



23 September 2010

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Dear Walter,

Definition for Investment-linked Contracts of Insurance

Thank you for your email dated 21 September inviting further comments on draft policy proposals for a number of regulations to be promulgated under the FAA and FSPA.

You have advised that, at the time of writing, you had not had time to consider the comments we submitted on 17 September. We strongly urge that those comments are taken into account as they highlight some of the technical issues around the proposed definitions for “investment-linked contract of insurance” and “pure risk insurance”.

In addition to our submission of 17 September, we make the following comments:

1. The key theme is consistency and alignment of these definitions with definitions in other relevant Acts. To attempt to create new (and potentially conflicting) definitions is a big concern. This applies equally to investment-linked contracts of insurance and cash and term PIEs.
2. The proposed approach seems to be inconsistent with the way that the Category 1 and Category 2 definitions have been dealt with in the FAA. It seems that the Category 1 product definition affecting investment-linked life insurance was intended to be reasonably narrow, with all other policies falling into Category 2. This can be seen from the language in the definition of Category 2 product: “a contract of insurance (other than an investment linked policy of insurance).” However, it seems to us that the Ministry’s proposed approach would

effectively bring all policies into Category 1 until shown otherwise under the, yet to be determined (and arguably unnecessary), definition of "pure risk insurance." We believe that, if this had been the intention, the relevant part of the Category 1 definition would have read "a contract of insurance (other than a pure risk insurance contract)" and the relevant part of the Category 2 definition would have read "a pure risk insurance product as defined in regulations." This is not the case.

3. Paragraph 2 of your email over-simplifies the idea of a "pure risk" contract. Both pure risk and investment-linked are sub-sets of insurance contracts. To be an insurance contract in the first place, there must be transference of risk. So your analysis of contracts "not aimed at risk mitigation" should instead focus on whether the policy has what is colloquially referred to as an investment component or element (which need not be the principal purpose).
4. In relation to cash and term PIEs, there are perfectly good definitions in other legislation. The cash or term PIE definition should be based on the current definition in the Securities Act (Cash and Term Portfolio Investment Entities) Exemption Notice 2009, and in particular:
 - there needs to be care given to the way in which the unit qualities are defined (e.g. fixed principal amount); and
 - all money raised from the public by way of subscriptions for units must be invested in debt securities issued by a registered bank.
5. Given the prevalence of company groups in the financial services sector and limiting Category 2 investments in a cash or term PIE to bank term deposits, bonus bonds and call securities, there is limited consumer risk in relaxing the requirement that the issuer of the PIE be the same as the issuer of the underlying securities.

There is no logical reason for this requirement as there is no additional risk, given the underlying securities still have to be term or call securities. In fact, there is an argument that there is less risk where PIE products are invested in third party securities as there is the opportunity for the PIE issuer to diversify and spread the risk between different issuers of term and call securities. It is appropriate that any additional complexity is dealt with under the disclosure requirements, which we note are currently being considered under the Securities Act discussion paper.

6. In terms of the 3rd section in your email, relating to fees, these should also be consistent with the fees for the Securities Act.

Yours sincerely

Deborah Keating
EXECUTIVE OFFICER