurance contract? There may be concerns about issues of privacy, or the scientific reliability or actuarial significance of genetic test results.

A21 As genetic tests become cheaper and more widely used, and knowledge of the genetic basis of common disorders expands, the relevance of genetic test information is likely to grow.

A22 The Australian Law Reform Commission (ALRC) completed a lengthy investigation into the issues raised by the use of human genetic information in March 2003.³³⁶ The ALRC recommended that the insurance industry should be required to adopt a range of improved consumer protection policies and practices in relation to its use of genetic information, including family history, for underwriting purposes. The report included the following recommendations:

- The establishment of an independent statutory authority to be known as the Human Genetics Commission of Australia (HGCA), that should, as a matter of priority, establish procedures to assess and make recommendations on whether particular genetic tests should be used in underwriting mutually rated insurance, having regard to their scientific reliability, actuarial relevance and reasonableness.³³⁷
- The Investment and Financial Services Association and the Insurance Council of Australia should develop mandatory policies for their members to ensure that once the HGCA has made a recommendation in relation to the use of a particular genetic test in underwriting, the test is used only in conformity with the recommendation.³³⁸
- Members should be required to state on relevant insurance application forms that not all genetic test results have to be disclosed, and that applicants may obtain further information about this from the insurer; and to provide accurate information to applicants on request in relation to those genetic tests that the HGCA has recommended not be used in underwriting.³³⁹

³³⁶ Australian Law Reform Commission *Essentially Yours: The Protection of Human Genetic Information in Australia* ALRC Report 96 (Sydney, March 2003).

³³⁷ Australian Law Reform Commission, above n 336, recommendation 27-1.

³³⁸ Australian Law Reform Commission, above n 336, recommendation 27-2.

³³⁹ Australian Law Reform Commission, above n 336, recommendation 27-3.

- The Investment and Financial Services Association and the Insurance Council of Australia, in consultation with the HGCA and the Institute of Actuaries of Australia, should develop and publish policies for their members on the use of family medical history for underwriting mutually rated insurance.³⁴⁰
- The Insurance Contracts Act 1984 (Aust) should be amended to clarify the nature of the obligation of an insurer to provide written reasons for an unfavourable underwriting decision on the request of an applicant. Where such a decision is based on genetic information, including family medical history, the insurer should be required to give reasons that are clear and meaningful and that explain the actuarial, statistical or other basis for the decision.³⁴¹

A23 The New Zealand Human Rights Commission has been monitoring the issue of what use of genetic information should be permissible by insurers in New Zealand. It supports the recommendations of the ALRC, but does not consider that a sufficient case has been made in New Zealand for the passage of legislation to achieve those objectives.³⁴²

A24 The Investment Savings and Insurance Association of New Zealand has developed a genetic testing policy that states that insurers may request that the results of existing genetic tests be made available to the insurer for the purposes of classifying the risk. However, insurers will not ask applicants to undergo genetic tests, and will not use genetic test information obtained from one person to assess a relative's risk. Genetic testing may not be used as a basis of preferred risk underwriting (that is, offering individuals insurance at lower than standard premium rates). The professional association representing the health insurance industry in New Zealand, Health Funds Association of New Zealand Inc, has a similar policy.

Independent oversight of genetic testing

A25 In New Zealand at present, if an individual is concerned about the way an insurer has used genetic test information, he or she can lodge a complaint under the Human Rights Act 1993. However, this leaves questions about the actuarial relevance of genetic information, and the accuracy of reliance on it in the underwriting process, to be determined on a case-by-case basis, and places the onus on the consumer to raise the issue. Is this acceptable, or is there a need for an adequate independent mechanism to evaluate actuarial relevance and scientific reliability?

A26 In Australia, the ALRC recommended that the HGCA provide independent oversight of the use of predictive genetic tests in insurance. In the United Kingdom, the Genetics and Insurance Committee, established in 1999, is the Government's advisory committee, which decides whether particular genetic tests can be used in setting insurance premiums. The criteria it uses are the accuracy, clinical relevance and actuarial relevance of the test. Its terms of reference include providing independent wide-ranging oversight of how insurers are using genetic tests, specifically to provide independent scrutiny of compliance

³⁴⁰ Australian Law Reform Commission, above n 336, recommendation 27-4.

³⁴¹ Australian Law Reform Commission, above n 336, recommendation 27-5.

³⁴² Human Rights Commission, submission no 32.

with the Association of British Insurers' Code of Practice and the terms of a five-year moratorium agreed in 2001 on the use of genetic test results by insurance companies.³⁴³

- A27 The UK Government also gets advice from the Human Genetics Commission, established in 2000. It advises ministers on current and potential developments in human genetics and the likely impact on human health and healthcare as well as the social, ethical, legal and economic implications.³⁴⁴
- A28 We suggest that the Government here should continue to monitor developments in the insurance industry, and follow those in Australia, the United Kingdom and other countries as appropriate, with a view to reviewing New Zealand insurance practices as the need arises.

Secondary markets

- A29 Policyholders have the right to transfer their life policies. Some secondary markets have developed where people buy life policies as investments, sometimes for more than the surrender values.
- A30 There was little concern expressed in submissions and consultation about the secondary markets in New Zealand. One submitter observed that the secondary market was fuelled to an extent by the potential for demutualisation of the large life companies, however, in New Zealand demutualisation is all but over.
- A31 Another submitter noted that the buyers of these policies may subsequently want to bundle them as an asset class, and there are issues in accurately describing the inherent risks for potential investors, which could usefully be referred to the Securities Commission.

Directors' duties

- A32 In New Zealand, the only statutory duties placed on directors of life insurers are those contained in the Companies Act 1993. Directors do not owe a specific duty to policyholders, although they do have duties under that Act in relation to creditors.³⁴⁵ Directors have duties not to allow the company's business to be carried on in a manner likely to create loss to creditors, and not to agree to a company incurring an obligation unless it can reasonably meet that obligation. Breaches of these duties confer no direct remedy on creditors, because the duties are owed to the company, but if a company is placed in liquidation, a creditor can apply under section 301 for an order that a director or other relevant person pay compensation to the creditor. Creditors may also 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.³⁴⁶

³⁴³ Genetics and Insurance Committee, website accessed via <www.advisorybodies.doh.gov.uk> (last accessed 28 October 2004).

³⁴⁴ Details of the Human Genetics Commission membership, terms of reference and its work to date are on its website at <www.hgc.gov.uk> (last accessed 28 October 2004).

³⁴⁵ Companies Act 1993, s 135, s 136.

³⁴⁶ Companies Act 1993, s 383.

- A33 In February 2004, the Securities Commission released a report setting out a principles-based approach to corporate governance in New Zealand.³⁴⁷ The principles set out in the report are broadly stated, to cover a wide range of companies and other entities that have economic impact or are accountable to investors or to the public more generally. Transparency through high standards of reporting and disclosure is considered to be of paramount importance, because shareholders and other stakeholders can properly evaluate an entity and its governance only if they are fully informed. The principles focus strongly on reporting and disclosure of corporate governance structures and processes, as well as on reporting of financial and other material matters.
- A34 In Australia, under the Life Insurance Act 1995 (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 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, that the insurer gives priority to the interests of policyholders of the fund. Directors breaching this duty become personally liable for losses to statutory funds.
- A35 In the discussion paper, we raised the possibility of imposing additional duties on directors of life insurers as is done in Australia. Views were divided on this issue in submissions and consultation. Some submitters took the view that directors should be required to give priority to policyholders' interests, others that they should be required to have reasonable regard to the interests of policyholders. Others still maintained that imposing additional duties on directors in this regard was not justified.
- A36 One of the concerns raised in consultation was that the duties owed by directors to creditors are not sufficient to protect the interests of policyholders. Unlike some other creditors, policyholders have not made conscious decisions trading credit risk off against other contract terms. The relationships between policyholders and life insurers are likely to be longer term than relationships with other creditors.
- A37 We are not satisfied that a sufficient case has been made for imposing special duties on directors in relation to life policies. The existing Companies Act 1993 duties outlined above provide sufficient incentives for directors to consider properly the insurer's obligations to its policyholders, and imposing special duties in relation to life policies may result in shareholders and other creditors being unfairly treated. To the extent that policyholders can be said to be a special class of creditor, we have recognised this by recommending a prudential supervisor to look after their interests.

Duty to act in best interests of company

- A38 At present, section 131(2) of the Companies Act 1993 provides that a director of a company that is a wholly owned subsidiary may, when exercising powers or performing duties as a director, if expressly permitted to do so by the constitution of the company, act in a manner which he or she believes is in the best interests of that company's holding company, even though it may not be

³⁴⁷ Securities Commission *Corporate Governance in New Zealand, Principles and Guidelines* (Wellington, 16 February 2004).

in the best interests of the company. Section 131(3) provides that a company that is a subsidiary (but not a wholly owned subsidiary) may do the same if expressly permitted to do so by the constitution of the company and with the prior agreement of the shareholders (other than its holding company).

- A39 In our discussion paper we noted that the effect of section 131 is that if a life insurer is a New Zealand company, the directors may be entitled to act in the interests of a holding company of the insurer, rather than in the interests of the insurer itself, thus weakening the position of policyholders.
- A40 Submissions noted that sections 135 and 136 Companies Act 1993,³⁴⁸ which impose duties on directors in respect of creditors, are not limited by section 131(2) and (3), and so no amendment to section 131 is necessary.

Complaints handling

- A41 In our discussion paper, we considered the role of the industry-based complaint schemes operating in New Zealand, being the Insurance and Savings Ombudsman (ISO) scheme and the Banking Ombudsman scheme. We raised the question as to whether there should be a statutory requirement that every life insurer have an internal complaints process and belong to an ombudsman scheme.
- A42 There was widespread support in submissions and consultation for the ISO and the Banking Ombudsman schemes, which were generally described as working well. One of the statutory functions of the Retirement Commissioner is to monitor the effectiveness of those schemes, and the Retirement Commissioner noted that overall the voluntary approach to dispute resolution appears to have been successful.
- A43 The major area of concern in submissions was the need for better complaints processes for issues arising in relation to financial advisers. We suggest that complaints processes form part of the review of financial intermediaries to be carried out by the Government-appointed task force.
- A44 The ISO suggested that one area where legislative support would assist is in relation to employment-related group life insurance or superannuation schemes. The ISO noted that the exclusion of complaints related to such schemes is inconsistent with the way complaints about other life insurance and superannuation policies are treated. This means consumers who belong to such schemes have no right of redress other than the courts.
- A45 The Periodic Report Group 2003 discussed this issue in its report, in relation to group and employer superannuation.³⁴⁹ It described the rationale for the exclusion of such schemes - that the contract is between the insurer and the trustee or employer, not the individual members of the scheme. It noted that one potential remedy was for the trustees or sponsoring employer to be legally obliged to become participants of an ombudsman or other disputes handling

³⁴⁸ Section 135 provides that a director must not agree to or permit the business of the company to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. Section 136 provides that a director must not agree to a company incurring an obligation unless that director believes at that time on reasonable grounds that the company will be able to perform its obligation when required to do so.

³⁴⁹ Periodic Report Group 2003 *Retirement Income Report 2003* (Wellington, December 2003) 87.

scheme. However, the Periodic Report Group 2003 was concerned that approach would introduce further compliance costs for employer schemes and would be difficult to justify in terms of the number and nature of disputes arising between trustees, employers and members. Instead, it considered that the promotion of best-practice guidelines for dispute resolution would be a good solution for members of these schemes.

APPENDIX B

Comparison of our proposals
with IAIS principles

COMPARISON OF OUR PROPOSALS WITH IAIS
INSURANCE CORE PRINCIPLES AND METHODOLOGY,
OCTOBER 2003

Introduction to the principles

The following comments taken from the introduction to the principles are of note:

- Insurance supervision within an individual jurisdiction may be the responsibility of more than one authority. The IAIS expectation is that the principles are applied within a jurisdiction rather than necessarily by one supervisory authority (paragraph 8).
- It is important to take into account the domestic context while implementing the criteria in a jurisdiction. The ways and means of implementation will vary across jurisdictions, and there is no mandated method of implementation (paragraph 13).
- There may be instances where it can be demonstrated that the principles have been observed through means other than those identified in the criteria (paragraph 14).

The key aspects of each principle are summarised below.

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.*

Comment

Under our proposals New Zealand will:

- continue to have a policy framework, as outlined in chapter 1, based on disclosure;

- continue to have an institutional framework, consisting of the Securities Commission, Registrar of Companies, Accounting Standards Review Board, Commerce Commission, High Court, and various self-regulatory bodies such as the ISI, NZSA and ICANZ;
- have a legal framework, consisting of the Financial Reporting Act 1993, Securities Act 1978, Companies Act 1993, Insurance Contracts Act (proposed), Fair Trading Act 1986, and other Acts.

New Zealand already has:

- a well developed and effective financial infrastructure, consisting of banks, insurance companies, finance companies and so on;
- efficient life insurance markets, evidenced by sufficient competitors, few collapses and competitive prices.

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.

Comment

The stated objectives are very high level. We do not consider that an insurance regulator with wide powers over the insurance industry is the best model for New Zealand, especially having regard to the existing New Zealand regulatory regime for other securities and insurance products.

Each “supervisor” in our proposed regime will have clearly defined objectives and responsibilities, for example, the Securities Commission, Accounting Standards Review Board, accounting and actuarial auditors, policyholder agent and High Court. The Securities Commission and Accounting Standards Review Board already have functions and powers set out in legislation. The roles of the accounting and actuarial auditors, policyholder agent, and High Court will also be set out in legislation.

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.

Comment

Each “supervisor” in our proposed regime, that is, the Securities Commission, Accounting Standards Review Board, accounting and actuarial auditors, policyholder agent, and High Court:

- will have adequate powers, be independent and accountable;

- will have legal protection to the extent that is appropriate, having regard to the incentive to perform that legal liability for wrongdoing provides;
- should have good resources, although, in the case of those funded from general taxation (as distinct from directly by the insurers or by industry levy), this will depend upon adequate funding being voted by Parliament;
- should treat confidential information appropriately.

ICP4: Supervisory process

The supervisory authority must conduct its functions in a transparent and accountable manner.

Comment

Every “supervisor” in our proposed regime will be required to “conduct its functions in a transparent and accountable manner”.

ICP5: Supervisory cooperation and information sharing

The supervisory authority is to cooperate 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.

Comment

In our proposed regime the Securities Commission will be the body responsible for liaison with offshore regulators.³⁵⁰ The policyholder agent would have a statutory obligation to inform the Securities Commission of any action proposed to be taken in relation to an overseas life insurer.

ICP 6: Licensing

An insurer must be licensed before it can operate within a jurisdiction. Requirements for licensing must be clear, objective and public. In particular–

- *no domestic or foreign insurance establishment is to escape supervision*
- *legislation is to determine the method by which a foreign insurer can carry on business in the jurisdiction*
- *a supervisory authority should be provided with certain information about foreign insurers, such as name and address of branch and authorised agent*
- *confirmation should be obtained from the home supervisory authority that an insurer is authorised to carry on the types of insurance proposed, and that the insurer is solvent and meets the regulatory requirements of the home jurisdiction*

³⁵⁰ If the Reserve Bank of New Zealand was the government monitor, it would be appropriate for it to have a liaison role with offshore prudential regulators.

- *life and non-life business of foreign and domestic insurers should be handled “separately”, ie, life insurers should not be licensed to underwrite non life business, unless they have satisfactory processes for separate handling of the risks.*

Comment

Licensing is not part of our proposed regime. Our regime:

- requires audited forecast financial information for start-up life insurers (so there is disclosure of the initial financial position and expected financial performance);
- will continue the existing requirement that all overseas-established life insurers that carry on business in New Zealand (and that are exempted from the requirement to incorporate in New Zealand) must register as “overseas companies” under the Companies Act 1993;
- does not require that life and non-life business be handled “separately”;
- requires solvency to be monitored by the accounting and actuarial auditors and prudential supervisor.

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.

Comment

We agree with the above, and consider that the main responsibility for assessment of fitness and propriety of key functionaries lies with the life insurer. We do not support a system of assessment of owners, board members and management beyond the existing Companies Act 1993 provisions. We believe it is not possible to weed out incompetent directors or management in advance. Directors that prove to be seriously incompetent can be disqualified under the Companies Act 1993.

We note that ICANZ is the principal regulator of auditors in New Zealand and sets and enforces standards of conduct for auditors.³⁵¹

Under our proposed regime, audit actuaries and policyholder agents must be persons approved and monitored by the Securities Commission.

³⁵¹ Section 199 of the Companies Act 1993 requires that an auditor must be a member of ICANZ, or a member of a comparable association outside New Zealand approved by the Registrar of Companies, or eligible to act as an auditor outside New Zealand and approved by the Registrar of Companies. The Institute of Chartered Accountants of New Zealand can only enforce standards on its own members. The issue of regulation of auditors is relevant to the operation of the Financial Reporting Act 1993 and is expected to arise in the context of the Ministry of Economic Development review of that Act.

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. (Principle requires notification of changes in ownership relevant to 5 to 10 percent of shares, and supervisory approval for acquisitions of “significant ownership”.)

Comment

Our proposed regime gives approval powers for portfolio transfers and amalgamations (mergers) to the High Court, with input from the prudential supervisor.

We do not consider that changes of control of life insurers require regulation from the point of view of policyholder protection. Other legislation, such as the Commerce Act 1986, the Takeovers Act 1993 and the Overseas Investment Act 1973, regulates certain takeovers for other policy purposes.

ICP9: Corporate governance

The corporate governance framework must recognise and protect rights of all interested parties. The supervisory authority must require compliance with all applicable corporate governance standards.

Comment

The Companies Act 1993 contains an enforceable corporate governance framework, and our proposed regime requires all life insurers to be companies incorporated in New Zealand, unless exempted from this requirement by the Securities Commission.

The Securities Commission has issued corporate governance principles and guidelines, but these are not legally enforceable. Life insurers listed in New Zealand are required by the NZX Listing Rules to disclose corporate governance practices.

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.

Comment

Principle 6 of the Securities Commission’s corporate governance principles and guidelines requires boards to require entities to operate rigorous processes for risk management and internal control, and to receive regular reports on risk management and internal control processes. Boards of issuers are expected to report (to investors and stakeholders) on risk identification and management and on relevant internal controls.

An internal audit function is not required by Securities Commission's principles and guidelines, but they state that an internal audit function can assist effective risk management and internal control in entities that face significant financial, operating and compliance risks.

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.

Comment

In our proposed regime the Securities Commission will keep a general overview of the life insurance market as part of its functions under section 10 of the Securities Act 1978, in particular to keep under review the law relating to bodies corporate, securities, and unincorporated issuers of securities, practices relating to securities, and activities on securities markets.

The Registrar of Companies and the Securities Commission have certain powers under the Corporations (Investigation and Management) Act 1989 (mainly to step in, in the case of serious mismanagement or financial deterioration).

We consider that the Government should encourage the establishment of market analysts who would publish comparative market information for use by policyholders and financial advisers.

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.

Comment

Under our proposed regime:

- the prudential supervisor will undertake off-site monitoring, and evaluate the solvency position of the life insurer;
- what information is provided, and its form and frequency, will be determined by statute (Financial Reporting Act 1993 and Securities Act 1978) and accounting and actuarial standards and, if there is a policyholder agent, by the individual contract between the policyholder agent and the insurer;
- immediate reporting of material adverse changes will be required by the Securities Act 1978;
- an advantage of the policyholder agent is that “one rule fits all” does not apply – the policyholder agent can tailor information needs to the life insurer so that there could, for example, be different information needs for smaller

as compared with bigger insurers, and New Zealand as compared with overseas insurers;

- the Securities Commission will continue to evaluate the condition of the life insurance market.

ICP13: On-site inspections

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.

Comment

Under our proposed regime:

- The prudential supervisor will have statutory powers of inspection. If there is a policyholder agent, further powers will likely be negotiated with the life insurer.
- The Securities Commission and Registrar of Companies have powers under the Securities Act 1978 and Corporations (Investigation and Management) Act 1989;
- the audit actuary and accounting auditors will also act as on-site monitors.

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 objectives of supervision. A progressive escalation of action is envisaged.

Comment

Under our proposed regime:

- the prudential supervisor will have a range of actions available to it, both formal and informal;
- in particular, the prudential supervisor will have powers of inspection, and power to initiate voluntary administration (or a regime akin to judicial management – see paragraph 6.18) or liquidation.

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. Powers could include:

- *restricting business activities*
- *stopping the writing of new business*
- *withholding approval for new activities or acquisitions*
- *directing the insurer to stop practices that are unsafe or unsound*
- *putting assets of the insurer in trust or restricting disposal of those assets*
- *revoking the licence of an insurer*

- *removing directors and managers*
- *barring individuals from insurance business*

Punitive sanctions against individuals or insurers may be appropriate, and the supervisory authority is to have legal protection for actions taken in good faith.

Comment

Under our proposed regime:

- the prudential supervisor will have a range of actions available to it (see paragraph 6.12);
- if there is a policyholder agent, additional powers (for example, the power to appoint a receiver) may be negotiated between the policyholder agent and the life insurer;
- the Registrar of Companies and the courts have powers under the Companies Act 1993 to disqualify delinquent directors, and the Securities Commission has powers in relation to breaches of the Securities Act 1978;
- a government monitor would be given statutory protection for negligent acts (otherwise taxpayers effectively end up as guarantors of life insurers), but a policyholder agent would have no such protection.

We do not consider it necessary or desirable to give a government monitor (as distinct from a policyholder agent, who can achieve extra powers by negotiation with the life insurer) powers to tell a life insurer how to run its business, in particular because the government monitor (unlike the policyholder agent) would not be liable for its mistakes. See further chapter 6, paragraph 6.32.

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.

Comment

Under our proposed regime:

- the Companies Act 1993 defines insolvency and provides procedures for liquidation;
- the Companies Act 1993 or other legislation will provide procedures for voluntary administration (or a regime similar to judicial management);
- the prudential supervisor will be able to initiate voluntary administration and/or liquidation of a life insurer;
- if there is a policyholder agent, the agent may have power to put the life insurer into receivership;
- a liquidator, voluntary administrator, or receiver could arrange for the transfer of the life insurer's obligations, or for an amalgamation with another insurer, subject to the approval of the court.

We do not consider that policyholders should be given some sort of priority on liquidation, because this disadvantages other creditors. Nor do we think that establishment of a policyholder protection fund is necessary or desirable.

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.

Comment

Under our proposed regime, the prudential supervisor is responsible for monitoring the solvency of the life insurer, on the basis of information audited by the insurer's accounting auditors and audit actuary. To do this properly will often involve looking at the relationship of the insurer to other members of its group of companies and at intra-group transactions and arrangements. To this extent the prudential supervisor should monitor the group as well as the insurer.

Our proposed regime requires life insurers to get a financial strength rating (at least until analysts that monitor New Zealand life insurers are properly established). The credit rating agency will likely take the risks associated with the wider group into account.

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.

Comment

Under our proposed regime, the accounting auditors and audit actuary will review risk management systems as part of their audits.

The Securities Commission corporate governance principles require the board of a life insurer to operate rigorous processes for risk management and internal control.

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 insurer's 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.

Comment

We agree that the responsibility for these matters lies with the board of the life insurer rather than with the prudential supervisor.

Under our proposed regime, the accounting auditors and the audit actuary will both have a role in reviewing underwriting and pricing policies and the reinsurance strategy and arrangements as part of their audits. These matters will be integral to an assessment of solvency by the accounting auditors and the audit actuary and, subsequently, by the prudential supervisor.

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.

Comment

Under our proposed regime:

- The ASRB will approve actuarial standards on technical provisions. The NZSA already has a professional standard on valuation of liabilities (PS3).
- The adequacy of technical provisions, that is, amounts available to meet liabilities, is a key part of the solvency assessment and therefore will be part of the assessment by the audit actuary and the prudential supervisor (who will need to have actuarial expertise available to it for this purpose).

ICP21: Investments

The supervisory authority is to require insurers to comply with standards on investment activities, including requirements on investment policy, asset mix, valuation, diversification, asset-liability matching and risk management. Insurers must also have overall strategic investment policy approved by the board. Audit procedures must cover investment activities.

Comment

The quality of the life insurer's investment portfolio (including concentrations, liquidity, quality of assets, safe keeping and so on) will be a key part of a solvency assessment by the accounting auditor, the audit actuary and the prudential supervisor.

Investment strategy will also be part of the risk management processes required by corporate governance principles.

Credit rating agencies will review the investment strategies and activities of life insurers.

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.

Comment

The comments above in relation to investments also apply in relation to derivatives and similar commitments.

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.

Comment

Under our proposed regime, the prudential supervisor will monitor solvency via the audited financial statements and other disclosures to it.

We do not believe a capital adequacy standard is needed – see the discussion in paragraphs 5.24 to 5.26.

ICP24: Intermediaries

The supervisory authority is to set requirements, either directly or through the supervision of insurers, for the conduct of intermediaries. Intermediaries are to be licensed and make certain disclosures.

Comment

We consider that the New Zealand law relating to financial intermediaries is in need of review, and it is shortly to be reviewed by a Government-appointed task force.

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.

Comment

The Securities Act 1978 already requires certain disclosures to consumers about savings policies (see chapter 4). Our proposals extend the disclosure requirements and apply them to risk only as well as savings policies.

Foreign insurers carrying on business in New Zealand are covered by our proposals to the same extent as New Zealand insurers, unless they are exempted by the Securities Commission.

New Zealand has various consumer complaints systems already for life insurance.

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.

Comment

The Securities Act 1978 and Financial Reporting Act 1993 fulfil this role already in respect of most life insurers. We recommend that these Acts be extended to apply to all life insurers.

ICP27: Fraud

The supervisory authority is to require that insurers and intermediaries take the necessary measures to prevent, detect and remedy insurance fraud.

Comment

Under existing New Zealand law, fraud of any kind can be civilly or criminally punished (depending on the nature of the offence) – see chapter 5 of our discussion paper. These laws are not (and should not be) entity or sector specific, but apply across the economy.

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. Measures are to be consistent with the recommendations of the Financial Action Task Force Money Laundering (FATF).

Comment

New Zealand has existing laws that deal with these matters – see chapter 5 (in particular, paragraphs 5.105 and 5.133) of our discussion paper. These laws are not (and should not be) entity or sector specific, but apply across the economy. There is a Ministry of Justice-lead working group that is currently looking at areas in which our laws could better comply with the FATF recommendations.

APPENDIX C

Insurance Contracts Bill

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The Parliament of New Zealand enacts as follows:

1 Title

This Act is the Insurance Contracts Act 2004.

2 Commencement

- (1) This Act (except **section 106**) comes into force on a date to be appointed by the Governor-General by Order in Council.

- (2) **Section 106** comes into force on the day after the date on which this Act receives the Royal assent.

Part 1

Preliminary provisions

3 Purpose of Act

The purpose of this Act is to reform and modernise the law relating to certain contracts of insurance to ensure—

- (a) that a fair balance is struck between the interests of insurers, insureds, and other members of the public; and
- (b) that the provisions included in those contracts, and the practices of insurers in relation to those contracts, operate fairly.

4 Overview

In this Act,—

- (a) this Part deals with preliminary matters, including interpretation and the application of this Act to the Crown:
- (b) **Part 2** contains provisions relating to mis-statements (including when a contract of insurance may not be avoided by reason of mis-statement) and provisions relating to when a contract of insurance can be avoided by reason of a failure to disclose a fact:
- (c) **Part 3** contains provisions relating to the terms of contracts of insurance, including restrictions on certain types of exclusions and other provisions:
- (d) **Part 4** contains provisions relating to life policies, including the assignment and mortgage of life policies, life insurance by minors, and interest payable on life policies:
- (e) **Part 5** contains miscellaneous provisions, including provisions relating to regulations, contracting out, and repeals.

5 Interpretation

In this Act, unless the context otherwise requires,—

aircraft has the same meaning as in section 2 of the Civil Aviation Act 1990

assignment—

- (a) means an assignment of a life policy made in accordance with **Part 4** otherwise than by way of mortgage; and
- (b) includes a surrender of a life policy to the life insurer liable under it

avoid, in relation to a contract of insurance, means avoid from its inception

chief executive means the chief executive of the Ministry of Economic Development

continuous disability insurance contract means a contract of insurance—

- (a) that forms part of a life policy; and
- (b) that is for a term of not less than a year; and
- (c) by the terms of which a person is entitled to a benefit in the event, during the term of the contract, of—
 - (i) the death of a person by accident or by another cause specified in the contract; or
 - (ii) injury to or the disability of a person as the result of accident or sickness

court means, in relation to any matter, the court by or before which the matter falls to be determined

de facto partner has the same meaning as in section 2C of the Property (Relationships) Act 1976

insolvent, in relation to an insured, means—

- (a) that the insured is subject to a statutory or contractual regime under which the assets of the insured have been, or are to be, realised for the benefit of secured or unsecured creditors; or
- (b) that the insured is unable to pay the insured's debts that would be provable in bankruptcy or on a liquidation as they fall due and from the insured's own money

insured—

- (a) means a person who has entered into, or who proposes to enter into, a contract of insurance with an insurer; and
- (b) includes a person who is entitled to the whole or part of the benefit of the contract of insurance

insurer means a person by whom or on whose behalf the risk or part of the risk to which a contract of insurance relates is accepted

life insurance—

- (a) means 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, whether or not a benefit is included under a continuous disability insurance contract; and
- (b) includes—
 - (i) 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
 - (ii) an instrument securing the grant of an annuity for a term dependent on the continuance of human life

life insured, with respect to a life policy, means the person upon whose death or survival benefits payable under that life policy are contingent

life insurer—

- (a) means any person or body of persons, whether incorporated or not, and whether incorporated or established in New Zealand or elsewhere, that is liable under any life policy; but
- (b) does not include any friendly society (within the meaning of section 2 of the Friendly Societies and Credit Unions Act 1982)

life policy means a contract for life insurance

Minister means the Minister of the Crown who, under the authority of any warrant or with the authority of the Prime Minister, is for the time being responsible for the administration of this Act

mortgage means an instrument made in accordance with **Part 4** that is given as security over a life policy to secure payment or the performance of an obligation

policy document, in relation to a life policy,—

- (a) means an instrument that evidences the life policy; and
- (b) includes, if that instrument comprises 2 or more counterparts, each of those counterparts

policyholder means the person who, for the time being, is legally entitled to a life policy

principal officer—

- (a) means the principal officer for the time being in New Zealand of a life insurer or any other officer whom the life insurer appoints to act as principal officer for the purposes of this Act; and
- (b) includes, in respect of all matters under the Tower Corporation Act 1990, the Tower Corporation and any officer to whom the Tower Corporation delegates any of its powers, functions, or duties under this Act

regulations means regulations in force under this Act

ship has the same meaning as in section 2 of the Admiralty Act 1973

vehicle has the same meaning as in section 2(1) of the Land Transport Act 1998.

6 Meaning of contract of insurance

- (1) In this Act, unless the context otherwise requires, **contract of insurance** includes—
 - (a) a contract that would ordinarily be regarded as a contract of insurance although some of its provisions are not by way of insurance; and
 - (b) a contract that includes provisions of insurance in so far as those provisions are concerned, although the contract would not ordinarily be regarded as a contract of insurance.
- (2) If a provision included in a contract that would not ordinarily be regarded as a contract of insurance affects the operation of a contract of insurance to which this Act applies, that provision must, for the purposes of this Act, be regarded as a provision included in the contract of insurance.

Compare: Insurance Contracts Act 1984 s 10 (Aust)

7 Conflict of laws

This Act applies to a contract of insurance if the contract—

- (a) is governed by the law of New Zealand; or
- (b) would be governed by the law of New Zealand but for a choice of law provision in the contract.

8 Act binds the Crown

This Act binds the Crown.

**Part 2
Mis-statements and disclosure***Mis-statements***9 Mis-statements in general contracts of insurance**

- (1) A contract of insurance may not be avoided by reason only of a statement made in any proposal or other document on the faith of which the contract was entered into, reinstated, or renewed by the insurer unless the statement—
- (a) was substantially incorrect; and
 - (b) was material.
- (2) This section does not apply to a life policy.

Compare: 1977 No 14 s 5

10 Mis-statements in life policy

- (1) A life policy may not be avoided by reason only of a statement (other than a statement as to the age of the life insured) made in any proposal or other document on the faith of which the life policy was entered into, reinstated, or renewed by the life insurer unless the statement—
- (a) was substantially incorrect; and
 - (b) was material; and
 - (c) was made fraudulently or within the period of 3 years immediately preceding the earlier of—
 - (i) the date on which the life policy is sought to be avoided; or
 - (ii) the date of the death of the life insured.
- (2) For the purposes of **subsection (1)**, a statement is made **fraudulently** if the person making the statement makes the statement—
- (a) knowing that the statement is incorrect; or
 - (b) without belief in the statement's correctness; or
 - (c) recklessly, without caring whether the statement is correct.

Compare: 1977 No 14 s 4

11 Meaning of substantially incorrect and materiality

- (1) For the purposes of **sections 9 and 10**,—

- (a) a statement is **substantially incorrect** only if the difference between what is stated and what is actually correct would have been considered material by a prudent insurer; and
 - (b) a statement is **material** only if that statement would have influenced the judgment of a prudent insurer in fixing the premium or in determining whether the prudent insurer would have taken or continued the risk on substantially the same terms.
- (2) This section applies despite any admission, term, condition, stipulation, warranty, or proviso in the application or proposal for insurance or in the contract of insurance.

Compare: 1977 No 14 s 6

12 Life policy may not be avoided by reason only of mis-statement of age

A life policy may not be avoided by reason only of a mis-statement of the age of the life insured.

Compare: 1977 No 14 s 7(1)

13 Insurer may vary contract of life insurance in case of mis-statement of age

- (1) This section applies if the date of birth of a life insured under a life policy was not correctly stated to the life insurer at the time when the life policy was entered into, reinstated, or renewed by the life insurer.
- (2) The life insurer may vary the life policy by substituting for the sum insured (including any bonuses) an amount that is not less than the amount calculated in accordance with the following formula:

$$v = \frac{s \times p}{q}$$

where—

- v is the amount of the sum insured (including any bonuses) as varied
- s is the amount of the sum insured (including any bonuses)
- p is the amount that is equal to the premium that has, or to the sum of the premiums that have, become payable under the life policy

- q is the amount that is equal to the premium, or to the sum of the premiums, that the insurer would have charged if the life policy had been based on the correct date of birth or correct dates of birth.
- (3) For the purposes of **subsection (2)**, in relation to a life policy that provides for periodic payments, the **sum insured** means each of those payments (including any bonuses).
- (4) However, if the sum insured (including any bonuses) is less than the amount calculated under **subsection (2)**, the life insurer must, if the life insurer has not varied the life policy under **subsection (2)**,—
- (a) vary the life policy by reducing, as from the date that the life policy was entered into, the premium payable to the premium that the insurer would have charged if the life policy had been based on the correct date of birth; and
- (b) repay to the policyholder the amount of overpayments of premium less any amount that has been paid as the cash value of bonuses in excess of the cash value that would have been paid if the life policy had been based on the correct date of birth.
- (5) A variation of a life policy has effect from the time when the contract was entered into.
- (6) The life insurer must, as soon as practicable after the life policy has been varied under this section, notify the policyholder of the variation.

Compare: 1977 No 14 s 7(2), (3); Insurance Contracts Act 1984 s 30 (Aust)

Restriction on remedy for non-disclosure

14 Avoidance because of failure to disclose a fact may only be exercised within 10 working days

- (1) A right of an insurer to avoid a contract of insurance because of the failure of an insured to disclose a fact to the insurer before the contract is entered into may be exercised only within 10 working days of the risk first attaching.
- (2) For the purposes of this section, **risk first attaching** does not include the attaching of a risk on entering into a contract of insurance replacing interim cover or on the reinstatement or renewal of a contract of insurance.

- (3) This section has effect despite any warranty by the insured that the insured's disclosure obligation has been complied with.

15 Section 14 does not apply in certain circumstances

- (1) **Section 14** does not apply—
- (a) if, before the contract of insurance is entered into, the insured knew, or in the circumstances a reasonable person in the position of the insured would have known, both of the following matters:
 - (i) the undisclosed fact; and
 - (ii) that disclosure of the undisclosed fact would have influenced the judgment of a prudent insurer in fixing the premium or in determining whether the prudent insurer would have taken the risk on substantially the same terms; or
 - (b) if, before the contract of insurance is entered into,—
 - (i) the insurer expressly asks the insured to answer a specific question that does not require the insured, in order to answer it, to decide whether the disclosure of a particular fact is, or might be, relevant to the judgment of the insurer in fixing the premium or in determining whether the insurer will take the risk on substantially the same terms; and
 - (ii) the insured answers the question in a way that is substantially incorrect because of the failure to disclose a fact; or
 - (c) to contracts of reinsurance.
- (2) For the purposes of this section, an answer to a question is **substantially incorrect** only if the difference between what is stated and what is actually correct would have been considered material by a prudent insurer.

Part 3

Terms of contracts of insurance

Restrictions on terms

16 Arbitration provisions not binding

- (1) A provision of a contract of insurance entered into by an insured otherwise than in trade does not bind the insured if the provision has the effect of—
- (a) requiring, authorising, or otherwise providing for differences or disputes in connection with the contract to be referred to arbitration; or
 - (b) limiting the rights otherwise conferred by the contract on the insured by reference to an agreement to submit a difference or dispute to arbitration.
- (2) **Subsection (1)** does not affect an agreement to submit a difference or dispute to arbitration if the agreement was entered into after the difference or dispute arose.

Compare: 1977 No 14 s 8; Insurance Contracts Act 1984 s 43 (Aust)

17 Provisions prescribing manner or time of claims or actions not binding in certain circumstances

- (1) This section applies to the following types of provisions in a contract of insurance:
- (a) provisions that prescribe the manner in which notice of a claim by the insured must be given;
 - (b) provisions that prescribe a time limit within which notice of a claim by the insured must be given;
 - (c) provisions that prescribe a time limit within which an action by the insured must be commenced.
- (2) A provision to which this section applies does not bind the insured—
- (a) if the contract of insurance is a life policy and the claim or action relates to the death of the insured; and
 - (b) in any other case unless the court or arbitrator determining the matter considers that, in the particular circumstances,—
 - (i) the insurer has been prejudiced by the insured's failure to comply with the provision; and
 - (ii) as a result of that prejudice, it would be inequitable if the provision did not bind the insured.

Compare: 1977 No 14 s 9(1)

18 Insurer not liable to pay greater cost

- (1) If the insured under a contract of insurance fails to give notice of a claim in the manner, or within the time, that is prescribed by the contract and the cost of repairing, replacing, or reinstating any property when it falls to be met is greater than that which would have applied if the notice had been given in the manner, or within the time, that is prescribed by the contract, the greater cost is not prejudice to the insurer for the purposes of **section 17**.
- (2) However, an insurer is not liable to apply or pay in repairing, replacing, or reinstating any property a greater sum than that for which the insurer would have been liable if the notice of claim had been given in the manner, or within the time, that is prescribed by the contract of insurance.
- (3) This section does not apply to a life policy.

Compare: 1977 No 14 s 9(2)

19 Section 17 does not apply to claims-made policies

Section 17 does not apply to a provision of a contract of insurance if—

- (a) that provision defines the period within which claims made against the insured or claims arising out of circumstances notified to the insurer are within the risk accepted by the insurer under the contract; and
- (b) the contract is a contract in which the period during which liability for claims against the insured is within the risk accepted by the insurer is defined by reference to the time when—
 - (i) those claims are made; or
 - (ii) claims or circumstances that may give rise to a claim are notified to the insurer.

20 Increased risk exclusions

- (1) An insured is not bound by an increased risk exclusion if the insured proves on the balance of probability that the loss for which the insured seeks to be indemnified was not caused, or contributed to, by the happening of the event or the existence of the circumstance referred to in the increased risk exclusion.
- (2) For the purposes of this section, an **increased risk exclusion** is a provision in a contract of insurance that—

- (a) defines the circumstances in which the insurer is bound to indemnify the insured against loss so as to exclude or limit the liability of the insurer to indemnify the insured on the happening of certain events or on the existence of certain circumstances; and
 - (b) defines the liability of the insurer in that manner, in the view of the court or arbitrator determining the matter, because the happening of those events or the existence of those circumstances was, in the view of the insurer, likely to increase the risk of loss occurring.
- (3) However, this section does not apply to an increased risk exclusion that—
- (a) defines the age, identity, qualifications, or experience of a driver of a vehicle, a pilot of an aircraft, an operator of goods, or a master or pilot of a ship; or
 - (b) defines the geographical area in which the loss must occur; or
 - (c) excludes loss that occurs while a vehicle, an aircraft, any goods, or a ship is or are being used for commercial purposes other than those permitted by the contract of insurance.

Compare: 1977 No 14 s 11

Pro rata conditions of average

21 Prohibition on inclusion of pro rata condition of average in contract of insurance relating to house and contents

- (1) A contract of insurance relating to a house, to any of the contents of a house, or to both must not contain a pro rata condition of average.
- (2) A provision of a contract of insurance that breaches **subsection (1)** is of no effect.
- (3) For the purposes of this section, **house**—
 - (a) means a building or a part of a building occupied or intended to be occupied as a separate dwelling; and
 - (b) includes any outbuildings used primarily for domestic or residential purposes.
- (4) The application of this section to a contract of insurance relating to a house is not excluded by reason only that part of the premises is used—
 - (a) as a shop or office; or

(b) for business, trade, or professional purposes.

Compare: 1985 No 117 s 15

22 Disclosure of pro rata condition of average in certain cases

- (1) If a contract of insurance contains a pro rata condition of average, the condition is of no effect unless, before that contract is entered into, the insurer clearly informs the insured in writing of the nature and effect of the condition.
- (2) However, if it is not reasonably practicable for the information required by **subsection (1)** to be given to the insured in writing before the contract is entered into, that subsection must be treated as having been complied with if the insurer—
 - (a) gives the information orally before the contract is entered into; and
 - (b) gives the information in writing as soon as it is reasonably practicable to do so.
- (3) The requirement to clearly inform the insured in writing of the nature and effect of the condition must be treated as having been complied with if the information is given in writing in the prescribed form.
- (4) **Subsection (3)** does not limit the means by which **subsections (1) and (2)** may be satisfied.
- (5) This section does not apply to a contract of insurance to which **section 21** applies or to a contract of marine insurance (within the meaning of section 3 of the Marine Insurance Act 1908).

Compare: 1985 No 117 s 16

Insurable interest

23 Insurable interest not required

- (1) A person for whose use or benefit or on whose account a contract of insurance is entered into is not required to have an interest in any event for the purposes of—
 - (a) a contract of indemnity against loss; or
 - (b) a life policy.
- (2) This section does not limit the Marine Insurance Act 1908.

Compare: 1985 No 117 s 7

24 Need for insurable interest in life policy abolished

A life policy on the life of a person is not void or illegal by reason only of the fact that the insured under the contract does not have, or did not have when the contract was entered into, any interest in the life of that person.

Compare: 1985 No 117 s 6

*Provisions relating to sale of land***25 Definitions for purposes of this section and sections 26 to 30**

For the purposes of this section and **sections 26 to 30**,—

contract of sale means a contract for the sale of land and all or any fixtures on the land

relevant period means the period between—

- (a) the making of the contract of sale; and
- (b) the earlier of—
 - (i) the purchaser taking possession of the land and fixtures; or
 - (ii) final settlement under the contract of sale

vendor includes a mortgagee of the vendor and any person claiming through the vendor

vendor's insurance means a contract of insurance maintained by the vendor for any damage to, or destruction of, any part of the land or fixtures agreed to be sold under the contract of sale.

26 Purchaser of land entitled to benefits of insurance between dates of sale and possession or settlement

(1) During the relevant period,—

- (a) the vendor's insurance has effect for the benefit of the purchaser as well as for the vendor; and
- (b) the purchaser is entitled to be indemnified by the insurer under the vendor's insurance in the same manner and to the same extent as the vendor would have been if there had been no contract of sale.

(2) **Subsection (1)**—

- (a) does not apply to the extent that the purchaser is entitled to be indemnified under any other contract of insurance; and

- (b) does not require the insurer to pay more in total under the vendor's insurance than it would have had to pay if there had been no contract of sale.

Compare: 1985 No 117 s 13(1)

27 Certain defences or answers invalid

- (1) It is not a defence or answer to a claim by a purchaser against an insurer under **section 26** that the vendor otherwise would not be entitled to be indemnified by the insurer because the vendor has suffered no loss, or has suffered diminished loss, because the vendor is, or was, entitled to be paid the purchase price, or the balance of the purchase price, by the purchaser.
- (2) It is not a defence or answer to a claim by a purchaser against an insurer under **section 26**, in relation to the land or fixtures sold, that the purchaser's entitlement under the vendor's insurance is affected, or defeated, by the existence or terms of another contract of insurance.
- (3) It is not a defence or answer to a claim by a purchaser against an insurer (other than the vendor's insurer) that the purchaser's entitlement under the contract of insurance to which the claim relates is affected, or defeated, by a claim under **section 26**.

Compare: 1985 No 117 s 13(2)

28 Purchase price reduced by amount payable to vendor's mortgagee

- (1) The purchase price payable under a contract of sale must be reduced by the amount specified in **subsection (2)** if, in respect of that contract, there is damage to, or destruction of, any part of the land or fixtures during the relevant period.
- (2) The amount is the amount payable in respect of the damage or destruction under the vendor's insurance to a mortgagee of, or any person claiming through, the vendor.

Compare: 1985 No 117 s 13(3)

29 Application of sections 26 to 28

- (1) **Sections 26 to 28—**
- (a) have effect despite any provision to the contrary in any enactment, rule of law, contract of insurance, deed, or other contract; and

- (b) apply, with all necessary modifications, to a sale or exchange of land and fixtures by order of a court as if the order were a contract of sale.
- (2) However, those sections do not apply to the extent that the purchaser and vendor under the contract of sale expressly agree at any time.

Compare: 1985 No 117 s 13(5), (6)

30 Double insurance relating to contracts for sale of land

If there is a contract of sale, it is not a defence or answer to a claim by the purchaser against an insurer (other than the vendor's insurer) that the purchaser's entitlement under the contract of insurance to which the claim relates is affected or defeated by the existence or terms of any contract of insurance held by, or on behalf of, the vendor.

Compare: 1985 No 117 s 14

Rights of third parties

31 Application of sections 32 to 39 to contracts of insurance (other than contracts of reinsurance)

- (1) **Sections 32 to 39** apply to every contract of insurance (other than contracts of reinsurance) entered into before or after the commencement of this section under which the insurer promises to indemnify the insured for the insured's liability to pay damages or compensation to another person (the **third party**).
- (2) However, **sections 32 to 39** do not affect the discharge of an insurer's liability under a contract of insurance if the discharge was concluded before the commencement of this section.

32 Insolvency or death of insured before payment

The benefit of an insurer's promise under a contract of insurance to indemnify the insured for the insured's liability to pay damages or compensation to a third party must be treated as a benefit conferred on the third party that is enforceable against the insurer by the third party under section 4 of the Contracts (Privity) Act 1982 as if it were a promise by the insurer to pay those damages or that compensation to the third party if,

before payment is made by the insurer to indemnify the insured,—

- (a) the insured has become insolvent; or
- (b) the insured's estate is being administered under Part XVII of the Insolvency Act 1967 (in the case of an insured who has died); or
- (c) the insured has been deceased for not less than 60 days and no administrator of the insured's estate has been appointed in New Zealand; or
- (d) the insured is a company that has been removed from the New Zealand register under section 317 of the Companies Act 1993; or
- (e) the insured is an overseas company that has been removed from the overseas register under section 341 of the Companies Act 1993; or
- (f) the insured is a body corporate (other than a company) that has been dissolved or has ceased to exist; or
- (g) the insurer cannot, after reasonable inquiry, find the insured.

33 Extent of insurer's liability in actions by third parties

- (1) An insurer is not liable to a third party in an action brought under **section 32** for any amount in excess of the total amount that the insurer is liable for under the contract of insurance.
- (2) If the amounts payable for claims made against an insurer by 1 or more actions under **section 32** exceed the total amount that the insurer is liable for under the contract of insurance, those claims must be abated proportionately to their amounts.
- (3) Payments made under the contract of insurance by the insurer to 1 or more third parties without actual notice of a possible claim by any other third party constitutes, to the extent of those payments, a valid discharge to the insurer in respect of the claim of the other third party or third parties.

34 Payments made without actual notice of insured's insolvency

A payment made under the contract of insurance by the insurer to the insured without actual notice that the insured is insolvent is, to the extent of that payment, a valid discharge to the insurer in respect of the insured's liability to the third party.

35 Variation or discharge of obligations before actual notice of insured's insolvency

Nothing in this Act prevents the variation or discharge of an insurer's obligation under a contract of insurance at any time before the insurer has actual notice that the insured is insolvent.

36 Payments to persons who have power over insured's property or estate not valid discharge

A payment made under the contract of insurance by the insurer to any person who has any power in respect of the property or estate of an insured mentioned in **section 32(a) to (g)** is not a valid discharge to the insurer in respect of that insured's liability to a third party.

37 Duty to give necessary information to third parties

- (1) Every insurer, every insured, and every receiver, manager, trustee, liquidator, personal representative, or other person in possession of the estate or property of the insured must, at the request of a third party, give to the third party any information that the third party may reasonably require to ascertain whether any promise of the insurer to indemnify the insured is one to which **section 32** applies.
- (2) The duty under **subsection (1)** includes a duty to allow, at a reasonable time, all contracts of insurance, receipts for premiums, and other relevant documents in the possession or power of the person on whom the duty is imposed to be inspected and copied.
- (3) A provision of a contract of insurance is of no effect if it purports, directly or indirectly,—
 - (a) to prohibit or prevent the giving of any information required to be given by this section; or
 - (b) to avoid the contract or to alter the rights of the parties under it upon the giving of any that information.
- (4) An application to enforce a duty imposed by this section may be made by originating application either in the High Court or in a District Court.
- (5) Every person who, without reasonable excuse, fails to comply with a duty imposed by this section commits an offence and is liable on summary conviction to a fine not exceeding \$1,000.

38 Actions by third parties against insurers

- (1) A third party may bring an action against an insurer under **section 32** although judgment has already been entered against the insured for damages or compensation in respect of the same matter.
- (2) Before commencing an action against an insurer under **section 32**, a third party must obtain the leave of the court in which the action is to be commenced unless—
 - (a) the insured is subject to a statutory or contractual regime under which the assets of the insured have been or are to be realised for the benefit of secured or unsecured creditors; or
 - (b) the insured's estate is being administered under Part XVII of the Insolvency Act 1967 (in the case of an insured who has died); or
 - (c) the insured is a company that has been removed from the New Zealand register under section 317 of the Companies Act 1993; or
 - (d) the insured is a body corporate (other than a company) that has been dissolved or has ceased to exist.
- (3) On an application by a third party for leave to bring an action against an insurer, the court must grant leave if it is satisfied that the third party has established a prima facie entitlement to bring that action.

39 Limitation period does not apply in certain cases

If an action for damages or compensation is commenced by a third party against an insured within the time allowed by section 4 of the Limitation Act 1950 and subsequently the third party commences an action under **section 32** against the insurer in respect of the same matter, section 4 of the Limitation Act 1950 does not apply to that action against the insurer.

*Application of proceeds of contracts of reinsurance***40 Application of sections 41 to 43**

- (1) **Sections 41 to 43** apply if—
 - (a) a company that is in liquidation is insured, under a contract of reinsurance entered into before the relevant date, against liability to pay amounts in respect of a relevant contract of insurance or relevant contracts of insurance; and

- (b) an amount in respect of that liability has been or is received by the company or the liquidator under the contract of reinsurance.
- (2) For the purposes of this section and **sections 41 to 43**,—
- relevant contract of insurance** means a contract of insurance entered into by the company, as insurer, before the relevant date
- relevant date** means the date on which the liquidation of the company commences in accordance with Part XVI of the Companies Act 1993.
- (3) **Sections 41 to 43** have effect despite any agreement to the contrary.

Compare: Corporations Act 2001 s 562A(1), (7), (8) (Aust)

41 Liquidator must pay amounts that are payable under contracts of insurance

- (1) If the amount received, after deducting expenses of or incidental to collecting that amount, equals or exceeds the total of all the amounts that are payable by the company under relevant contracts of insurance to which the amount received relates, the liquidator must, out of the amount received and in priority to all payments in respect of the expenses, fees, and claims mentioned in section 312 of the Companies Act 1993, pay the amounts that are so payable under those contracts of insurance.
- (2) If **subsection (1)** does not apply, the liquidator must, out of the amount received and in priority to all payments in respect of the expenses, fees, and claims mentioned in section 312 of the Companies Act 1993, pay to each person to whom an amount is payable by the company under a relevant contract of insurance to which the amount received relates an amount calculated in accordance with the formula:

$$a = \frac{p \times r}{t}$$

where—

- a is the amount that the liquidator must pay
- p is the amount payable to the person under the relevant contract of insurance

- r is the amount received under the contract of reinsurance, less any expenses of or incidental to collecting that amount
- t is the total of all the amounts payable by the company under relevant contracts of insurance.

Compare: Corporations Act 2001 s 562A(2), (3) (Aust)

42 Court may order payment of different amount

- (1) The court may, on application by a person to whom an amount is payable under a relevant contract of insurance, make an order to the effect that **section 41** does not apply to the amount received under the contract of reinsurance and that that amount must, instead, be applied by the liquidator in the manner specified in the order.
- (2) The manner specified in the order must be a manner that the court considers just and equitable in the circumstances.
- (3) The matters that the court may take into account in considering whether to make an order under **subsection (1)** include—
- (a) whether it is possible to identify particular relevant contracts of insurance as being the contracts in respect of which the contract of reinsurance was entered into; and
 - (b) whether it is possible to identify persons who can be said to have paid extra in order to have particular relevant contracts of insurance protected by reinsurance; and
 - (c) whether particular relevant contracts of insurance include statements to the effect that the contracts are to be protected by reinsurance; and
 - (d) whether a person to whom an amount is payable under a relevant contract of insurance would be severely prejudiced if **section 41** applied to the amount received under the contract of reinsurance.

Compare: Corporations Act 2001 s 562A(4), (5) (Aust)

43 Insured's rights unaffected

If receipt of a payment under **section 41** or **section 42** only partially discharges a liability of the company to a person, nothing in those sections affects the rights of the person in respect of the balance of the liability.

Compare: Corporations Act 2001 s 562A(6) (Aust)

Part 4

Contracts of life insurance

Interest payable under policies

44 Interest payable from 91st day after date of death

- (1) This section applies if—
 - (a) any money becomes payable by a life insurer under a life policy as a result of the death of the person on whose life the life policy was entered into; and
 - (b) that money is not paid, within 90 days after the date of death, to the person entitled to that money.
- (2) The life insurer must pay to that person, at the same time as that money is paid, interest on that money for the period beginning on the 91st day after the date of death and ending with the close of the day on which that money is paid.

Compare: 1908 No 105 s 41A(1)

45 Interest payable in respect of assets related money

- (1) **Section 44** does not require the life insurer to pay interest on assets related money.
- (2) For the purposes of this section, **assets related money** means the whole or any part of the money that becomes payable by a life insurer under a life policy as a result of the death of the person on whose life the life policy was entered into that—
 - (a) is related to the value of identifiable assets of a fund named in the life policy; and
 - (b) is required by the life policy to be calculated as at a date later than the date of death.
- (3) However, the life insurer must pay to the person entitled to the assets related money, at the same time as that money is paid, interest on that money for the period beginning on the 15th day after the earliest possible date that it could have been paid to that person and ending with the close of the day on which the assets related money is paid if—
 - (a) the claim requirements have been satisfied; and
 - (b) the assets related money is not paid within 14 days after that earliest possible date.

Compare: 1908 No 105 s 41A(2)

46 Rate of interest payable

- (1) The interest payable in relation to a particular day in the relevant period must be paid at the greater of—
 - (a) the rate specified in the life policy; or
 - (b) the Reserve Bank of New Zealand 90 day bank bill rate in effect at 10 am on that day.
- (2) For the purposes of **subsection (1)**, **relevant period** means the period in which interest must be paid under **section 44 or section 45**.

Compare: 1908 No 105 s 41A(3)

*Assignments of policies***47 Assignment of life policy at law**

- (1) An assignment of a life policy is not effective at law until it is registered in accordance with **sections 48 to 54**.
- (2) **Subsection (1)**—
 - (a) does not apply to an assignment to the life insurer that is liable under the life policy;
 - (b) is subject to **section 54**.

Compare: 1908 No 105 s 43(3)

48 Requirements for valid assignment by way of ordinary transfer

An assignment of a life policy by way of ordinary transfer is not effective at law unless the following requirements have been satisfied:

- (a) the assignment must be made using an instrument of transfer in the prescribed form;
- (b) the instrument of transfer must be endorsed on or attached to the policy document;
- (c) the instrument of transfer must be executed by the transferor and the transferee;
- (d) the instrument of transfer must be registered in a register of assignments kept for that purpose by the life insurer concerned;
- (e) the date of registration of the transfer must be inserted in the instrument of transfer by the life insurer concerned;

- (f) the instrument of transfer must be signed by the principal officer of the life insurer concerned.

Compare: 1908 No 105 s 43(1)

49 Effect of assignment at law

An assignment of a life policy has the following effects at law if the requirements of **section 48** are satisfied:

- (a) the life policy vests absolutely in the transferee:
- (b) the transferee has all the rights and powers, and is subject to all the liabilities, of the transferor under the life policy:
- (c) the transferee becomes the policyholder under the life policy:
- (d) the transferee may sue in the transferee's own name on the life policy:
- (e) the receipt of the transferee is a valid discharge both at law and in equity for all money payable under the life policy.

Compare: 1908 No 105 s 43(1)

50 Assignments otherwise than by way of ordinary transfer

- (1) This section applies if the assignment of a life policy is made otherwise than by way of ordinary transfer.
- (2) The assignment must be registered by leaving the instrument of assignment with the policy document at the office of the life insurer.
- (3) The principal officer must, if in his or her opinion the instrument of assignment is in due form and properly executed,—
 - (a) endorse a memorandum on the policy document; and
 - (b) retain the instrument of assignment in the office of the life insurer; and
 - (c) either—
 - (i) return the policy document, with the endorsement, to the person who is registering the assignment; or
 - (ii) retain the policy document if the assignment is by way of surrender to the life insurer.
- (4) The memorandum must—
 - (a) be in the prescribed form; and
 - (b) be signed by the principal officer.

Compare: 1908 No 105 s 43(2)

51 Assignments on trust

- (1) If an assignment of a life policy is on a trust, the trust must be effected by way of declaration of trust by a separate instrument.
- (2) No notice of the trust may be inserted in the assignment or endorsed on the life policy.

Compare: 1908 No 105 s 43(4)

52 Life insurer not affected by notice of trust

A life insurer is not bound to receive, and is not affected by, any express, implied, or constructive notice of any trust that affects any life policy.

Compare: 1908 No 105 s 42

53 Assignment by way of surrender

An assignment of a life policy that is by way of surrender to the life insurer liable under the life policy must be in the prescribed form.

Compare: 1908 No 105 s 43(5)

54 Assignment of life policy if life insurer established out of New Zealand

- (1) This section applies to an assignment of a life policy if the life insurer liable under the life policy—
 - (a) is established out of New Zealand; and
 - (b) does not have a place of business in New Zealand.
- (2) The assignment—
 - (a) does not need to be registered; and
 - (b) takes effect from the date of the assignment in the same manner as if it were registered.
- (3) However, if the assignment is otherwise than by way of ordinary transfer the assignment is not effective at law unless—
 - (a) there is endorsed on the policy document a memorandum in the prescribed form; and
 - (b) the memorandum is executed by the assignor and assignee.

Compare: 1908 No 105 s 43(6), (7)

*Mortgages of policies***55 Form and execution of mortgages**

Every mortgage of a life policy must be in the prescribed form and executed by the mortgagor.

Compare: 1908 No 105 s 44(1)

56 Mortgage of life policy must be registered

- (1) A mortgage of a life policy is not effective at law until it is registered under **section 57**.
- (2) However, a mortgage of a life policy to the life insurer that is liable under the life policy—
 - (a) does not need to be registered; and
 - (b) takes effect from the date of the mortgage in the same manner as if it were registered.

Compare: 1908 No 105 s 44(3), (4)

57 Registration of mortgage

- (1) A mortgage of a life policy must be registered by leaving the mortgage, the policy document, and a certified copy of the mortgage at the office of the life insurer.
- (2) The principal officer must, if the mortgage is in his or her opinion in due form and properly executed,—
 - (a) endorse on the policy document a memorandum in the prescribed form; and
 - (b) endorse on the mortgage a memorandum in the prescribed form; and
 - (c) retain the certified copy of the mortgage in the office of the life insurer; and
 - (d) return the policy document and the original mortgage, with the respective endorsements signed by the principal officer, to the person leaving the mortgage for registration.

Compare: 1908 No 105 s 44(2)

58 Mortgage of life policy if life insurer established out of New Zealand

- (1) This section applies to a mortgage of a life policy if the life insurer liable under the life policy—
 - (a) is established out of New Zealand; and
 - (b) does not have a place of business in New Zealand.

- (2) The mortgage—
 - (a) does not need to be registered; and
 - (b) takes effect from the date of the mortgage in the same manner as if it were registered.
- (3) However, the mortgage is not valid unless—
 - (a) there is endorsed on the policy document a memorandum in the prescribed form; and
 - (b) the memorandum is executed by the mortgagor and mortgagee.

Compare: 1908 No 105 s 44(4), (5)

59 Terms and conditions implied in mortgages generally

- (1) The terms and conditions set out in **Schedule 1** are implied in, and are taken to form part of, every mortgage of a life policy.
- (2) This section does not apply to a mortgage of a life policy to the life insurer liable under the life policy.

Compare: 1908 No 105 s 45(1)

60 Terms and conditions implied in mortgages to life insurer liable under life policy

The terms and conditions set out in **Schedule 2** are implied in, and are taken to form part of, every mortgage of a life policy to the life insurer liable under the life policy.

Compare: 1908 No 105 s 45(2)

61 Implied terms and conditions may be altered

An instrument creating a mortgage of a life policy may alter the terms and conditions implied under **section 59 or section 60** in any 1 or more of the following ways:

- (a) by varying any implied terms and conditions;
- (b) by negating any implied terms and conditions;
- (c) by providing additional terms and conditions;
- (d) by substituting terms and conditions for any implied terms and conditions.

Compare: 1908 No 105 s 45(3)

62 Several mortgages may be registered

- (1) Any number of mortgages may be registered against the same life policy in the case of mortgages that require registration in order to be effective at law.

- (2) Those mortgages take effect and have priority according to priority of the date of registration.

Compare: 1908 No 105 s 46

63 Registration of instrument or mortgage after advances by the life insurer

- (1) This section applies if—
- (a) the life insurer liable under a life policy has advanced money on the security of the life policy or has taken a mortgage of the life policy; and
 - (b) an instrument affecting that life policy that is made to, or in favour of, a person other than the life insurer is presented for registration after the money has been advanced or the mortgage is taken.
- (2) The principal officer of the life insurer is entitled to require, as a condition that must be fulfilled before registration, that all persons claiming an interest under the instrument execute an acknowledgment, to be endorsed on the instrument,—
- (a) of the existence of the advance by the life insurer or the mortgage to the life insurer; and
 - (b) of the amount due to the life insurer in respect of the advance or mortgage at the time of the acknowledgment.

Compare: 1908 No 105 s 47

64 Mortgagee may execute assignment when exercising the mortgagee's power of sale

- (1) A mortgagee may, if the mortgagee has sold a life policy under the power of sale in the mortgage,—
- (a) execute an assignment by way of ordinary transfer of the life policy; and
 - (b) include in the assignment a statement to the effect that the mortgagee has sold the life policy in the exercise of the mortgagee's power of sale.
- (2) All of the provisions of this Act relating to the registration and effect of assignments of life policies apply to the assignment of the life policy if the mortgagee has, in accordance with **subsection (1)**, executed an assignment and included in the assignment the statement referred to in **subsection (1)(b)**.

Compare: 1908 No 105 s 48

65 Life insurer or purchaser not affected by notice of improper sale and not required to see to application of proceeds

- (1) This section applies to the following persons:
 - (a) a life insurer whose principal officer is required to register an assignment of a life policy by a mortgagee;
 - (b) any purchaser of a life policy from a mortgagee.
- (2) The persons to whom this section applies—
 - (a) are not required to inquire into the propriety or regularity of the sale; and
 - (b) are not affected in any way by express, implied, or constructive notice that the sale is in any way improper or irregular; and
 - (c) are not required to see to the application of the proceeds of the sale.

Compare: 1908 No 105 s 49

66 How mortgages are discharged

- (1) The mortgagee of a life policy must endorse on a mortgage held by the mortgagee a memorandum of discharge in the prescribed form if—
 - (a) the sum secured by the mortgage has been paid off either wholly or in part; or
 - (b) for any other reason the mortgagee is required to wholly or partially discharge the mortgage.
- (2) On the registration of the memorandum of discharge, the life policy is released and discharged from the mortgage to the extent specified in that memorandum.
- (3) If any 1 or more of the discharges are only partial discharges, further discharges, as often as the case may require, may be executed in the same form and registered in the same manner as specified in this section.

Compare: 1908 No 105 s 50(1), (2)

67 Discharge or partial discharge of mortgage of life policy if life insurer established out of New Zealand

- (1) This section applies to a memorandum of discharge or of partial discharge of a mortgage of a life policy if the life insurer liable under the life policy—
 - (a) is established out of New Zealand; and
 - (b) does not have a place of business in New Zealand.

- (2) The memorandum of discharge or of partial discharge—
 - (a) does not need to be registered; and
 - (b) takes effect from the date of the memorandum of discharge or of partial discharge in the same manner as if it were registered.
- (3) However, the memorandum of discharge or of partial discharge is not valid unless—
 - (a) there is endorsed on the policy document a memorandum in the prescribed form; and
 - (b) the memorandum is executed by the mortgagee.

Compare: 1908 No 105 s 50(3), (4)

68 How discharges are registered

- (1) A memorandum of discharge, or of partial discharge, of a mortgage of a life policy is registered by leaving the mortgage, the memorandum endorsed on the mortgage, and the policy document at the office of the life insurer.
- (2) The principal officer must, if the memorandum of discharge, or of partial discharge, is in his or her opinion in due form and properly executed,—
 - (a) endorse on the policy document a memorandum in the prescribed form; and
 - (b) endorse on the mortgage a memorandum of the registration of the discharge, or of the partial discharge, of mortgage in the prescribed form; and
 - (c) either—
 - (i) return the mortgage and the policy document, with the respective endorsements signed by the principal officer, to the person leaving the memorandum of discharge, or of partial discharge, for registration; or
 - (ii) if the mortgage is to the life insurer, retain the mortgage and the policy document.

Compare: 1908 No 105 s 51

69 Provisions that relate to assignments of policies apply to assignments of mortgages

All the provisions of this Act that relate to the assignment of life policies, the registration of assignments of life policies, or the registering of ownership of life policies apply, with all necessary modifications, to the assignment of mortgages of

life policies, the registration of those assignments, and the registering of ownership of mortgages of life policies.

Compare: 1908 No 105 s 53

Other provisions relating to registration

70 How ownership of life policy is registered if ownership acquired by bankruptcy or under will, intestacy, or writ of execution

- (1) This section applies if the ownership of a life policy is acquired—
 - (a) by bankruptcy; or
 - (b) under a will or intestacy; or
 - (c) under a writ of execution issued out of any court.
- (2) The person acquiring ownership of a life policy may have the person's ownership of the life policy registered by providing the policy document to the principal officer with any evidence that is reasonably necessary to establish the ownership.
- (3) The principal officer may require the person to provide any further reasonable evidence that the principal officer thinks fit to establish the ownership.
- (4) The principal officer must, if the principal officer is satisfied with the evidence,—
 - (a) endorse on the policy document a memorandum in the prescribed form; and
 - (b) return the policy document, endorsed with the memorandum signed by the principal officer, to the person who acquires the ownership of the life policy.
- (5) The endorsement vests the life policy in the person as fully and effectually as if it had been assigned to the person under the provisions of this Act.

Compare: 1908 No 105 s 52

71 Principal officer may require reasonable evidence of matters affecting validity before registering

A principal officer may, before he or she registers a document under this Act, require any reasonable evidence that he or she thinks fit as to—

- (a) the validity of the signatures on the document; or

- (b) any other matters that might, in his or her opinion, affect the validity of the document.

Compare: 1908 No 105 s 54

72 Registration may be ordered by court

- (1) The court may, on the application of any person, order that a document or matter is to be registered in accordance with this Act.
- (2) If an application is made under **subsection (1)**,—
 - (a) the applicant must, as soon as is reasonably practicable, serve notice of the application on the principal officer who is required to register the document or matter; and
 - (b) that principal officer may appear and be heard in relation to the application.
- (3) The court may—
 - (a) make any other orders that it thinks fit for the purpose of giving effect to an order under **subsection (1)**; and
 - (b) make any order subject to any terms and conditions that it thinks fit.
- (4) The principal officer must register a document or matter in accordance with an order made under this section as soon as is reasonably practicable after receiving the order.

Compare: 1908 No 105 s 55

73 Time of registration

The time of registration to be placed by the principal officer on any life policy or instrument must in all cases, and for all purposes of this Act, be as nearly as possible the time when the registration was first capable of being effected by the principal officer.

Compare: 1908 No 105 s 56

74 Principal officer to keep record of registrations

- (1) The principal officer must keep a written record of each registration effected by him or her.
- (2) The records must be kept in the prescribed manner.

Compare: 1908 No 105 s 57

75 Notice of unregistered dealings does not affect life insurer or other persons

- (1) The principal officer, the life insurer, and all other persons, in all transactions and dealings of any kind concerning any life policy, are not affected by notice of an unregistered interest in the life policy.
- (2) A registered transaction or dealing with the duly registered assignee or mortgagee of a life policy—
 - (a) must not be set aside merely because of notice of an unregistered interest in the life policy; and
 - (b) is not affected in any manner by notice of an unregistered interest in the life policy.
- (3) **Subsections (1) and (2)** do not apply in the case of fraud.
- (4) In this section, **unregistered interest**, in relation to a life policy, means an interest that is not registered under this Act.

Compare: 1908 No 105 s 58

76 Provision for lost or destroyed policies or instruments

- (1) The principal officer may, on any reasonable evidence and subject to any reasonable terms and conditions that he or she thinks fit, issue a certified copy of a life policy if the life policy is lost or destroyed.
- (2) A certified copy of a life policy must be treated as—
 - (a) taking the place of the life policy that is lost or destroyed for the purposes of this Act; and
 - (b) being the sole evidence of the contract made by the life policy.
- (3) The principal officer may effect a registration on any reasonable terms and conditions that he or she thinks fit, despite the loss or destruction of—
 - (a) an instrument required to be registered; or
 - (b) an instrument that needs to be provided for a registration under this Act.
- (4) If a certified copy of a life policy has been issued under this section and is afterwards lost or destroyed, then another certified copy may, in the same manner, be issued to take the place of the original life policy.

Compare: 1908 No 105 s 59

77 Courts may enforce equities

Nothing in this Act prevents a court of competent jurisdiction from enforcing any equities that may exist as between the parties to a transaction or matter relating to a life policy, an interest in a life policy, or an interest in any money payable under a life policy.

Compare: 1908 No 105 s 60

78 Fee for registration

- (1) A life insurer may charge a fee not exceeding a prescribed amount for effecting a registration under this Act.
- (2) The life insurer may refuse to effect a registration until the fee is paid.

Compare: 1908 No 105 s 61

*Surrender values***79 Applying surrender value to keep life policy in force**

- (1) A life insurer may apply the whole or any part of the surrender value of a life policy in payment of overdue premiums and interest on those overdue premiums.
- (2) The money that is applied under **subsection (1)**, with accrued interest,—
 - (a) is a first charge on the money payable under the life policy and on the surrender value of the life policy; and
 - (b) may be deducted as against every mortgagee or assignee.
- (3) This section is subject to—
 - (a) any bylaws or regulations made by the life insurer or that affect the life insurer; and
 - (b) the terms and conditions of the life policy.
- (4) For the purposes of this section and **section 80**, **surrender value** means the surrender value of the life policy that is declared by the life insurer issuing the life policy.

Compare: 1908 No 105 s 63

80 Policies to be kept in force by surrender value

A life policy is not void because of the non-payment of premiums if the premiums and interest in arrear are not in excess of the surrender value.

Compare: 1908 No 105 s 64

*Life insurance of minors***81 Insurance by minor who has not turned 10 years**

A minor who has not yet turned 10 years may enter into a life policy on the minor's own life only if the life policy is entered into in accordance with a contract approved under section 9 of the Minors' Contracts Act 1969.

Compare: 1908 No 105 s 66A

82 Insurance by minor who has turned 10 years

(1) A minor who has turned 10 years may do, execute, suffer, and perform all acts, deeds, matters, and things necessary or proper for the purpose of entering into a life policy on the minor's own life.

(2) **Subsection (1)** is—

- (a) subject to section 6 of the Minors' Contracts Act 1969 if the minor has not yet turned 16 years; and
- (b) subject to section 5(2) of the Minors' Contracts Act 1969 if the minor has turned 16 years.

(3) **Subsection (1)** is subject to **sections 83 to 85**.

Compare: 1908 No 105 s 66B

83 Dealings by minors with policies

(1) If any life policy entered into on the life of a minor is owned by the minor, the minor—

- (a) may, if he or she has turned 16 years,—
 - (i) surrender the life policy;
 - (ii) give discharges for the money payable under the life policy;
 - (iii) dispose of the life policy by will in accordance with section 6 of the Wills Amendment Act 1955 or section 2 of the Wills Amendment Act 1969;
 - (iv) dispose of, or deal with, the life policy or an interest in the life policy in any manner authorised by this Act; and
- (b) may, if he or she has not yet turned 16 years, do any of the things mentioned in **paragraph (a)(i), (ii), and (iv)** if those matters are done with the approval of a District Court.

(2) **Subsection (1)** applies whether or not the life policy was entered into in the first place by the minor.

- (3) **Subsection (1)(a)** applies whether the life policy was entered into before or after the minor turned 16 years.
- (4) If a minor who has turned 16 years exercises a power referred to in **subsection (1)(a)(i)** or **subsection (1)(a)(ii)**, section 5(2) of the Minors' Contracts Act 1969 applies to the surrender or discharge.
- (5) If a minor who has turned 16 years enters into a contract for a life policy to which **subsection (1)** applies, section 5(2) of the Minors' Contracts Act 1969 applies to the contract.
- (6) Nothing in this section or in **section 82** limits section 4 of the Minors' Contracts Act 1969 (which confers full contractual capacity on married minors).

Compare: 1908 No 105 s 66C

84 Presumption for policies entered into and dispositions made

- (1) It is conclusively presumed, as concerns a life insurer that is liable under a life policy, and so far as concerns a good faith purchaser of a life policy,—
 - (a) that the insured who entered into the life policy had, at the time when that person entered into the life policy, turned 10 years; or
 - (b) that the person who disposed of the life policy had, at the time when that person disposed of the life policy, turned 16 years.
- (2) The presumption set out in **subsection (1)** does not apply if the life insurer that entered into the life policy, or the good faith purchaser, had,—
 - (a) at the time that the life policy was entered into, actual knowledge that the person purporting to enter into the life policy had not yet turned 10 years; or
 - (b) at the time of the disposition, actual knowledge that the person purporting to dispose of the policy had not yet turned 16 years.
- (3) Nothing in this section applies to a life policy entered into under a contract approved under section 9 of the Minors' Contracts Act 1969.

- (4) For the purposes of this section, **good faith purchaser** means a person who claims under a disposition of a life policy entered into in good faith and for valuable consideration.

Compare: 1908 No 105 s 66D

85 Insurance on life of minor who has not yet turned 16 years

- (1) A life policy on the life of a minor who has not yet turned 16 years may be entered into by any of the following persons:
- (a) any 1 or more of the parents or guardians of the minor;
 - (b) a parent or guardian of the minor and the spouse or de facto partner of that parent or guardian, jointly;
 - (c) any person who has obtained the consent of a District Court to do so.
- (2) No person may enter into a life policy on the life of a minor who has not yet turned 16 years except as provided in—
- (a) **subsection (1)**; or
 - (b) **section 81** or **section 82** or **section 86**; or
 - (c) section 9 of the Minors' Contracts Act 1969.
- (3) **Subsection (1)** is subject to **sections 82 to 90**.

Compare: 1908 No 105 s 67

86 Endowment insurances on lives of minors

It is lawful for a life insurer to enter into a life policy, on the life of a minor of any age, that provides for the payment of money—

- (a) on the expiry of a certain period; or
- (b) on the attainment of a specified age by the minor in respect of whom the life policy is entered into.

Compare: 1908 No 105 s 67A

Limitations on payments in respect of death of minors

87 Limitation on total amount of payments if deceased minor had not turned 10 years

- (1) A life insurer must not knowingly pay under a life policy, on the death of a minor who had not turned 10 years, a sum that is more than the total of the following amounts:
- (a) the total amount of premiums paid under the life policy, together with interest on the premiums (compounded annually) at the Reserve Bank of New Zealand 90 day

- bank bill rate in effect at the date of the death of the minor; and
- (b) the amount that, when added to any other sum permitted by this paragraph to be paid by any other life insurer or by any friendly society, equals the prescribed amount.
- (2) **Subsection (1)** does not limit **sections 44 to 46** and interest under those sections may be paid in addition to the amounts required to be aggregated for the purposes of **subsection (1)**.

Compare: 1908 No 105 s 67B

88 Limitation on persons to whom payments may be made if deceased minor had not turned 16 years

A life insurer must not knowingly pay, on the death of a minor who had not turned 16 years, any sum under any life policy entered into on or after 1 April 1986 to any person other than—

- (a) a person specified in **section 85(1)**; or
- (b) an executor or administrator of a person specified in **section 85(1)**; or
- (c) a person to whom payment may be made under section 65(2) of the Administration Act 1969; or
- (d) any person who is entitled to that sum by virtue of an assignment approved under **section 83(1)(b)**.

Compare: 1908 No 105 s 67C

89 Life insurer to supply statement in respect of limitations

- (1) A life insurer must not enter into a life policy on the life of a minor who has not yet turned 16 years unless—
- (a) a statement explaining the effect of **sections 87 and 88** is set out in the proposal for the life policy; and
- (b) the insured who enters into the life policy has signed an acknowledgment that the person is aware of the limitations imposed by those sections.
- (2) A life policy that is entered into in breach of **subsection (1)** does not make the life policy illegal, unenforceable, or of no effect.

Compare: 1908 No 105 s 67D

90 Offences

Every person commits an offence and is liable on summary conviction to a fine not exceeding \$1,000 who,—

- (a) being a life insurer, breaches **section 87** or **section 88** or **section 89(1)**; or
- (b) being a person claiming money on the death of a minor who had not turned 16 years,—
 - (i) produces to the life insurer from which the money is claimed a false certificate of death or one fraudulently obtained; or
 - (ii) in any way attempts to defeat the provisions of this Act concerning payments on the death of minors.

Compare: 1908 No 105 s 67E

Money payable under life policy for benefit of minors or persons who are incapable of exercising their rights

91 Money payable to Public Trust

- (1) Any money becoming payable under a life policy to, or for the benefit of, a minor or an incapable person may be paid to Public Trust if there is no trustee or other person capable in law of giving a valid discharge for the money on behalf of the minor or the incapable person.
- (2) **Subsection (1)** does not apply if another trustee or other person capable in law of giving a valid discharge for the money on behalf of the minor or the incapable person is lawfully appointed.
- (3) The High Court may, on an application that is made on behalf of the person beneficially interested, appoint Public Trust or any other person as trustee of the money on any terms that the High Court thinks fit.
- (4) For the purposes of this section and **sections 92 to 96**, **incapable person** means a person who is incapable of exercising his or her rights.

Compare: 1908 No 105 s 69

92 Powers of Public Trust receiving money

If any money is paid to Public Trust under **section 91(1)**, it may, unless and until another trustee is appointed, act as trustee of the money as effectively and with the same powers as if it had been duly appointed as trustee under **section 91(3)** or by any person entitled to appoint a trustee.

Compare: 1908 No 105 s 70

93 Trustee may apply money of minors or other incapable persons for their maintenance, education, protection, or advancement in life

- (1) Public Trust (whether acting under **section 92** or by special appointment), or any other trustee of the money payable under a life policy to, or for the benefit of, a minor or an incapable person, may apply all or part of the corpus or the interest of the money for the maintenance, education, protection, or advancement in life of the person on whose behalf Public Trust or the trustee holds the money.
- (2) The power under **subsection (1)** may be exercised in any manner that Public Trust or the trustee thinks fit.
- (3) This section does not apply, in the case of a special appointment, if Public Trust or the other trustee is directed otherwise by the appointing instrument.

Compare: 1908 No 105 s 71

94 Payment to trustee a valid discharge to life insurer

- (1) The payment made to Public Trust, or to any other trustee under this Act, is a valid and sufficient discharge to the life insurer for the insurance money that is paid.
- (2) The life insurer is not—
 - (a) required to see to the application of the money; and
 - (b) liable for the subsequent misapplication or non-application of the money by any trustee.

Compare: 1908 No 105 s 72

95 How insurance money received by trustee may be invested

The money received by Public Trust, acting under **section 92**, or by any trustee under this Act may be invested by Public Trust or the trustee in accordance with Part II of the Trustee Act 1956.

96 Income not required for maintenance, education, protection, or advancement in life must be capitalised

All or any part of the annual income arising from the investment of the insurance money not required for the maintenance, education, protection, or advancement in life of the minor or the incapable person must be capitalised and

invested in the same manner as the money from which the income is derived.

Compare: 1908 No 105 s 74

Insurances by spouses or de facto partners

97 Spouse or de facto partner may insure his or her own life

- (1) A life policy entered into by any person on his or her own life, and expressed, at the time that the life policy is entered into, to be for the benefit of any or all of the following persons, creates a trust in favour of the objects named in the life policy:
 - (a) the person's spouse;
 - (b) the person's de facto partner;
 - (c) the person's children.
- (2) The money payable under a life policy referred to in **subsection (1)**, as long as any object of the trust remains unperformed,—
 - (a) does not form part of the estate of the insured; and
 - (b) is not subject to his or her debts.
- (3) However, if it is proved that the life policy was entered into and the premiums paid with intent to defraud the creditors of the insured, the creditors are entitled to receive, out of the money payable under the life policy, a sum equal to the premiums that are paid.

Compare: 1908 No 105 s 75A(2)

98 Appointment of trustees and investment of money

- (1) The insured may, in relation to the money payable under a life policy referred to in **section 97**, by the life policy, or by a memorandum signed by the insured, do 1 or more of the following:
 - (a) appoint a trustee;
 - (b) appoint a new trustee;
 - (c) provide for the appointment of a new trustee;
 - (d) provide for the investment of that money.
- (2) The life policy, immediately on its being entered into, vests in the insured and his or her legal personal representatives in trust for the purposes of the trust if there is any default in the appointment of a trustee.
- (3) A trustee or a new trustee may be appointed by a court having jurisdiction under the Trustee Act 1956 if, at the time of the

insured's death or at any time afterwards, there is no trustee or it is expedient to appoint a new trustee.

Compare: 1908 No 105 s 75A(3)–(5)

99 Receipt of trustee or legal personal representative is valid discharge

The receipt of the following is a discharge to the life insurer for the sum secured by a life policy referred to in **section 97**, or for the value of that life policy, in whole or in part:

- (a) a trustee duly appointed;
- (b) the legal personal representative of the insured, in the event of a default in the appointment of a trustee or in default of notice to the life insurer.

Compare: 1908 No 105 s 75A(6)

100 Reversion or vesting of policies assigned to husband, wife, or de facto partner

- (1) This section applies if—
 - (a) a policyholder has assigned a life policy on his or her own life to his or her wife or husband or de facto partner; and
 - (b) that wife or husband or de facto partner has died in the lifetime of the policyholder without having disposed of the life policy by will; and
 - (c) either or both of the following apply:
 - (i) the premiums actually paid on the life policy do not, at the date of the death of the assignee, exceed the prescribed amount;
 - (ii) the sum assured by the life policy does not, exclusive of bonuses, exceed the prescribed amount.
- (2) The life policy, with all bonus additions to the life policy, reverts to and vests in the surviving husband or wife or de facto partner (as the case may be), subject to all outstanding interests and equities that affect the life policy.

Compare: 1920 No 84 s 2(1)

101 Life insurer may declare executor or other persons to be holder of life policy

- (1) This section applies if—
 - (a) a policyholder has assigned a life policy on his or her life to his or her wife or husband or de facto partner; and

- (b) that wife or husband or de facto partner has died in the lifetime of the policyholder having made a will under which she or he has disposed of the life policy; and
- (c) either or both of the following apply:
 - (i) the premiums actually paid on the life policy do not, at the date of the death of the assignee, exceed the prescribed amount;
 - (ii) the sum assured by the life policy does not, exclusive of bonuses, exceed the prescribed amount.
- (2) The life insurer may, without requiring probate of the will, declare that the executor of the will, or any person who may be entitled under the will to the life policy, is the policyholder.
- (3) If a declaration is made under **subsection (2)**, the principal officer must register a memorial that the executor or other person is the policyholder.
- (4) The executor or other person becomes the policyholder on the registration of the memorial, subject to all outstanding interests or equities affecting the life policy.
- (5) The life insurer may, in its discretion, require probate of the will to be taken out.

Compare: 1920 No 84 s 2(2)

102 Vesting life policy without requiring probate or letters of administration

- (1) If the policyholder of a life policy, not being the life insured, dies in the lifetime of the life insured, the life insurer may, in its discretion and without requiring probate or letters of administration, declare that any person is the policyholder if—
 - (a) that person proves to the satisfaction of the life insurer either or both of the following:
 - (i) that the person is entitled to the benefit of the rights conferred by the life policy (whether under the will of the deceased policyholder or on the intestacy of the deceased policyholder); or
 - (ii) that the person is entitled to obtain probate of the will of the deceased policyholder, or letters of administration of his or her estate; and
 - (b) either or both of the following apply:

- (i) the premiums actually paid on the life policy do not, at the date of the death of the policyholder, exceed the prescribed amount:
 - (ii) the sum assured by the life policy does not, exclusive of bonuses, exceed the prescribed amount.
- (2) If a declaration is made under **subsection (1)**, the principal officer must register a memorial that the person is the policyholder.
 - (3) The person becomes the policyholder on the registration of the memorial, subject to all outstanding interests or equities affecting the life policy.
 - (4) This section does not apply to any life policy to which **section 100 or section 101** applies.

Compare: 1925 No 25 ss 2, 5

Offence

103 Offence for non-compliance with Part

- (1) Every life insurer that fails, without reasonable excuse, to comply with any of the requirements of this Part commits an offence and is liable on summary conviction to a fine not exceeding \$10,000.
- (2) **Subsection (1)** does not apply to the requirements of **sections 87 to 89**.

Compare: 1908 No 105 s 80

Part 5

Miscellaneous provisions

104 Representatives of insurer are agents of insurer

- (1) A representative of the insurer who acts for the insurer during the negotiation of a contract of insurance within the scope of the representative's actual or apparent authority must be treated, as between the insured and the insurer and at all times during the negotiations until the contract is entered into, as the agent of the insurer.
- (2) An insurer must be treated as having notice of all matters material to a contract of insurance known to a representative of the insurer concerned in the negotiation of the contract before the proposal of the insured is accepted by the insurer.
- (3) In this section, **representative of the insurer** includes—

- (a) an employee of the insurer; and
 - (b) a person entitled to receive from the insurer commission or other valuable consideration in consideration for the person's arranging, negotiating, soliciting, or procuring the contract of insurance between a person other than that person and the insurer.
- (4) This section does not limit the Insurance Intermediaries Act 1994.

Compare: 1977 No 14 s 10

105 Actions tried in High Court must be tried before a Judge alone

- (1) Every action maintained on a contract of insurance or against an insurer in connection with a contract of insurance must, if tried in the High Court, be tried before a Judge without a jury.
- (2) The service of a third-party notice making an insurer a party to an action does not affect the manner in which the issues between the plaintiff and the defendant are to be tried.
- (3) Despite **subsection (2)**, an insurer who is made a party to an action by a third-party notice may require the issues arising between the insurer and the party who served the third-party notice to be determined by a Judge without a jury if—
- (a) the insurer agrees to be bound by the issues arising between the plaintiff and the defendant; and
 - (b) the insurer, within the time limited for filing the insurer's statement of defence, files a notice to that effect in the High Court and serves copies of it on the other parties to the action.
- (4) This section applies despite section 19A of the Judicature Act 1908.

Compare: 1977 No 14 s 12

106 Regulations

The Governor-General may, by Order in Council, make regulations for all or any of the following purposes:

- (a) prescribing forms for the purposes of this Act; and those regulations may require—
 - (i) the inclusion in, or attachment to, forms of specified information or documents;
 - (ii) forms to be executed by specified persons;

- (b) prescribing requirements, not inconsistent with this Act, with which documents delivered for registration must comply:
- (c) providing for any other matters contemplated by this Act, necessary for its administration, or necessary for giving it full effect.

107 Marine Insurance Act 1908 to be subject to this Act

- (1) The Marine Insurance Act 1908 does not limit any provision of this Act, and the provisions of this Act prevail in any case where they are in conflict with any provision of that Act.
- (2) **Subsection (1)** is subject to **sections 22 and 23**.

108 No contracting out

- (1) The provisions of this Act have effect despite any provision to the contrary in any agreement or in any contract of insurance (whether embodied in a life policy or not).
- (2) **Subsection (1)** is subject to **section 29**.

109 Repeals

- (1) The following enactments are repealed:
 - (a) Insurance Law Reform Act 1977 (1977 No 14):
 - (b) Insurance Law Reform Act 1985 (1985 No 117):
 - (c) Life Insurance Act 1908 (1908 No 105):
 - (d) Part III of the Law Reform Act 1936.
- (2) Despite **subsection (1)(b)**, the Inalienable Life Annuities Act 1910 continues to apply as if this Act had not been passed to any inalienable life annuity policy entered into under that Act that is in force at the commencement of this Act.

110 Section 83 of the Fires Prevention (Metropolis) Act 1774 ceases to have effect as part of law of New Zealand

- (1) The First Schedule of the Imperial Laws Application Act 1988 is amended by omitting the words "section 83, and" from the item relating to the Fires Prevention (Metropolis) Act 1774 ((1774) 14 Geo. 3, c. 78) and, accordingly, section 83 of that Act ceases to have effect as part of the laws of New Zealand.
 - (2) Sections 17 to 19 and 21 of the Interpretation Act 1999 apply to that provision as if that provision were part of an Act of the Parliament of New Zealand.
-

Schedule 1

s 59

Terms and conditions implied in mortgages not being mortgages to life insurer liable under life policy mortgaged**1 Definitions**

In this schedule—

life policy means the life policy that is mortgaged

term means the term of the mortgage.

2 Mortgagor must make payments and do all acts and things necessary to keep life policy in full force

- (1) The mortgagor, during the term,—
 - (a) must duly and punctually, at the proper times for so doing, make all payments and do all other acts and things as are necessary to keep the life policy in full force; and
 - (b) must not do, or permit or suffer to be done, any act or thing that may cause the life policy to lapse or become void, or become liable to lapse or become void.
- (2) The mortgagor must, after making any of those payments, on request produce to the mortgagee the receipt for the payment.

3 Mortgagee may make payments

- (1) If the mortgagor fails or neglects to make all or any part of the payments necessary to keep the life policy in force, the mortgagee may, in the mortgagee's discretion, make any of those payments on behalf of the mortgagor.
- (2) An amount paid under **subclause (1)**, together with interest on that amount at a prescribed rate from the date of payment by the mortgagee until repayment to the mortgagee,—
 - (a) is repayable by the mortgagor to the mortgagee immediately upon demand; and
 - (b) until repayment, is a charge on the life policy.
- (3) The life policy must not be redeemable until the amount payable under **subclause (2)** is repaid.

4 Custody of life policy

The mortgagee is entitled to the custody of the policy document during the term.

5 Amount assured by life policy becomes claim or payable

- (1) This clause applies if the amount assured by the life policy becomes a claim or becomes payable before the day specified in the mortgage for the payment of the principal money that is secured by the mortgage.
- (2) The principal money and interest on that money up to date is due and payable to the mortgagee on the day on which the amount assured became payable (instead of the day specified in the mortgage for the payment).
- (3) The mortgagee's receipt and discharge for the payment of the amount is, to the extent of the amount, a receipt and discharge of the money assured by the life policy.

6 Discharge of mortgage

- (1) The mortgagee must promptly execute a discharge of the mortgage in accordance with this Act after—
 - (a) all the principal money and interest secured by the mortgage at the time specified for payment of that amount have been repaid; and
 - (b) the performance and observance of any other obligations or agreements specified in the mortgage.
- (2) The mortgagee must promptly deliver the mortgage, with the discharge endorsed, and the policy document to the mortgagor after the mortgagee has executed the discharge of mortgage.

7 Assignment or subsequent mortgage of life policy

The mortgagee must, during the term, on being given reasonable notice of the mortgagor's desire to assign the life policy or to mortgage the life policy subject to the mortgage,—

- (a) produce the policy document, as often and for so long as may be reasonably required, at the office of the life insurer; and
- (b) permit the assignment or mortgage to be registered.

8 Mortgagee's powers on default

- (1) This clause applies if the mortgagor—
 - (a) defaults in the payment of the principal or interest money secured by the mortgage, in whole or in part, on the days or times in the mortgage fixed for the payment of those amounts; or

-
- (b) otherwise defaults in the observance or performance of the conditions or agreement to secure the observance or performance of which the mortgage is made; or
 - (c) defaults in the observance or performance of any 1 or more of the covenants contained or implied in the mortgage.
- (2) The mortgagee may, at any time after a default referred to in **subclause (1)**,—
- (a) sell the life policy or sell the interest in the life policy that is mortgaged; or
 - (b) buy in the life policy or interest at any sale; or
 - (c) offer the life policy or interest for sale as often as is required; or
 - (d) surrender the life policy or interest to the life insurer issuing it on receiving the surrender value for the life policy or interest.
- (3) The sale may be conducted in the manner and on the terms and conditions in all respects as the mortgagee, in the mortgagee's absolute discretion, thinks fit.
- (4) The mortgagee must apply the proceeds of any sale or the amount of the surrender value (as the case may be) in the following manner and order of priority:
- (a) in payment of all costs, charges, and expenses that the mortgagee has incurred in connection with the sale or surrender or otherwise in connection with the mortgage;
 - (b) in payment of all the principal, interest, or other money secured by the mortgage;
 - (c) the surplus (if any) to the mortgagor.
-

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Schedule 2**Terms and conditions implied in mortgages to life insurer liable under life policy mortgaged****1 Definitions**

In this schedule—

life policy means the life policy that is mortgaged

term means the term of the mortgage.

2 Interest

The mortgagor must pay to the mortgagee interest at the rate mentioned in the mortgage, on the principal amount received under the mortgage, by equal half-yearly payments on the days mentioned in the mortgage for that purpose.

3 Mortgagee may deduct principal moneys from money paid under life policy

- (1) If the money insured by the life policy that is mortgaged becomes payable during the term, the mortgagee may deduct all principal money secured by the mortgage, and all interest that is due at that time (including interest accrued to the date of the death of the assured or the maturity of the life policy, as the case may be) and all other charges on the life policy, from the amount assured by the life policy when paying over that amount.
- (2) No further interest is payable to the mortgagee on the principal money after it is deducted under subclause (1).

4 Life policy void if total amount payable under mortgage exceeds surrender value

- (1) A life policy is void if,—
 - (a) at any time during the term, the total amount of principal and interest due under the mortgage, together with overdue premiums on the life policy, interest on overdue premiums, and all other charges on the life policy, exceeds the surrender value of the life policy at that time; or
 - (b) the life policy is allowed to lapse.
- (2) For the purposes of **subclause (1)**, the total amount of interest due under the mortgage includes interest that has accrued but is not due.

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5 Discharge of mortgage

- (1) The mortgagee must promptly execute a discharge of the mortgage in accordance with this Act and return the life policy to the mortgagor if—
 - (a) all the principal and interest money secured by the mortgage is duly paid off and satisfied according to the terms and provisions of the mortgage; and
 - (b) the life policy, at that time, is in full force and has not lapsed or become void, or become liable to lapse or to be declared void.
- (2) If the life policy has become void, the avoidance must be treated as full satisfaction and discharge of the principal and interest money due on the mortgage.

APPENDIX D
List of submitters

Preliminary Paper 53 and Consultation Draft

NAME	COMPANY/ORGANISATION
John Blyth	
Neil Campbell	University of Auckland
Malcolm Congdon	Insurance Brokers Association of New Zealand
Richard Coon	Sentinel Ltd
Diana Crossan	Retirement Commission
Donald Dugdale	
Jane Diplock/Liam Mason/ Narmada Patel	Securities Commission
Gayle Emmert	American Income Life Insurance Company
John Farrell	
John Foote	
Geoffrey Fuller	
RH Garrett	Munich Reinsurance Company of Australasia Ltd
Richard Geisler	New Zealand Society of Actuaries
Daryl Hayes	Tower Life (NZ) Limited
Robert Henderson	South Pacific Treasury Ltd
Dick Jessup	
Deborah Keating	Investment Savings and Insurance Association of New Zealand Inc
Boyd Klap QSO	
Marian Kljakovic	Ministry of Economic Development
Joy Liddicoat	Human Rights Commission
Dermot Martin	UniMed
Simon McArley	New Zealand Law Society

Bernard McCrea	American International Assurance Company (Bermuda) Ltd
AD McLaren/Michael Cathro	New Zealand Association of Credit Unions
Ian McPherson	Southern Cross Healthcare
John Melville	Melville Jessup Weaver
Bob Moffat	Trustee Corporations Association of New Zealand
Geof Mortlock	Reserve Bank of New Zealand
Michael Naylor	Massey University
Andrea Pettett	Health Funds Association of New Zealand Inc
David Pickens	Institute of Chartered Accountants of New Zealand
Richie Rama	AXA New Zealand
Geoff Rashbrooke	
Chris Ryan	Insurance Council of New Zealand Inc
Phil Simmons	RGA Reinsurance Company of Australia Ltd
David Smith/ Giselle McLachlan	IAG New Zealand Limited
Karen Stevens/Lionel Hinton	Insurance & Savings Ombudsman
Don Stewart	Stewart Financial Group Ltd
Noel Vaughan	
Jane von Dadelszen	Ministry of Women's Affairs

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References beginning with, or consisting only of, an alphabetic character refer
to the appendices, for example, C refers to the entire appendix C;
A12 refers to the twelfth paragraph of appendix A.

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