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19 March 2021

By email: ipsareview@rbnz.govt.nz

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy

Dear Sir/Madam,

ICNZ submission on Review of the Insurance (Prudential Supervision) Act 2010 (Scope and Overseas Insurers)

Thank you for the opportunity to submit on the Review of the Insurance (Prudential Supervision) Act 2010 Options Paper 1: Scope of the Act and Overseas Insurers.

By way of background, ICNZ's members are general insurers and reinsurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand property and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

Please contact Nick Whalley (nickw@icnz.org.nz) if you have any questions on our submission or require further information.

This submission has two parts:

- overarching comments, and
- responses to individual questions.

Overarching comments

As a starting point, it is important to acknowledge that overall, the Insurance (Prudential Supervision) Act 2010 (**IPSA**) regime is fundamentally sound and generally works well. That said, after a decade of operation, a review is appropriate and opportunities for improvement can be seen.

Issues and proposals in this consultation fall within two overarching tranches, namely:

- Who should be regulated under IPSA: This focusses on how broadly the definitions of 'contracts of insurance' and 'carrying on Business in New Zealand' are framed, and the applicability of the policyholder in New Zealand test, these being key elements for determining whether a business is captured by the IPSA regime. As a general observation, arguably the way the regime is currently structured means that businesses will be treated very differently based upon how they have formulated their specific offering, where they are principally based (either in New Zealand or overseas), how they interface with the New Zealand market and what corporate structure they use.
- How those regulated under IPSA are treated: Focussing on how New Zealand branches of overseas insurers and overseas reinsurers are treated under the IPSA regime, how groups are supervised and with respect to outsourcing requirements.

In considering these matters we have had regard to the following overarching principles:

- The purposes set out in section 3(1) of the Insurance (Prudential Supervision) Act 2010 (**IPSA**), namely to promote the maintenance of a sound and efficient insurance sector and public confidence in it.
- The principles under section 4 of IPSA, including the importance of maintaining the sustainability of the New Zealand insurance market, the adequate protection of the interests of policyholders and the public interest (in the event that an insurer is in financial distress or facing other difficulties), the need to maintain competition within the insurance sector, and the need to avoid unnecessary compliance costs. In our view, this reflects not only what kinds of business might have 'insurance-like' characteristics but also whether such businesses require the sort of prudential regulation that IPSA provides.
- Ensuring an even playing field for all participants in the insurance sector, emphasising competitive neutrality,[1] regulatory transparency and consistency, avoiding undue reliance overseas regulations and supervision, while also not imposing undue barriers to entry, duplication in regulatory regimes, unnecessary compliance costs, or making the sector so unattractive that a business chooses not to participate in it, noting the desirability of encouraging overseas insurers and reinsurers to participate in the New Zealand insurance market (including increasing competition, innovation, expanding capacity, providing greater options for consumers and facilitating the pooling and diversification of risk globally).
- Providing sufficient regulatory certainty, avoiding unnecessary regulatory burden, disproportionate responses or overly constraining innovation, noting that additional costs caused by a regulatory change will most likely be passed onto customers in the form of additional premium.
- Ensuring the regime is sufficiently durable, with built in flexibility to respond to new challenges that may arise including disruptive new business models leveraging technology (e.g. Insurtech).
- Lastly, appreciating that regulation creating a 'one size fits all' approach may be prohibitive and impractical in such a small market such as New Zealand, which benefits from competition between insurers of varying sizes, legal forms, governance structures and locations, we consider that regulation should focus on addressing material risks of harm to New Zealand policyholders created by differences between the treatment of domestic insurers and overseas insurers under the regime.

While it is reasonably straightforward to identify relevant principles and issues with the regime, applying principles and framing up solutions to them is another, potentially more challenging, matter. In some areas this exercise is rendered more difficult due to tensions between, and even internally within, principles. In other cases (i.e. for some areas in respect of issues 2, 4 and 6) we consider that it is inappropriate to express a preference on a particular option or specific further details at this stage because underlying considerations / parameters have not been identified and need to be worked through first. We express our views on these underlying considerations / parameters where this is the case. Another complication is that each of the proposals outlined in this consultation overlap or impact on the separate Reserve Bank of New Zealand (**RBNZ**) consultation on the Review of Insurance Solvency Standards: Structure and IFRS 17.[2] Additionally, as outlined at various points during this submission, some matters overlap with other regulatory workstreams. Careful and well considered analysis is required to ensure a joined-up and consistent approach.

Having reflected on the above and the issues identified in the options paper, ICNZ has taken the following positions:

No.	Issue	Position
1.	Definition of 'contract of insurance'	We support the introduction of a 'deem in' power (option 1.3). We also consider that the definition of 'contracts of insurance' and exempted arrangements under section 7 of IPSA should be reviewed and amended to be clearer.

[1] This involves ensuring there is no material difference in regulations (including obligations and other requirements, protections / options for redress, or compliance costs between different market participants), with domestic and overseas insurers being treated consistently and held to the same regulatory standard as much as is possible. Viewed in this light, exemptions for overseas insurers, for example, should not put domestic insurers at a competitive disadvantage.

[2] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Insurers/ISS-review/Public-Consultation-Structure-of-Solvency-Standards-Nov-2020.pdf?revision=de89ac95-2a13-4e85-b525-ffbe9496bf03&la=en.

No.	Issue	Position
2.	Definition of 'carrying on business in New Zealand'	We support the formulation of a new definition of 'carrying on insurance business in New Zealand' (option 2.2). However, we do not consider it is appropriate to express any specific views on what a replacement definition should look like at this stage given this is position is not anticipated in the options paper. This is a complex area that requires detailed further analysis. We do not support the inclusion of a level of written premium that automatically implies a company is not 'carrying on business in New Zealand' (option 2.3). We express no opinion on whether the applicable definition should be altered to remove captive insurers from the licensing regime (option 2.4).
3.	Policyholder in New Zealand test	We support the removal of the policyholder in New Zealand test (option 3.2).
4.	Treatment of overseas branches	We are opposed to a requirement for branches to be incorporated in New Zealand (option 4.2). There are a number of complex and competing matters to consider when evaluating any asset in New Zealand requirement (option 4.3), with different views being expressed across the membership in this respect. We set out principles-based views in this regard. As complementary measures, we consider that some of the options outlined under the enhanced status quo option (option 4.4) should also be progressed.
5.	Inwards reinsurance	We support the current treatment of reinsurers under IPSA (option 5.1). We are supportive of a focus on insurers and their own reinsurance arrangements. However, if changes are contemplated in this regard (option 5.3), care needs to be taken to ensure these are consistent with other requirements and unnecessary regulatory burden is avoided.
6.	Group supervision	We consider that it is premature to express any preference on options regarding group supervision. Before going further, greater clarity is required to understand which group entities these proposals are intended to apply to.
7.	Outsourcing	We support the status quo (option 7.1). If requirements for outsourcing were to be introduced, we consider that risk-based outsourcing rules would be most appropriate (option 7.2).

The reasoning for each position and further details are set out below. Please note that for certain matters the positions taken by ICNZ and some of its members diverge. Where this is the case, members may submit to you separately on them.

Additionally, and for the avoidance of doubt, the views expressed relate to the general insurance sector only. While it may be that our views are shared with other sectors within the broader insurance market (e.g. life and health insurers), as we represent general insurers, we do not consider that it is appropriate to comment in these respects.

Responses to individual questions

<u>1. Definition of 'contracts of insurance' (pages 9-11): Which of the options do you think is most appropriate in relation to the current IPSA definition of 'contracts of insurance'?</u>

We support the introduction of a 'deem in' power (option 1.3)

We are supportive of the introduction of a 'deem in' power, specifically the inclusion in IPSA of a power enabling the RBNZ (or the Minister through a regulation-making power) to deem particular activities (i.e. specific classes of contractual arrangements/transactions or the offering of a specific insurance business) as being subject to some or all parts of the IPSA regime.

This position reflects that, while no major changes to the scope of the IPSA are considered necessary, boundary issues exist and there is a need to ensure the regime can capture material non-traditional 'insurance-like' business. This change helps ensure there is a level playing field and adequate policyholder protection is maintained. This would also make the IPSA regime more flexible and resilient to insurance sector changes, enabling RBNZ to supervise activities that would have otherwise been excluded due to the fixed and traditional

nature of the definition of 'contract of insurance'. We note that similar designation powers are available under the Financial Markets Conduct Act 2013 (**FMCA**).[3]

This approach is preferable, in our view, to the alternative option of addressing this issue through RBNZ publishing guidance (option 1.4). Consistent with remarks made in the options paper, we consider that such a light touch approach would not provide sufficient certainty (being a matter of interpretation). This would also be an inappropriate way of addressing this issue from our perspective, given the criticality of the definition of 'contracts of insurance' to the determination of whether IPSA applies.

To ensure the 'deem in' power is expeditiously used, it will be important that RBNZ undertakes active monitoring of all activity (including emerging activity) within the New Zealand market. There may still be a role to play for guidance, including explaining 'deem in' decisions to market participants and educating the public about the nature of particular excluded arrangements and the risks customers face in these respects.

Regarding the request in the options paper for examples of 'insurance-like' activities not currently caught by the IPSA definition, we note the following:

- BuiltIn Insurance – home building guarantee: Tauranga firm 'Builtin Insurance' describes itself as a specialist in builders and tradies insurance, advertising a home building guarantee product covering New Zealand home builders against construction defects for 10 years and guaranteed completion of the contract at the agreed price.[4] A recent National Business Review article records that the underwriter of the guarantee product, Southern Pacific Insurance Corporation (SOPAC) is a American Samoa-domiciled underwriter that had filed accounts claiming its main asset is $US214 million of "*natural rough rubies*".[5] New Zealand Gemmological chair Jill Towers is quoted in this article as saying that "*an asset comprising rough rubies of such a value is unbelievable,…*" The article also records that RBNZ has confirmed that, because SOPAC is not carrying out insurance business in New Zealand, it does not need to be licenced as an insurer.
- Capricorn Mutual: Australian firm 'Capricorn Mutual' describes itself as a non-profit mutual providing members and their associates with a competitive alternative to insurance, offering market leading protections tailored to the motor trades industry, including a broad range of business and personal buildings, contents, business interruption, vehicle, goods in transit and liability covers.[6] Capricorn's New Zealand Product Disclosure Statement records that the covers provided by Capricorn are not insurance and they are not regulated by the RBNZ as an insurer under New Zealand law or by any other New Zealand regulator as a provider of any other financial service.[7]

In our view, in evaluating these examples, New Zealand policyholder protection should be a key consideration. The product may look like insurance, be sold like insurance, and offered as an alternative to insurance, but lack the protections inherent in insurance through regulation under IPSA including the requirement to be registered with an external dispute resolution scheme.[8] The public may rightly expect to have the same degree of regulatory oversight as insurance products in these circumstances (particularly where the cover involves a significant financial exposure) and not appreciate the subtle but critical differences between an insurance contract provided by a licensed insurer, and an arrangement that is not. Other considerations include the need for competitive neutrality between the regulated and unregulated community (in relation to products that are materially equivalent), and minimising the potential for providers to game the system by framing their offerings in such a way as to avoid the IPSA regime applying to them.

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[3] See section 562 of the FMCA under which the FMA may designate a security to be a 'financial product' coming within the scope of the FMCA.

[4] https://builtininsurance.co.nz/10-year-guarantee/. ICNZ wrote to RBNZ about this matter on 26 August 2020 and is yet to receive a response.

[5] https://www.nbr.co.nz/story/rough-rubies-and-bankrupt-auditor.

[6] https://www.capricorn.coop/about/capricorn-mutual.

[7] https://www.capricorn.coop/-/media/project/csl/capricorn/capricorn-mutual/documents/new-zealand/cml-pds-2020-nz.pdf.

[8] Under section 19(1)(k)(i) of IPSA licensed insurers are required to be registered under Financial Service Providers (Registration and Dispute Resolution) Act 2008 (**FSPR**). The FSPR includes a requirement for registrants to be a member of an approved dispute resolution scheme.

For completeness, as outlined previously,[9] while section 219 of IPSA prohibits the use of specific words in names and section 16 of IPSA restricts representations of being a 'licensed insurer', we believe consideration should also be given to extending this to a more general prohibition on activity and conduct by non-insurers representing themselves to customers as insurers, noting the similar holding out prohibitions under the Financial Markets Conduct Act 2013 in relation to giving financial advice.[10] In particular, we consider that entities should be prohibited from using words like 'insurer', 'insurance', 'insurance company', and other related terms (e.g. business interruption or liability cover), where doing so has the potential to mislead given the nature of the entity and the product(s) sold. We also consider that a requirement should be introduced for intermediaries to clearly disclose to customers that they acting in that intermediary role rather than as an insurer,[11] given this is something that we understand customers may not appreciate. There is also merit in amending section 219(2) of IPSA to includer 'insurer' for the avoidance of doubt.

We also support other steps being taken

While we are supportive of the introduction of a 'deem in' power, we do not consider that the RBNZ needs to be constrained to any one particular option in respect of these matters. We consider that the definition of 'contracts of insurance' under section 7(1) and (2) of IPSA should be reviewed and amended to be clearer. Specifically:

- Clarifying what terms such as "*unless the <u>context</u> otherwise requires*", "*a sum of money or its <u>equivalent</u>*", "*whether by way of indemnity or <u>otherwise</u>*'" and "*<u>element</u> of uncertainty*" mean (our emphasis).[12]
- Considering relevant commentary in the authoritative textbook Colinvaux's Law of Insurance in New Zealand including commentary indicating that "…*the definition may provide less certainty than the approach taken in other jurisdictions*" and that "[i]*t is clear that in the context of the IPSA many contracts that would be found to be "contracts of insurance" in other jurisdictions will not be "contracts of insurance" in New Zealand*."[13]

We consider that the exemptions under section 7(3) of IPSA should also be reviewed and updated, noting they are very broadly framed currently. We note the following in this respect:

- <u>Derivatives:</u> Index insurance (particularly parametric insurance) products are becoming increasingly common in developed economies overseas for weather based events.[14] While we acknowledge comments made in the options paper that these arrangements may not fall within the definition of 'contract of insurance' (because pay-outs are fixed and based on an external reference point, rather than indemnifying the insured for the loss actually suffered), we note that the definition of 'contract of insurance' is not restricted to contracts of indemnification, and that these arrangements still involve the transfer of risk, and a payment being made in exchange for a promise to pay a sum of money (or equivalent), on the happening of an uncertain event beyond the insurer's control.[15]
- <u>Warranties, guarantees and waivers</u>: As outlined previously,[16] under IPSA there is opportunity for people selling indemnity contracts for a fee to potentially game things by formulating arrangements as a warranty, guarantee or waiver rather than an insurance contract. To address this issue detailed definitions for 'warranties', 'guarantees' and 'waivers' should be introduced, with reference to specific types of

[9] See our submission on the IPSA review Issues Paper in 2017, https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf.

[10] Section 431G of Financial Markets Conduct Act 2013.

[11] Section 220(1)(c) of IPSA currently provides a blanket exemption from section 219 requirements for those who arrange, negotiate, solicit, or promote contracts of insurance or the renewals of contracts of insurance or both (for example, a broker or other insurance intermediary).

[12] In connection with this consideration should be given to clarifying the definition of 'premium' in section 6 of IPSA which refers to "*any money or other consideration that is in substance a premium (regardless of what it is called in the contract)*".

[13] Colinvaux's Law of Insurance in New Zealand 2nd Edition (2017), paragraphs 10.2.4 and 10.2.5.

[14] It has also been suggested that such arrangements may be an attractive alternative to Business Interruption insurance at some point in the future, due to the ease with which pay-outs can be determined.

[15] See section 7 of IPSA. If such arrangements are not caught by the definition of 'contract or insurance' or specifically written into the legislation, they nonetheless provide a good example of why the regulator may need the ability to 'deem in' covers outside of the standard 'contract of insurance' definition.

[16] See our submission on the IPSA review Issues Paper in 2017, https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf.

arrangements and criteria which distinguishes between 'insurance-like' and other arrangements in substance and treats them appropriately.[17] Failure to do this will only incentivise 'insurance-like' products to be developed and marketed which lack the policyholder protections regulated insurer offer while meeting greater compliance costs.

- Collision damage waivers connected with car rental agreements: We disagree with the analysis set out in the options paper in this regard. In this situation the original insurance contract is between the insurance company and the car rental company. The rental agreement between the car insurance company and the renter of the vehicle is a separate agreement between the car rental company and the renter of a vehicle, removing the obligation to reimburse the car rental company for the excess in the event of an accident. This does not alter the fact that the obligation to pay the excess remains with the car rental company, under the original insurance contract, and that under the rental agreement there is a transfer of risk (that the excess will need to be paid) from the renter to the rental company on the occurrence of an uncertain event (the accident). It has all the features of an insurance contract and should be treated as such in our view.

Our key concerns here again are customer protection, competitive neutrality, and the need to minimise the potential for gaming.

There may still be a role for RBNZ guidance to play in this respect – including regularly advising the sector how it is applying this definition to arrangements, with reference to tangible examples and educating customers about what is, and is not, insurance and captured by the IPSA regime and the implications.

2. Definition of 'carrying on business in New Zealand' (pages 12-13): Which of the options do you think is most appropriate in relation to the current IPSA definition of 'carrying on business in New Zealand'?

We support the formulation of a new definition of 'carrying on insurance business in New Zealand' (option 2.2)

While we acknowledge that while generally, the 'carrying on insurance business in New Zealand' test under section 8(1)(a)(i)-(iv) of IPSA works, issues have arisen regarding its application to overseas insurers issuing insurance in New Zealand. This test is critical to determining whether an overseas insurer issuing insurance in New Zealand is captured by the IPSA regime.

Given the complexity of this matter, it is useful to unpack how the IPSA regime operates in this respect:

- Section 8(1)(a)(iii) of IPSA prescribes that a person carries on insurance business in New Zealand if they are carrying on business within the meaning of section 332 of the Companies Act 1993.
- However, 'carrying on business' under section 332 of the Companies Act 1993 lacks clarity as it relates to insurance. This definition predominantly focusses on what is not carrying on a business (rather than what is) and does not indicate how many, or what value, of insurance contracts would be enough to meet the threshold.[18]
- In practical terms, RBNZ's approach to assessing this matter is to consider the degree of connection to New Zealand, including the extent to which policies are being directly marketed to New Zealand customers and whether they have a place of business, staff, or infrastructure in New Zealand. This is a subjective and potentially inconsistently applied test which lacks specificity and is not supported, or prescribed for, in legislation.

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[17] We consider that any definition of excluded 'guarantee' for section 7(3) of IPSA should include surety bonds, to provide clarity that surety bonds do not constitute contracts of insurance. Surety or performance bonds are typically provided in a contract where a contractor is obliged to provide services to a principal. The surety bond is provided in favour of the principal and the contractor pays the guarantor/insurer a fee for the service. Such arrangements should be excluded from the IPSA regime because: (1) the guarantor/surety typically deals with the contractor/debtor rather than the principal, whereas under insurance the insurer would deal with the person whose solvency it is insuring; (2) the guarantor/surety promises to pay the original debt of the debtor, whereas an insurer promises to pay a sum of money on the occurrence of a certain event (independent of the obligation to pay a new debt under a contract of indemnity); and (3) the guarantor/surety has a direct claim against the debtor in the event that the surety bond is called upon, whereas an insurer has no independent rights against the debtor and is merely subrogated to the remedies of the insured.

[18] Specifically, under section 332(b) of the Companies Act 1993 the definition specifies that it is possible for an entity or group to hold property in New Zealand, issue an individual insurance contract to New Zealanders or carry out a short contract that is not one of a number of similar transactions, without being deemed to carry on business.

The treatment outlined is problematic because it does not necessarily capture overseas insurers insurance activities that, in our view, should come within the scope of IPSA, particularly where they do not have a physical presence, or personnel, in New Zealand - including ones potentially providing a substantial level of insurance to New Zealand that are not required to register as an overseas company under the Companies Act 1993 or that are resident or incorporated in New Zealand.

In our view, as a matter of principle, customers (and their assets and other insurance exposures) in New Zealand should have appropriate and consistent regulatory protection regardless of where the insurer is based and how they operate. This is also important on broader public interest grounds and confidence in the sector. As indicated previously,[19] we see this issue becoming increasingly important due to rapid advances in technology, with insurance (including speciality covers) being able to be acquired through non-traditional means, over the internet, and/or via other non-traditional parties. It is also important, in our view, to maintain a level playing field across all relevant participants as the market evolves. Accordingly, we support the formulation of a new definition of 'carrying on insurance business in New Zealand' (option 2.2).

Whether an insurer triggers the 'carrying on business in New Zealand' test is also important because, it would also trigger requirements under proposed conduct legislation.[20] Accordingly, if participants writing business in New Zealand are not covered, their customers are less protected and competitive neutrality issues again arise.

Parameters for a new insurance-focussed definition

To address this issue, we recommend that a new insurance-focussed legislative definition of 'carrying on business in New Zealand' for overseas businesses be developed that does not rely on the test under section 332 of the Companies Act 1993. While we acknowledge that changing this definition would result in a change to this regulatory regime, we consider that this is overcome by the fact that the current arrangement is opaque and not working particularly well.

We do not consider that it would be appropriate, at this stage, to express any specific views on what a replacement legislative test for 'carrying on business in New Zealand' for overseas insurers would look like. This is a complex area that requires detailed further analysis and consideration before legislative drafting takes place. In considering what a replacement test could look like we believe it is useful to reflect upon the following matters:

<table>
<tr><th>Consideration</th><th>Comments</th></tr>
<tr><td colspan="2">Factors potentially favouring a business being treated as carrying on business in New Zealand</td></tr>
<tr><td>1. Whether the insured risk arises in, or relates to, New Zealand. This includes a risk that related to property, or liability exposures arising, in New Zealand.[21]</td><td rowspan="2">These are relevant positive factors that could suggest that an overseas insurer is carrying on business in New Zealand. We consider that these factors are a good starting point for identifying, while a business is based abroad and not physically 'operating' from within New Zealand, whether it is nonetheless providing relevant insurance that ought to be caught by the ISPA regime.

In conjunction with factor 3. below, these factors will be particularly pertinent when an overseas insurer is selling common and mass-market general insurance products within the New Zealand market (such as residential and commercial building, contents and vehicle covers, and business interruption, contract works and liability insurances). In turn, this would ensure a more level playing field, with all relevant market participants selling equivalent products being held to the same regulatory standard.

However, as outlined under factors 4. to 7. below, we believe it would not be appropriate for these factors to be completely determinative of this matter and it may be that they are overridden by other considerations.</td></tr>
<tr><td>2. Whether there is a New Zealand insured. This could include both policyholders and non-policyholders.[22]</td></tr>
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[19] See our submission on the IPSA review Issues Paper in 2017, https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf.

[20] Financial Markets (Conduct of Institutions) Amendment Bill.

[21] If this approach is adopted, it may be necessary to define what a New Zealand insurance risk is, for example as has occurred in the European Union under Article 11 of Solvency II.

[22] We accept that having such a requirement would, based on the current scheme of IPSA, overlap to a certain extent with the New Zealand policyholder requirement under section 8(1)(c) of IPSA. However, as outlined in the next section below (section 3), we propose that this provision be removed. Focussing on those insured in New Zealand (rather than the 'policyholder' as defined under section 6 of IPSA) reflects that parties may be insured under insurance policies despite not being the policyholder as defined (i.e. the person who has entered into the contract of insurance with the insurer or the person that contract has been assigned or transferred to).

<table>
<tr><th>Consideration</th><th>Comments</th></tr>
<tr><td></td><td></td></tr>
<tr><td>3. Whether the insurance is being advertised to, or is easily accessible by, New Zealand customers.</td><td>This is another positive factor that could suggest that the overseas insurer is carrying on business in New Zealand. We refer to our comment above here. In some cases, it would be necessary to look beyond whether the insurance is being specifically targeting New Zealand customers (e.g. it may be advertised, or easily accessible online, to a broader audience).

We note that this factor aligns with an element of RBNZ’s current approach.</td></tr>
<tr><td colspan="2">Factors potentially against a business being treated as carrying on business in New Zealand</td></tr>
<tr><td>4. Whether the insurance is for an atypical risk. This includes situations where the insurance requires specialised underwriting expertise (e.g. aviation insurance or insurance related to large-scale energy, space objects, or materials with hazardous radioactive, toxic, biological or explosive properties).</td><td rowspan="5">In including these factors that may suggest that an overseas insurer is not carrying on business in New Zealand, we are minded to avoid duplication in regulation and supervision where affairs most sensibly sit with the overseas insurer’s home jurisdiction or the New Zealand licensed insurer, as the other party to the arrangement. We also wish to avoid unduly restricting access to insurance that, due to the application of a very broad carrying on business in New Zealand test, would result in the relevant insurance being unavailable because the relevant provider was not prepared to meet full IPSA requirements.

In the situation where a consideration of the relevant factors, on balance, would warrant the overseas insurer not being treated as ‘carrying on business in New Zealand’, to the extent there is a risk to New Zealand customers, we consider that some requirements under IPSA would still need to apply to them. While this is a matter that needs to be the subject of further consideration and analysis, our preliminary views are that this could include:
• Requirements to clearly disclose to the customer that the relevant insurer is not a New Zealand licensed insurer, to obtain an acknowledgement from the customer in writing about this fact, and to provide details to the customer about how the insurer is regulated and supervised instead.
• A power for the RBNZ to restrict or impose conditions on the relevant activities should any material policyholder protection issues arise.[23] The RBNZ would need to actively monitor the relevant market activity to ensure any issues are promptly identified and addressed.
• In respect of 5., a requirement for the relevant intermediary to confirm in writing that that the risk cannot be reasonably placed with a New Zealand licensed insurer.

In formulating factors 4. to 7. into in any new legislative test, careful attention would be required to ensure that the stated circumstances are sufficiently specific and clear that operators cannot easily modify their activities to avoid the full application of the IPSA regime.

In setting out the factors and comments in this section, we have drawn upon some of the features of the treatment of Unauthorised Foreign Insurers under the prudential insurer regime in Australia.[24]</td></tr>
<tr><td>5. Whether the insurance is for risks that cannot be reasonably placed with a New Zealand licensed insurer. This may include situations where there is no New Zealand insurer that will insure the risk, the terms (including price) provided by any New Zealand insurer are substantially less favourable, or situations where insurance via an New Zealand insurer would otherwise be substantially less favourable.</td></tr>
<tr><td>6. Whether the insurance is sold as part of a global insurance programme, in respect of which the New Zealand component is only a small part.

A global insurance programme involves insurance arranged for a multinational business with coverage encompassing the entire world.</td></tr>
<tr><td>7. Whether the insurance is sold to another business carrying on insurance business in New Zealand themselves. Such as where an insurer is taking insurance for their own assets and exposures. This is as opposed to an overseas insurer providing insurance to end customers (e.g. end residential or commercial policyholders).</td></tr>
<tr><td>8. Whether the insurance is required due to foreign laws. This may arise where, for example, the insured is operating in another country via the same legal entity.</td></tr>
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[23] Such issues could include concerns about the non-payment of claims or difficulties making complaints, the adequacy / equivalency of the applicable overseas supervision or regulations, inappropriate sales practices of intermediaries operating on the overseas insurer’s behalf, or concerns about ownership connections between intermediaries and the business.

[24] An 'unauthorised foreign insurer' is the term used for an insurer who carries on a general insurance business outside of Australia. Unauthorised foreign insurers are able to offer insurance in Australia. However, they are not regulated by APRA and do not need to meet capital or other requirements. See the Insurance Act 1973 and Part 2 of Insurance Regulations 2002 for more detail.

In analysing this matter, we consider that it would also be useful to reflect upon the following questions that highlight potential boundary issues regarding the application of any new test:

- With respect to travel insurance placed with overseas insurers, what would be the appropriate treatment of inbound visitors travelling to New Zealand (for work, study or leisure) or equivalent outbound New Zealanders travelling abroad?[25]
- What would be the appropriate treatment where an overseas company has insurance with an overseas insurer related to substantial New Zealand exposures? For example, that company's liability for any products it sells into New Zealand or professional indemnity exposure for advice if its staff provide into New Zealand.[26]
- Conversely, what would be the appropriate treatment where a New Zealand company has insurance with an overseas insurer related to substantial exposures overseas (e.g. product liability and/or professional indemnity risks)?
- What would be the appropriate treatment where the overseas insurer provides worldwide cover (e.g. travel or liability insurances) to a non-multinational New Zealand or overseas customer, in so far as New Zealand exposures are involved?[27]

For the avoidance of doubt, in developing any new 'carrying on business in New Zealand' legislative test, care needs to be taken to ensure that overseas reinsurers are not caught by the IPSA regime consistent with the current position. Our views on the appropriate treatment of reinsurers are set out under section 5 below.

We do not consider that RBNZ guidance (option 2.1) would be an appropriate way to address this issue

We do not consider RBNZ guidance (option 2.1) would be an appropriate way to address this issue. This lacks sufficient certainty and would not appropriately reflect the importance of this matter to the IPSA regime. That said, we would expect that supplemental guidance by RBNZ could be useful in reinforcing any new legislative test (i.e. outlining how it is being applied with reference to examples). Active monitoring would also be a critical requirement to support this new approach.

We do not support the inclusion of a level of written premium under which a company is deemed not to be 'carrying on business in New Zealand' (option 2.3)

While hypothetically we see the attraction of excluding smaller firms from the ambit of the IPSA regime, on the basis that this would be a pragmatic and proportionate response to small operators, this would detract from competitive neutrality. In any event, on balance, we consider that introducing a level of written premium threshold, under which a business is deemed not to be 'carrying on business in New Zealand', would ultimately be arbitrary and problematic to implement. In particular:

- The appropriate threshold is likely to be difficult to determine and would need to be regularly updated to reflect changes in the size of the market.
- Determining whether a particular business fell under and over the threshold would involve significant cost and complexity for them, noting that:
  - Businesses' scale may change over time (up and down) and would need to be proactively monitored and managed.
  - Fluctuations in a business' premium pool may cause them to quickly fall in and out of the regime (i.e. such as where a significant customer comes on-board or leaves). The specifics and timing of this may be

[25] While inbound travellers would appear to satisfy factors 1. and 2. above once they are in New Zealand, travel insurance would also provide cover abroad and it may be considered that these are not the kind of customers that protection under IPSA ought to be extended to given they are foreign nationals. The reverse may apply to equivalent outbound travellers travelling abroad. In this context, it may be useful to focus on the jurisdiction where any claim would be paid from. Also, as above, care needs to be taken to ensure that the definition is not so wide that overseas insurers are not prepared to continue to offer insurance.

[26] While it appears that factor 1. would be satisfied in these circumstances, factor 2. would not be and, putting the secondary connection to New Zealand customers to one side (in terms of New Zealanders ability to claim against these overseas entity's policies) which would appear to be too remote, it may be questionable whether this is the type of customer that protection under IPSA should apply to given they are based overseas.

[27] Consideration of this could involve some of the arguments made in the footnotes above. Additionally, it may be appropriate to consider, aligned to factor 6., how significant the New Zealand portion of the exposures are relative to those abroad. If the New Zealand portion is small, it may be more appropriate for the overseas insurer to be regulated and supervised elsewhere.

difficult to identify, particularly when the insurer is large and/or has a number of lines of insurance businesses and/or brands.

- There is potential for gaming, i.e. a market participant actively sizing their business through pricing and acquisition activity to avoid the application of the regime.

A further complication is that this approach relies on the regulator having sufficient visibility and oversight of all players in the market and/or likely self-reporting by those participants potentially caught by the regime. If there are no consequences for non-compliance, some may consider that it is too difficult to track their position and/or not worth the cost of satisfying these requirements. Another risk is that the specific requirements related to the threshold are so onerous that an overseas business decides not to participate in the New Zealand market.

We do not have a view on whether the applicable definition should be altered to remove captive insurers from the licensing regime (option 2.4)

We do not have any view on whether the applicable definition should be altered to remove captive insurers from the licensing regime (option 2.4). We see the points for and against their inclusion reasonably finely balanced, specifically:

- On one hand, we appreciate that as captive insurers are separate entities within a broader business enterprise providing insurance only to that business, they pose no broader risk to third party policyholders and as such this could be considered a private matter.
- On the other, as has been noted in the options paper, captive insurers may value licensing and supervision, as this enables them to have easier access to reinsurance. Also, as noted, regulation may reduce the risk that problems with the captive's solvency spread and cause problems to the wider group.

If captive insurers are to continue to be licensed under IPSA we agree that, for efficiency and to preserve the integrity of the licensing system and public confidence in the insurance sector, they should be subject to IPSA rules in the normal way.

<u>3. Policyholder in New Zealand test (page 14): Which of the options do you think is most appropriate in relation to the 'Policyholder in New Zealand' test as part of the determination of whether an insurer should be licensed under IPSA?</u>

We support the removal of the policyholder in New Zealand test (option 3.2)

We consider that the policyholder in New Zealand test, that is the requirement for there to be at least one policyholder in New Zealand set out under section 8(1)(c) of IPSA, should be removed. Consistent with remarks made in the options paper:

- <u>Reputation:</u> There is a reputational risk associated with unlicensed insurance businesses based in New Zealand offering insurance or reinsurance overseas. We would not want New Zealand to be perceived as a haven for such entities or for it to be considered that, based upon this situation, all insurers operating in New Zealand are not appropriately regulated.
- <u>International responsibilities and reciprocity:</u> International insurance regulation relies on relationships between home and host country regulators. Relationships with overseas regulators could be damaged if New Zealand was not seen as fulfilling its international responsibilities of ensuring that there are no gaps in the regulatory net.[28]

Additionally, while we acknowledge that under IPSA such businesses cannot hold themselves out as being licensed or regulated in New Zealand when this is not the case,[29] we do not consider that this mechanism provides sufficient protection for these matters because those overseas (including potential purchasers of insurance and regulators) are likely to still assume that they are appropriately regulated in New Zealand, under

[28]We note that, with respect to foreign insurance businesses operating in New Zealand, the RBNZ will always rely upon home country regulators to a certain extent, so it is appropriate that it is seen as reciprocating.

[29] See section 218 of IPSA.

New Zealand law in any event, because that is where the business is based.

Developing definitions of New Zealand risk and insureds (as outlined in the previous section) would also make the policyholder in New Zealand test less relevant in our view. We acknowledge that, in making this change, the current purpose of IPSA may need to be amended given such businesses do not pose a risk to New Zealand policyholders.

4. Treatment of overseas branches (pages 15-20): Which of the options do you think is most appropriate in relation to the treatment of overseas branches?

The proposed asset in New Zealand requirement (option 4.3)

ICNZ has insurer members that are incorporated in New Zealand and who operate as branches of overseas insurers. Strong views exist across our membership on the question of whether branches should be required to hold assets in New Zealand. Some consider that current arrangements or minor enhancements to the status quo are appropriate, while others advocate for all branches to be required to have assets in New Zealand. Notwithstanding this, as an industry body, ICNZ considers that it is incumbent on us to share our principles-based views on this matter consistent with our vision of 'New Zealanders have trust and confidence in the insurance industry', noting that policyholder protection is fundamental to trust and confidence in the sector and the RBNZ must ensure that protection exists.

We would expect the RBNZ to evaluate and balance the following complex and competing considerations in making its determination regarding any asset in New Zealand requirement:

Consideration	Comments
1. Sufficient New Zealand policyholder protection should the branch face financial difficulty	As outlined above, this should be the paramount consideration. As we see it the particular concern is that, should an overseas insurer operating through a branch experience financial difficulty, its unique characteristics (including how it is regulated), mean its policyholders may be more exposed than they may otherwise be (e.g. as if the relevant insurer was incorporated in New Zealand). This could include: • Challenges potentially faced by New Zealand policyholders having to navigate overseas insolvency regimes to recover amounts owed (i.e. claim payments or premium refunds). This is because while some assets that underpin policy liabilities may sit in New Zealand, and are attributed to the branch for accounting purposes, ownership of the assets that underpin these liabilities sits with the overseas insurer abroad. While New Zealand policyholders have legal rights to recover amounts owed if the overseas insurer faces difficulties, they would need to do so via an overseas jurisdiction's insolvency regime. This may prove more difficult and costly relative to the steps that would need to be taken to recover amounts owed by a locally incorporated insurer under the New Zealand insolvency regime. • The New Zealand policyholder being left out of pocket because the relevant branch has an overseas policyholder preference (**OPP**). An OPP involves an overseas insurer's home insolvency regime paying policyholders in that home jurisdiction ahead of those in New Zealand.[30] If the relevant overseas insurer's home jurisdiction is Australia (which is where most of New Zealand's overseas insurers are located), under the APRA regime, a preference automatically applies in favour of Australian policyholders. The fact that New Zealand policyholders of branches may be vulnerable to OPP is something specifically highlighted by the IMF in their 2017 review.[31] We provide further comments on OPPs below, noting the potential relevance of this matter beyond branches.
2. Public interest	Consideration 1. aligns with the broader public interest - maintaining confidence and the integrity of the New Zealand insurance market. As outlined in 9. below, there is also public interest in ensuring branches' ongoing participation in the New Zealand insurance market.
3. Consistency with the common practice abroad	As outlined in the options paper, many other jurisdictions require branches to hold assets in country. From a reputational perspective, it is important that New Zealand is not perceived as having less consideration for the protection of policyholders than other countries do.

[30] An OPP specifically involves an arrangement that has, or may have the effect, either directly or indirectly, of being materially disadvantageous to New Zealand policyholders as compared to policyholders in another jurisdiction. New Zealand policyholders must be notified about an OPP on documents and where the insurer refers to rating agency ratings (see section 72 of IPSA and regulation 7 and 8 of the Insurance (Prudential Supervision) Regulations 2010).

[31] IMF Country Report No. 17/121 New Zealand Financial Sector Assessment Program, May 2017, page 29 (paragraph 26).

Consideration	Comments
4. The range of tools and IPSA requirements the RBNZ already has at its disposal for branch supervision	These include: • Requirements of branches to provide financial statements on business at a branch level and regular data. • Provision under IPSA to access information held by overseas supervisory bodies.[32] • The assessment of equivalence with an overseas insurer's home jurisdiction when granting licenses or exemptions.[33] The RBNZ is also able to amend or revoke exemptions granted.[34] As expanded upon below, we strongly support the RBNZ actively monitoring and reviewing exemptions for equivalence. We consider that it is imperative that RBNZ uses the tools available to it to ensure New Zealand policyholders are protected.
5. Competition within the insurance sector	Aligned with 9. below, this reflects the benefit of the branches' ongoing participation in the New Zealand insurance market from a competition perspective. Please note that this different to competitive neutrality.
6. Competitive neutrality between locally incorporated insurers and branches	This reflects the view that the unique characteristics of branches (including how they are regulated), constitute concessions granted to them which may be perceived as providing an unfair advantage.
7. The durability of the IPSA regime	While no issues have arisen to-date (as we understand it), this does not mean that this could not happen in the future (including in respect of any new branches entering the New Zealand market and experiencing financial difficulty).
8. The risk profiles of branches	Branches have different risk profiles from locally incorporated insurers. Each branch may also have a very different risk profile. To explain: • On one hand, a branch of a large, well-capitalised overseas insurer operating in many countries with robust supervision in their home jurisdiction, diversified exposures, with New Zealand exposures only making up a small part, is likely to constitute a low risk from a New Zealand policyholder protection perspective. • Conversely, a branch whose New Zealand exposures makes up a material part of their total business and/or who is subject to less robust supervision in their home jurisdiction, is likely to pose a higher risk from a policyholder protection perspective.
9. Branches' ongoing participation in the New Zealand insurance market	This includes increasing competition, innovation, expanding capacity, providing greater options for customers, and facilitating the pooling and diversification of risk globally. These matters are also relevant from a public interest perspective.
10. Flexibility of capital flows from abroad	Insurers benefit from the flexibility of capital flows from abroad. This includes: • As a small and high risk country, in the event of a major catastrophe event (such as an earthquake), the considerable benefit in sharing and spreading risk across jurisdictional boundaries, noting that New Zealand is significantly reliant upon a large pool of funds held by the international insurance community. • The benefit of capital being freely deployed commercially across the globe to best effect (including diversifying risk and investing in jurisdictions that will result in the most favourable returns and/or which are most secure or stable). • The advantage of capital being held abroad in that it is insulated from adverse impacts on values and returns should a New Zealand only shock or downtown occur, such as may occur following a major catastrophe event.
11. Regulatory burden, cost, proportionality and efficiency (including any second order impacts to policyholders)	Aligned with 8., 9. and 10. above, reflecting upon any requirements branches have in other jurisdictions, and the potential for duplicate, complex and/or restrictive requirements to result in branches not being prepared to participate in the New Zealand market or to have material financial impacts that need to be passed onto policyholders in the form of increased premiums.
12. Ensuring the regime reflects the unique features of the New Zealand insurance market (i.e. small size and high risk) and is fit for purpose, even though this could involve a departure from the common practice abroad	Aligned with comments made in 10. above, this includes the fact that, in the event of a major catastrophe event (such as an earthquake), New Zealand is a beneficiary of risk being shared and spread across jurisdictional boundaries.

[32] Sections 74 and 135(2) of IPSA.

[33] Sections 19(1)(j), 38 and 59 of IPSA.

[34] Section 232(3) and 232(6) of IPSA.

Consideration	Comments
13. Ensuring any asset in New Zealand requirement, if introduced, is sufficiently robust	This involves the requirement being sufficiently 'watertight' so that New Zealand policyholders are not left exposed. This includes ensuring robust processes are in place for oversight and that any requirement is applied sufficiently promptly, and at a sufficient level, to ensure that New Zealand policyholders are appropriately protected in practical terms. Otherwise, there are risks such as assets being withdrawn before they can be called upon or are subject to a high-ranking security interest in the home jurisdiction that takes precedence.

In evaluating and balancing these considerations, RBNZ can also draw upon its recently revised set of principles governing the solvency standard review,[35] which include (of relevance):

- Principle 1: We take a substance over form approach and tailor our requirements to New Zealand.
- Principle 2: We will have regard to international comparability, particularly LAGIC, Solvency II, the ICS and the ICPs, with the caveat that principle number 1 will take precedence.
- Principle 3: Capital must be of sufficient quality to enable insurers to meet obligations to policyholders in a range of adverse scenarios.
- Principle 4: The quantum of capital requirements should be set in relation to material risks that may impact the insurer's ability to meet its obligations to policyholders.
- Principle 5: Insurers should be subject to consistent methods and consistent assumptions in determining capital requirements.
- Principle 6: Capital requirements of New Zealand insurers should reflect a risk-based approach, taking into account the risks that are specific to New Zealand, the nature of the New Zealand market, and the Reserve Bank's regulatory approach.
- Principle 7: The solvency framework should be practical to administer and minimise unnecessary complexity and compliance costs.

  We consider that these principles provide useful general guidance about the approach the RBNZ could take in this respect. In this regard, ICNZ notes the particular emphasis in the principles on substance over form (including this taking precedence over international comparability), policyholder protection, a risk-based approach and minimising complexity and compliance costs.

Having reflected on the matters outlined above, one option that ICNZ has contemplated is a targeted risk-based asset in New Zealand requirement for branches that primarily focusses on policyholder protection. As noted, some consider that current arrangements or minor enhancements to the status quo are appropriate, while others advocate for all branches to be required to have assets in New Zealand. The approach contemplated would involve RBNZ applying an asset in New Zealand requirement to a particular branch where it would not otherwise (i.e. by virtue of the application of existing RBNZ tools or IPSA requirements e.g. as outlined at 4. in the table directly above, or any additional reporting) have sufficient confidence that that branch's policyholders were adequately protected.

Consistent with the above, a risk-based approach could be taken in assessing the level that the asset in New Zealand requirement is set at. ICNZ would expect that this would involve an assessment of the relevant overseas insurer's liability to New Zealand policyholders and the extent to which these policyholders are more exposed, potentially with a contingency buffer for such matters as claim reserving errors and currency risks and tailoring to reflect its particular risk profile and capital resources involved.

In respect of any additional reporting, ICNZ envisages this could involve the reporting contemplated in paragraph 105 of the options paper (including home country solvency reports and notification of regulatory actions and material changes in regulation). We comment further on this matter in a later section.

We do not support a requirement for overseas branches to be incorporated in New Zealand (option 4.2)

We are opposed to the introduction of a requirement for all branches to be incorporated in New Zealand (option 4.2). We consider doing so would not strike the appropriate balance between the competing considerations outlined above, lack flexibility and be unduly restrictive, discouraging some overseas insurers from offering insurance in New Zealand through branches.

[35] https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Insurers/ISS-review/Review-of-Insurance-Solvency-Standards-mar-2021.pdf?revision=909c79b5-8c78-481d-9032-973709b95bae&la=en.

We also note the following in this regard:

- A requirement to have a locally incorporated subsidiary would result in a significant amount of restructuring costs for branches already here.
- An appropriately managed branch structure allows insurers to diversify risk, and generally have easier access to a larger pool of capital (being part of a larger company rather than a separate subsidiary one).
- The ability for branch operations to be licensed to conduct insurance business in New Zealand allows overseas insurers to operate and administer their businesses more efficiently for a number of reasons aside from the operation of the IPSA regime.

Please note that not all members support this position. Those that do not may submit to you separately on this matter.

We support other steps being taken

While we do not support the enhanced status quo (option 4.4) being implemented as an alternative to any asset in New Zealand requirement, we consider that there is merit in progressing some of the measures proposed under the enhanced status quo option, on the basis that they would complement it and/or address other issues with the application of the current IPSA regime. This includes:

- RBNZ actively reviewing and monitoring existing exemptions at regular intervals and following the occurrence of certain events (e.g. the failure of a licensee to comply with regulatory requirements, solvency issues arising or changes in overseas regulation), making adjustments as appropriate.[36] We note the following in this respect:
  - Exemptions from New Zealand requirements and reference to overseas regulations and supervisors, means that RBNZ is reliant on them to a significant extent. Overseas regulations and supervisors will not necessarily have New Zealand policyholders' best interests in mind and do not always have any jurisdiction over those contracts of insurance.[37] Overseas supervisors may also lack awareness of unique New Zealand risks (e.g. the significant earthquake exposure) and the changing environment in New Zealand and its implications. New Zealand branches of overseas insurers may also not present a significant level of risk to the home jurisdiction attracting the same level of scrutiny as an equivalent domestic insurer business. These 'blind spots' may flow through to governance of the overseas insurer particularly when the New Zealand branch is a small part of the overall business. We also note that, whereas directors of a New Zealand incorporated insurer are required to comply with the directors' duty to act in the best interests of that New Zealand company,[38] with branches the relevant directors would be required to act in the best interests of the overseas insurer entity, which may not align with that of the branch.
  - While the RBNZ is currently able to amend or revoke exemptions granted,[39] currently there is no mechanism to require the review of exemptions once they have been made at the point of licensing (or of entering a jurisdiction onto the prescribed list).
  - An important consideration should be the robust and regular case-by-case assessment of 'equivalence' of overseas regulatory and supervisory regimes relied upon on,[40] reflecting that while an overseas regime may be broadly equivalent it may still differ in important specific respects.[41] The

[36] The RBNZ has power to apply conditions to, and amend or revoke, exemptions under sections 232(3) and 232(6) of IPSA respectively.

[37] This is demonstrated by overseas policyholders often being specifically excluded from conduct regulation internationally, such as New Zealand's proposed conduct regulation.

[38] See section 221 of IPSA.

[39] Section 232(3) and 232(6) of IPSA. We comment further on exemptions in a later section.

[40] For example, pursuant to section 59 of IPSA, exemptions from the solvency requirement may only be given when, amongst other things, the insurer is subject to solvency requirements in their home jurisdiction that are 'at least as satisfactory' as the New Zealand standards that would otherwise apply. Supervision in the overseas jurisdiction must also be 'at least as satisfactory' as that in New Zealand. Also see the RBNZ's exemption powers under section 38 of IPSA (related to fit and proper requirements for directors and officers), which similarly involves an assessment of the adequacy of overseas insurer's home jurisdiction to be made.

[41] In terms of regulatory and supervisory equivalence, we query the comment made in paragraph 68 of the options paper that NZ regulation might be 'more stringent'. Whilst overseas branches do have some exemptions from IPSA, in our view the rationale should be that they are subject to other regulatory regimes with equivalent or more onerous requirements – if this were not the case then one

relevant overseas regime may also have changed to become more permissive so that it is no longer equivalent. The IMF have made similar recommendations in this regard.[42]

- In terms of monitoring regulatory changes in home jurisdictions, we understand and would expect that, at a minimum, the RBNZ has a regular and ongoing dialogue with relevant overseas regulators and supervisors, including APRA in Australia (where most of New Zealand's overseas insurers are domiciled), and relevant supervisory colleges where information is shared internationally.
- Where the RBNZ is so 'satisfied' of equivalency pursuant to exemption requirements, it should be transparent and consistent with its reasoning, reflecting the broad discretionary nature of its power.

A key focus for this monitoring and review work should be exemptions granted for solvency requirements, noting that recipients may not in reality be subject to an equivalently robust solvency requirement in their home jurisdictions (e.g. a requirement to meet a 1 in 1000 year catastrophe for their New Zealand based risks).[43] Reference could be made to the emerging International Capital Standard (ICS) for Internationally Active Insurance Groups (IAIG) here. The ICS aims to provide a globally comparable risk-based measure of capital adequacy for IAIGs. The ultimate goal is a single international capital standard that includes a common methodology that achieves comparable (i.e. substantially the same) outcomes across jurisdictions.[44]

- Additional work on overseas policyholder preferences (OPP). Rather than focussing on penalties for non-compliance as suggested, we consider the OPP disclosure obligation should be updated to be more relevant and workable. This could include:
  - Introducing a specific requirement on intermediaries, as is the case for FENZ levies, to provide disclosure of OPPs.[45] This reflects that it may be difficult for insurers in the intermediated market to enforce this requirement themselves, with pre-contractual communications being managed by the intermediary and as insurers are generally prohibited from communicating directly with customers pursuant to the relevant distribution agreements. Although not a part of this aspect of the RBNZ's consultation on IPSA, we also support intermediaries being required to inform the insured of the credit-rating of the insurer
  - Regular and robust RBNZ monitoring to determine whether new OPPs develop and that notification requirements are being adhered to.

  Consideration could also be given to developing educational materials for New Zealand policyholders to better inform them about the risks involved when an OPP is disclosed, noting that as indicated above we understand that New Zealand policyholders generally do not have a good understanding about these matters.

- Potential additional reporting requirements. As earlier alluded to, we consider that RBNZ should consider whether additional reporting (including reporting of home country accounts, solvency reports, financial condition reports as well as notification and explanation of any supervisory actions taken or changes in the regulatory framework of their home jurisdiction, as outlined in the options paper) is required to ensure policyholders of branches are sufficiently protected. In evaluating any additional reporting RBNZ should ensure:

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would expect the exemption would not have been granted in the first place. If there were concerns regarding the assessment of 'equivalence' this should be dealt with by imposing appropriate license conditions.

[42] IMF Country Report No. 17/121 New Zealand Financial Sector Assessment Program, May 2017.

[43] Alternatively, as previously submitted by ICNZ on numerous occasions, RBNZ should consider reducing this catastrophic risk requirement to align with most other jurisdictions where generally only a 1 in 200 year catastrophe requirement exists.

[44] https://www.iaisweb.org/file/95901/8-march-2021-press-release-ics-completes-first-year-monitoring. The Register of Internationally Active Insurance Groups which requires groups to be internationally active (with premium written in three or more jurisdictions, with GWP outside the home jurisdiction amounting to at least 10% of the group's total GWP) and have total assets of at least $50B USD and total GWP of at least $10B, includes Allianz and QBE, https://www.iaisweb.org/page/supervisory-material/insurance-core-principles-and-comframe/file/95411/register-of-internationally-active-insurance-groups-iaigs.

45 Section 87 of the Fire and Emergency New Zealand Act 2017.

- A clear connection is established between each aspect of the reporting required and how it will be practically used, with care taken to ensure it is proportional and justifiable from a cost versus benefit perspective.
- As much as possible, these align with requirements in other relevant jurisdictions.

A fundamental prerequisite to RBNZ completing the work above is having sufficient operational capability and capacity to do so.

Also, as outlined previously,[46] we believe that consideration should be given to whether the level of signoff required from an overseas insurer is proportionate to the significance of the approval sought, and whether the timeframes for submitting matters for regulatory approval is appropriate when applied to overseas insurers. There should be some room for lenience available under IPSA in these circumstances, as some of our overseas insurer members encounter difficulties when seeking signoff for approvals from directors of overseas boards.

5. Inwards reinsurance (pages 22-25): Which of the options do you think is most appropriate in relation to the treatment of overseas reinsurers?

We support the current treatment of reinsurers under IPSA (option 5.1)

We support the current treatment of overseas general insurance reinsurers under IPSA (option 5.1), noting that New Zealand regulators currently have relatively minor oversight of this sector, with general insurance reinsurers for the most part not being required to be licensed because they do not satisfy the applicable 'carrying on business in New Zealand' test.[47]

The current treatment of overseas reinsurers under IPSA is appropriate given their critical importance to ensuring a robust general insurance market in New Zealand. Specifically:

- New Zealand general insurers (both domestic and overseas) source the vast majority of their reinsurance from overseas global reinsurers. Significant levels of overseas reinsurance is held for natural hazard catastrophe risk but also under large quota share and other proportional or non-proportional reinsurance treaties. Overseas reinsurers also play an important role in terms of facultative reinsurance.
- Overseas reinsurance enables general insurers to take on risk beyond the capacity they would otherwise have, pooling risk across borders and smoothing losses that occur in extreme events.
- Overseas reinsurance also enables greater access to capital (including meeting the RBNZ's 1 in 1000 year catastrophe capital requirement), facilitating the writing of business that would otherwise not have been possible.
- Overseas reinsurers also play an important role in sharing relevant insights, leveraging their experience reinsuring risk across the globe and driving best practice for those they reinsurer.

On the other side of the equation, New Zealand risks make up a very small part of these global reinsurers' portfolios and New Zealand is likely to have limited sway over them. From an international standard-point, we understand that it is not commonplace for foreign reinsurers to be 'licenced' at a local level to provide reinsurance.[48]

We do not support greater licensing and supervision requirements for reinsurers (option 5.2)

We believe that introducing greater licensing and supervision requirements for reinsurers (i.e. option 5.2) may have a significant chilling effect and discourage new and existing reinsurers from supporting insurers

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[46] See our submission on the IPSA review Issues Paper in 2017, https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf.

[47] Consistent with this, as outlined in the options paper, the reinsurance market in New Zealand is dominated by large global reinsurance businesses based overseas, with currently only 3% of general reinsurance written by IPSA licensed entities.

[48] For those countries that do require this, we understand that the primary purpose is often to provide peace of mind that they are legitimate companies (e.g. that they have not been set up as a means for money laundering). Others that require this normally do so so reinsurers can appear on a 'preferred reinsurer' list to demonstrate they meet specific thresholds such as financial strength rating, capital requirements etc.

participating in the New Zealand general insurance market. This could result in a reduction in the availability and affordability of reinsurance which would be particularly problematic given the reinsurance market is already experiencing a period of market hardening.[49] In practical terms, it may be difficult and costly for overseas reinsurers providing reinsurance into New Zealand to comply with any detailed and specific New Zealand reporting requirements, given each of them generally deal with a large number of insurers across the globe.

It is also important to emphasise that, in a general insurance context, each general insurer generally has relationships with a number of overseas reinsurers that together form an overall reinsurance programme, with each reinsurer typically taking on a portion of the insurer's underlying risk. These programmes and the reinsurers within them are regularly reviewed (e.g. annually, biannually or every three years), taken to market and terms and rates re-negotiated (in most cases with the assistance of a reinsurance broker). While many insurers have strong, long-term relationships with reinsurers, there is a competitive overlay and, as part of these reviews and negotiations new reinsurers may be introduced and existing ones withdrawn. Introducing greater regulatory requirements for reinsurers would significantly restrict general insurers' ready access to this competitive global marketplace, reducing those they would be able to partner with, while raising barriers for reinsurers to compete and, as expanded upon more below, likely discouraging them from doing so.

Additionally, it is worth noting the complexities involving in contemplating greater regulation of reinsurers. For example, retrocession arrangements between reinsurers increase risk diversity but also the complexity for any regulation.

We also query whether there is evidence of any material issue that would warrant the introduction of such a significant change as greater licensing and supervision of reinsurers. Additionally:

- In terms of the risk of reinsurer failure, it should be acknowledged that, due to the small size of the New Zealand risk relative to global reinsurers' overall portfolios, should a major event occur in New Zealand (e.g. an earthquake), this would not cause them to fail or likely even negatively impact their solvency.[50] It is noteworthy that reinsurance met about 75% of the cost of the Canterbury Earthquake Sequence while, in the same period, also meeting losses from the 2011 Tohoku earthquake and tsunami.
- Reinsurers contract with insurers who are well placed to assess and manage counter party risks, have an obvious commercial interest in ensuring the reinsurers they partner with are sufficiently sound and resilient, and develop their reinsurance programmes with these matters in mind.[51] As outlined above, access to the competitive global marketplace is a key asset here. Insurers also obviously already have management obligations under IPSA regarding reinsurance.[52]
- While from a global perspective, risk may be concentrated with a small number of extremely large reinsurers, this risk will be diversified geographically across the globe and through different risk types, such that any one event is highly unlikely to cause difficulties. Additionally, as outlined above, general insurers generally have arrangements with a number of overseas reinsurers that together form an overall reinsurance programme, with each reinsurer typically only taking on a portion of the insurer's underlying risk.

For completeness:

- We reiterate that, as envisaged in the options paper, care needs to be taken to ensure that overseas reinsurers are not, as a consequence of other changes, caught by the IPSA regime and instead that the current position is maintained (e.g. by virtue of changes proposed under section 2, regarding a new

[49] We understand that this is because capacity in global capital markets has reduced, reinsurers are looking to make a price correction to return their businesses to the desired return on equity and replenish reserves. This reflects the global impacts of COVID-19 (losses and reduced investment returns) and high losses within the Asia Pacific region that New Zealand been grouped with over recent years (including tsunamis in Japan and the most recent Australia bushfires). It is expected that these price increases will continue for some time. We understand this is counter-cyclical, with the cost being driven more by global trends than insurance pricing in New Zealand.

[50] Instead, the risk to the general insurance market in New Zealand is that global reinsurers are weakened by poor experience globally at the same time as there is a large event in New Zealand.

[51]We understand that part of this will involve developing long-term relationships with reinsurance partners.

[52] See insurers' obligations as a component of their duty to carry on business in a prudent manner under section 20(2)(d) of IPSA. We consider that this is area where the regime could be enhanced (see below).

definition of 'carrying on business in New Zealand' for overseas insurers and section 4, related to the treatment of New Zealand branches of overseas insurers).

- The options paper appears to adopt the position that reinsurance for general insurance and life is similar and comparable. While there are some limited similarities, very different motivations drive their respective requirements. For general insurers in New Zealand, reinsurance is largely to protect against large losses for catastrophic events. The general insurance market in New Zealand is reasonably unique here (given its small size and high risk), with reinsurance being an essential component of risk protection.[53]
- We do not consider that the reference to general insurers' reinsurance arrangements being transactional is accurate. While it is correct that compared to life, general insurance reinsurance arrangements will generally be for a shorter duration, as outlined above, many reinsurers will be on a general insurer's reinsurance programme for extended periods of time with the development of strong, long-term relationships with reinsurers being an important part of them managing their reinsurance risk.
- Requiring overseas reinsurers to hold more assets in New Zealand as briefly mentioned in the options paper would undermine the key advantage New Zealand has in natural peril losses not being correlated with losses in global peak zones and driving capital requirements. Consequently, the incremental capital overseas reinsurers need to hold against New Zealand risk, is close to zero. To be effective, the amounts required to be held in New Zealand would also need to be a significant portion of catastrophe reinsurance limits. This would need to be billions of dollars for larger general insurers. Requiring overseas reinsurers to do so would also come at a cost, which would likely be passed onto insurers and in turn, New Zealand policyholders. Also, such a requirement runs counter to the need to diversify New Zealand's risks and the flexibility reinsurers require to meet their global commitments.

We are supportive of a focus on insurers and their own reinsurance management

We are supportive of the RBNZ focussing its supervisory efforts on licensed insurers and their particular reinsurance arrangements, with a focus on reinforcing prudent management and testing that arrangements are of an appropriate size, design, quality and robustness.

In terms of any changes to requirements in this regard (as envisaged under option 5.3), for consistency, and to minimise compliance burden, as far as possible these should align with overseas jurisdictions (including APRA requirements). We also encourage RBNZ to take a staged approach and only introduce requirements if, and when, necessary.

In evaluating potential changes to requirements in this respect, it will also be important to reflect on:

- The existing powers it has and the extent they are being used. For example, under section 20(2)(d) of IPSA the RBNZ can already consider an insurer's reinsurance arrangements in assessing whether they are carrying on business in a prudent manner. If not, they can invoke powers under sections 130, 138 and 143 of IPSA to investigate and give directions.
- Its capacity and capability to meaningfully engage with any additional requirements.
- Proportionality, and any second order impacts on reinsurers which, in light of the comments made in the section above, ought to be avoided at all cost in our view.[54]
- How RBNZ can best promote a sound insurance market and competitive neutrality without unduly increasing the regulatory burden. It would also be important, in our view, for a cost-benefit analysis to be completed in these respects.

Regarding proposed changes to solvency standards with respect to reinsurance (i.e. option 5.4), please see our submission to the RBNZ's separate consultation on the Review of Insurance Solvency Standards: Structure and

[53] Arguably this is more important than the equity/debt capital held by general insurers, as illustrated by the fact that general insurers may have around ten times more reinsurance than capital.

[54] For example, if insurers are required to provide the RBNZ with annual questionnaires regarding their reinsurance arrangements, it may be, in turn, that insurers need to make inquiries with multiple reinsurers, potentially leading to reinsurers operating in the New Zealand market being bombarded with incoming inquiries from multiple insurers.

IFRS 17. Please note that our responses here are detailed and technical and it is important that there is alignment between both IPSA and Solvency Standards workstreams.[55]

Consistent with comments above about the benefit of general insurers having unrestricted access to the international reinsurance market, we would not support restrictions being placed on what kinds of reinsurance an insurer can purchase. In our view, generally insurers will be best placed to assess and manage reinsurance requirements.

6. Group supervision (pages 27-31): Which of the options do you think is most appropriate in relation to group supervision?

We consider that it is premature to express any preference on options at this stage

We are not prepared to express a preference on options regarding group supervision at this stage because:

- It is unclear to us which group entities these options are intended to apply to. Initially the options paper states that the focus for group supervision is primarily on New Zealand based groups (including ones writing business overseas).[56] However, the subsequent text in this section appears to contemplate a broader application encompassing New Zealand subsidiaries, or New Zealand sub-groups, of overseas based groups, or subsidiaries of non-insurance groups (e.g. banks), noting that these subsidiary group entities make up a much more significant portion of the market.[57]
- The determination of the above will inform what solution is most appropriate and the consideration of the specific parameters required.

Without resiling from this position, in considering these matters, we believe it would be useful to reflect on the following:

- While an insurance entity's relationship within a broad group of companies (including holding/parent company and other group subsidiaries) can alter the risks it is exposed to,[58] this should not necessarily be viewed as a negative. There are benefits derived from a group structure, because an individual entity can draw upon the resources and capability of the wider group. Operational impediments may also be lower because overseas resourcing and infrastructure can be drawn upon. There may also be advantages in terms of economies of scale.
- The need to avoid significant, costly and disproportionate regulatory change.
- The existing powers RBNZ could use for group supervision and the extent to which they are used,[59] including:
  - In assessing an insurer's licensing application, considering, amongst other things, the appropriateness of its ownership structure having regard to the size and nature of the insurer's business.[60]
  - The power to impose requirements on 'associated persons' directly, to procure information or documents, or gain entry to search a place, in the context of investigations.[61]

[55] https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_Solvency_Standards_Structure_and_IFRS_17.pdf.

[56] See paragraph 137 of the options paper which states: "*The discussion here, then, is focused on groups that are headquartered in New Zealand.* ['*Headquartered' here is convenient short-hand. There are a variety of ways of deciding which jurisdiction is appropriately considered the lead supervisor for a cross-national group*.]" This paragraph goes onto state that "*The supervision of insurance groups is relevant to supervising subsidiaries of overseas groups operating in New Zealand in that it shows what RBNZ regulators might expect from a lead supervisor but that is not the primary focus*."

[57] The options paper indicates that insurance subsidiaries of overseas owned groups operating in New Zealand account for 64% of general insurance premiums.

[58] For example, because an individual entity is subordinate to decisions made higher in the group, weaknesses in one part of the group causing contagion effects, or because gaps between different jurisdictions' supervision enable group risk taking.

[59] Acknowledging that under IPSA RBNZ currently has no explicit powers regarding group supervision, with its' ability to do so being principally driven by its powers over licensed insurers themselves.

[60] Section 19(1)(i) of IPSA.

[61] Section 10(2) of IPSA, which sets out the definition of 'associated person', is broadly framed and includes other members of the group whether they are regulated by RBNZ or not.

- In the context of distress management, the power to, direct ‘associated persons’, or a director or Chief Executive of the associated person in certain circumstances.[62]
- The requirement for a licensed insurer to carry on business in a prudent manner includes having regard to related party transactions.[63]
- The RBNZ also has significant information gathering and sharing powers under sections 120 to 133 of IPSA.[64]

We also note the prohibition against constitutions permitting directors of an insurer to prioritise the best interests of the parent/holding company, where this is contrary to the best interests of the subsidiary,[65] and where a licensed insurer has subsidiaries, the requirement for it to meet the Solvency Standard at an insurer group level as well as at the level of the individual insurance entities, with some transactions with associated parties being either excluded from solvency calculations or assigned additional risk weights.[66]

In so far as any changes are envisaged following the analysis above, in light of earlier comments about New Zealand being a small and high risk market, and the need for supervision and regulation to focus on materiality and a risk-based approach, considering:

- Whether it is most appropriate to focus efforts on New Zealand based groups given New Zealand subsidiaries will have parents already subject to overseas regulation and supervision.
- Whether the desirability of consistency with general international practice is outweighed by a need to reflect the unique features of the New Zealand general insurance market and ensure the regime is fit for purpose.[67]
- RBNZ’s capacity and capability to undertake the supervision envisaged having regard to its limited supervisory resource.

Lastly, for completeness:

- In considering any enhancements to RBNZ’s information gathering and sharing powers as envisaged under this section, as above regard should again be had to RBNZ’s existing extensive powers and the extent to which they are used. For any enhancement, a clear connection should be established between the information required and how it will be practically used, with care taken to ensure it is proportional and justifiable from a cost versus benefit perspective. Consideration should also be given to ensuring sufficiently robust controls and protection measures are in place to protect privacy, commercial sensitivity and other interests and a requirement included to notify an entity that their information is being provided to another agency.
- We refer to our separate submission to the RBNZ on the Review of Insurance Solvency Standards: Structure and IFRS 17 regarding matters outlined in this section of the options paper that relate to, or have implications for, the relevant Solvency Standard, and reiterate that a consistent and joined-up approach should be adopted in this respect.
- We query the relevance of the examples referred to in paragraphs 154 and 166 of the options paper as they relate to issues at a global level during the Global Financial Crisis over a decade ago.

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[62] Section 145 of IPSA. This includes circumstances where there is a failure to comply with directions or other requirements of IPSA, the associated person’s circumstances prejudice the solvency of the licensed insurer or its ability to comply with IPSA, or where the affairs of the associated entity are being carried out in a manner that prejudices the solvency of the licensed insurer and its ability to comply with IPSA.

[63] Section 20(2)(f) of IPSA.

[64] These include powers to request any information, data or forecasts about any matters relating to the business, operation or management of the licensed insurer. There is also a power to require the commission of reports or perform investigations. Requests can be made to the licensed insurer or any ‘associated person’. Under section 124 of IPSA the RBNZ also has the power to require information from ‘other persons’ if they have reasonable grounds for believing they hold information relevant to prudential supervision.

[65] Section 221 of IPSA.

[66] While currently non-insurance entities are excluded, we have advocated for this to change in our submission to RBNZ’s separate consultation on the Review of Insurance Solvency Standards: Structure and IFRS 17, https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_Solvency_Standards_Structure_and_IFRS_17.pdf.

[67] As outlined in the options paper, there is some international precedent for the entity focussed approach and it is still possible to craft this in a way that is compatible with IAIS core principles.

7. Outsourcing (pages 33-34): Which of the options do you think is most appropriate in relation to outsourcing?

We support the status quo (option 7.1)

Our preference is to maintain the status quo position regarding outsourcing (option 7.1) as we believe licensed insurers already have sufficient regard to their outsource risk as part of their wider risk management and imposing additional requirements may add unnecessary regulatory burden in our view. Specifically:

- We are not aware of any issues with the current approach, which appears to be functioning well.[68]
- From a commercial and customer outcomes perspective, insurers are incentivised to ensure that they are appropriately managing their outsourcing risk and have internal procedures to that end.[69] Insurers may also be able to leverage their skills and experience providing risk management advice and business interruption covers to customers' in this respect.
- As acknowledged in the options paper, licensed insurers are also liable for compliance with prudential requirements regardless of whether they outsource business activities. They are required to have risk management policies covering outsourcing, which is just one of a number of operational risks they manage.[70] The duty to carry on business in a prudent manner is also relevant here.[71] The RBNZ already has oversight of these matters via its supervision of licensed insurers.

For completeness, the commentary in this section appears to focus on a New Zealand subsidiary reliant on services provided by a parent overseas being unavailable. It is also possible that a subsidiary could draw upon a wider group should issues arise (which would be a positive outcome) and we note other business structures may also be reliant upon outsource providers. We query whether a better way of framing this matter is by acknowledging that outsource risk is relevant to all licensed insurers regardless of which structure they operate under.

If additional requirements were introduced, our preference would be risk-based outsourcing rules (option 7.2)

Without resiling from the position above, if RBNZ were minded to introduce additional outsourcing requirements, we consider that risk-based outsourcing rules would be most appropriate (option 7.2). We also note the following in this regard:

- The scope of any outsourcing requirements would need to be clarified. In particular, it is unclear from the options paper whether the intention is to just cover core insurance functions (i.e. underwriting, claims management and call centres) or to extend requirements to how IT systems are contracted (as per the banking sector) and/or to claims procurement agreements. In considering these matters, we believe that careful attention should be given to ensure proportionality and only capture 'material' outsourcing arrangements.
- Care should be taken to ensure alignment with relevant outsourcing requirements abroad where an overseas insurer is involved (e.g. Australia, United Kingdom, United States of America), that a licensed insurer may have as a Financial Advice Provider under the new financial advice regime,[72] and/or any requirements resulting from the RBNZ's consultation on cyber resiliency,[73] so that, in so far as this is practical, there are not separate and/or duplicating requirements involved.

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[68] No tangible evidence or examples are included in the options paper outlining any concerns in this respect.

[69] Consistent with this, clause 7 of the ICNZ's Fair Insurance Code which is binding on our members, prescribes that "*We'll train our staff and our agents so they can fulfil our responsibilities to you. Their training will include the requirements of this code, privacy law and information about our products, and may also include principles of insurance and relevant consumer laws.*"

[70] We would expect that this would incorporate the matters outlined in paragraph 174 of the options paper.

[71] Specifically see requirement under section 20(2)(b) of IPSA regarding internal controls.

[72] See General Condition 4 (outsourcing) of the FMA's Standard Conditions for full financial advice provider licences, https://www.fma.govt.nz/assets/Consultations/Standard-Conditions-for-full-FAP-licences.pdf.

[73] See Part D (third-party management) of the RBNZ's Guidance on Cyber Resilience October 2020, https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Cyber%20resilience/Guidance-on-cyber-resilience.pdf?revision=a09a34bb-630c-4483-9370-5406ae3fd1f0.

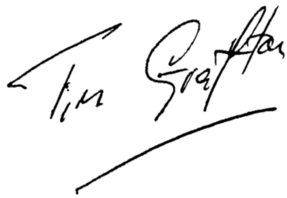
- RBNZ should adopt a risk-based approach in terms of which insurers it focuses on and the extent of its supervision.

Regarding business continuity, we acknowledge that while outsourcing may have an impact, this could be positive. Business continuity is also a distinct matter to outsourcing in our view and focussing only on this from an outsource perspective would only provide a partial view. We agree with comments in the options paper that the issue of business continuity is less acute for insurers than for banks.

Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Regulatory Affairs Manager by emailing nickw@icnz.org.nz.

Yours sincerely,



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