Financial Services Council
growing and protecting the wealth of New Zealanders

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30 June 2017

Richard Johnson, Senior Adviser
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By email: ipsareview@rbnz.govt.nz

Dear Richard,

Issues Paper – Review of the Insurance (Prudential Supervision) Act 2010 (IPSA)

The Financial Services Council of New Zealand Incorporated (FSC) thanks the Reserve Bank of New Zealand (Reserve Bank) for this opportunity to make a submission in relation to the IPSA issues paper. We support the continued aims of policyholder protection, a cost-effective regulatory regime and a sound insurance sector. Our response addresses the material themes we recommend the Reserve Bank considers during the review process, together with providing detailed responses to the specific questions from the Issues Paper.

In general, we support the recent media statements made by the Reserve Bank in relation to the International Monetary Fund's review, including the balance of principle-based vs. prescription.

The FSC represents New Zealand's financial services industry having 16 member companies and 14 associate members at 30 June 2017. Companies represented in the FSC include the major insurers in life, disability, income, and trauma insurance, and some fund managers and KiwiSaver providers. Law firms, audit firms, and other providers to the financial services sector are represented among the associate members.

This submission provides our view of the key issues and gives voice to the recommendations of our members.

Please contact me on [redacted] to discuss our submission.

Yours sincerely

Richard Klipin
Chief Executive Officer

Who we are

The Financial Services Council of New Zealand Incorporated (FSC) has 16 member companies and 14 associate members at 30 June 2017. Companies represented in the FSC include the major insurers in life, disability, income, and trauma insurance, and some fund managers and KiwiSaver providers. Law firms, audit firms, and other providers to the financial services sector are represented among the associate members.

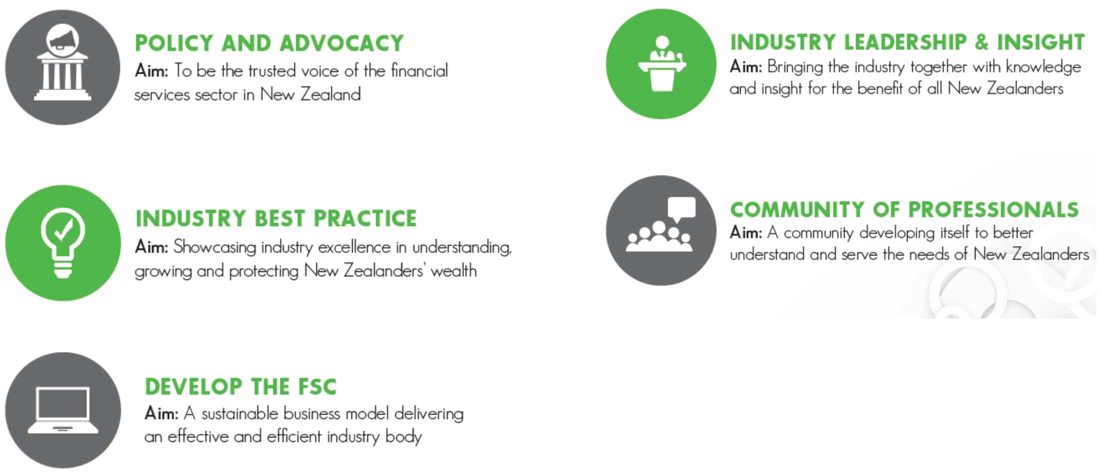
The FSC's vision is to be the voice of New Zealand's financial services industry, with three areas of strategic intent:

1. Strong and sustainable consumer outcomes
2. Sustainability of the financial services sector
3. Increasing professionalism and trust of the industry through the FSC Code of Conduct

Our purpose is to:

- be recognised as an organisation that represents the interests of the New Zealand financial services industry, including to regulators and Government
- promote best practice and integrity in the financial services industry, including through the institution of codes of conduct, standards and the publication of guidance for industry participants
- promote the financial services industry for the economic benefit of New Zealand and to enhance the sustainability of the industry, whilst recognising the primacy of the interests of consumers
- develop and promote evidence-based policies and practices designed to assist New Zealanders to build and protect their wealth
- promote the financial services industry as a medium for investment and protection for consumers
- promote, assist and generally advance the interests of members

To deliver on our vision and purpose FSC activity centres on five strategic pillars:



Responding to the Issues Paper - our approach

This submission is the result of an extensive consultation process across our member-base and represents the views of our members and our industry.

The FSC's guiding vision is to be the voice of New Zealand's financial services industry. Given the different business models, diversity and expertise of our members, there are times when there are a range of insights and views. Where this has been the case in relation to this submission, we have adopted the FSC's standard approach to managing significant issues:

- **Principles-based**: keeping the conversation focussed on the big issues while acknowledging the detail
- **Best practice**: ensuring the recommendations and solutions are aspiring to high standards of service for clients and driving consistency within the industry
- **Market competition**: believing a free market will find the balance that works best for the consumer and the industry

Specific Responses – Our Approach

For depth, there are instances in the 'Specific Responses' section where we have included the range of member views. Our intent in doing this is to highlight the material concerns of our members and open the door for continued conversation with the Reserve Bank.

We acknowledge the time and input of all our members in contributing to this submission.

Key Themes

Theme One – Efficiency and effectiveness
We welcome the review of the legislation to ensure it remains a good balance of compliance efficiency vs. risk. In our view, the current legislation is providing good protection for policy holders and there is no need for any fundamental change to the current legislation.

Keeping the legislation principles-based rather than moving to a prescriptive rules-based approach is more appropriate for the size of the New Zealand market. Prescription is likely to bring additional cost, which will ultimately flow on to consumers and reduce the ability for all New Zealanders to protect their wealth and wellbeing.

Further, we are generally comfortable with the effectiveness of the current statutory fund framework. We do not see any need to clarify or enhance it. In particular, we do not support extending the statutory fund regime to non-life products.

Theme Two – Maintaining competitiveness and capacity within the New Zealand market
To ensure the New Zealand insurance market remains competitive, and that insurers have the capacity to meet the needs of consumers, it is important to make it easy as possible for overseas reinsurers to access the market.

Overseas reinsurers increase choice and competition and provide specialist services not otherwise available in the New Zealand market. We do not support blanket offshore reinsurer licencing due to the potential unintended consequence of restricting capacity and access to global expertise. Restricting capacity would not be in the best interests of the industry or consumers, and therefore the current scope of IPSA changes in relation to reinsurers works well and requires no change.

Theme Three – Exemption regime
We believe the inclusion of a broad exemption regime should be considered as part of the review, and would support the efficacy of the existing prudential supervision regime. A broad exemption regime would allow the Reserve Bank to make class or individual exemptions where compliance with the relevant provision or provisions of IPSA or its regulations would be unduly onerous or burdensome for the applicant; provided the exemption is consistent with the purposes of the Act, promoting the maintenance of a sound and efficient insurance sector and is not broader than what is reasonably necessary to address the matters that gave rise to the exemption.

The Reserve Bank should be empowered to place terms and conditions on exemptions as it sees fit which allow for alternative prudential requirements and mechanisms (as is the case with the Reserve Bank's current exemption making powers).We reference section 7 of the Insurance Act 1973 (Australia) which provides APRA with fairly broad powers to determine that certain provisions do not apply to an insurer or a class of insurers while the determination is in force (these provisions include any provision of Part III – Authorisation to carry on insurance business, (other than the provisions in relation to transfers and amalgamations).

We believe the Reserve Bank should review whether the supervision of overseas insurers has added compliance costs for limited practical consumer benefit. The review should consider the inclusion of a mutual recognition regime in IPSA for overseas insurers incorporated or registered as a branch. This would recognise that overseas prudential and supervisory regimes, which meet sufficient standards, are satisfactory as vis-à-vis the law and regulatory requirements in New Zealand, and reduce duplication of regulation. This is provided that any mutual regime is coupled with specific New Zealand requirements to protect New Zealand policyholders.

It would be particularly useful for reinsurers to have the benefit of mutual recognition. This could enhance New Zealand licensed insurer's access to reinsurance support, which would be helpful in ensuring competitiveness and capacity within the New Zealand market.

In relation to Australia, our experience is that the mutual recognition regime under the Financial Markets Conduct Act 2013 (the FMCA) (and its predecessor regime through a class exemption) works well, while ensuring that New Zealand investors are still sufficiently protected through warning statements and New Zealand registration and disclosure requirements. The reciprocity of any mutual recognition regime under IPSA could be explored with APRA, if there is an appetite for New Zealand licensed insurers to underwrite policies for Australian policyholders.

Theme Four – Fit for purpose for the future

In financial services, the technology environment continues to change and develop. We expect new entrants and entities from sources, and in ways, that do not currently exist. It is important the legislation is sufficiently future-focussed to accommodate the changing playing field while ensuring sensible policy-holder protection.

Given the changing technological landscape, the definition of 'carrying on insurance business in New Zealand' is no longer suitable and should be considered as part of the review. We recommend the test should be New Zealand consumer exposure focused (rather than corporate presence), and reflect both technology changes and the increasing development of 'Insure-tech' products. As highlighted in Theme Three, a broad exemption regime will be necessary to deal with future insurance products and models, and to facilitate innovation in the New Zealand insurance market. This is analogous to the current FMA work to provide a class exemption for the giving of robo-advice in New Zealand.

Theme Five - Disclosure of financial strength ratings

While we appreciate the importance of financial strength ratings, we consider whether they need to be disclosed explicitly to policy holders in writing before entering into or renewing a contract of insurance (as required by section 64 of IPSA) is of questionable value.

Referring policy-holders to the Reserve Bank's website, which already lists all insurers and their ratings (http://www.rbnz.govt.nz/regulation-and-supervision/insurers/licensing/register), or offering an insurer's free phone number where they can obtain the current rating at any time is a viable option. This may be sufficient to meet the policy expectation of ensuring that consumers receive up to date and accurate information whenever they want it. Given the significant costs incurred in changing customer-facing forms/documents and IT systems, a modified approach would balance cost-effectiveness with consumer outcomes.

Further, while Financial Strength Rating disclosures are relevant to consumers, the current drafting of the legislation leaves no room for an insurer who may have a downgraded financial strength rating but continue to hold solvency margins well in excess of requirements. In these instances, public notice is required. We would be supportive of some flexibility within the regime here with the response based on the risk to consumers - e.g. a downgrade to ‘junk’ status would warrant notification, whereas AA- to A+ would not unless it was determined there was a related consequence that posed a material policyholder risk

Disclosures in relation to statutory funds should also be website based, rather than being required to be included in a policy document as is currently the case. This is not the most important information for policyholders. We submit also that statutory fund disclosure should be required only when a life insurer has more than one statutory fund.

Specific Questions

Question 1: Do you have any comments to make on the discussion in Part 1 of the Issues Paper?

We support the Reserve Bank's philosophical approach to prudential regulation of the New Zealand insurance sector. Our members advise that in the most part IPSA is working effectively for them.

Question 2: Do you consider that the Review should assess the current scope of IPSA in terms of the nature of insurance contracts or entities that are subject to the legislation? Please provide commentary in support of your view.

Our response depends on the nature of insurance being considered.

i. Reinsurance

   Overseas reinsurers increase choice and competition within the market and provide specialist services not otherwise available in the New Zealand market. We do not support offshore reinsurer licencing due to the potential unintended consequence of restricting capacity and access to global expertise. Restricting capacity would not be in the best interests of the industry or consumers, and therefore the current scope of IPSA in relation to reinsurers works well and requires no change.

ii. Insurance

   Our members support the scope of this review including an assessment of insurance entities that fall under the regime, particularly in the area of branch operations for overseas insurers. While the exemptions for branches where the overseas insurer is subject to appropriate supervision and regulation in the home jurisdiction drives some efficiency in the regulatory framework, areas of New Zealand policy holder interest must still be adequately protected to ensure the purpose of the prudential supervision regime is upheld. Disclosure alone is not necessarily effective as policyholders may not fully understand the implications of the disclosure. It is important to maintain a level playing field across all entities that have policy holders in New Zealand.

   However, we do not support extending the legislative scope to include a wider range of entities within an insurer's corporate group.

   Further, the definition of 'carrying on insurance business in New Zealand' is no longer suitable and should be considered as part of the review. The adoption of the Companies Office test which focuses on physical presence is no longer suitable, and the test should be impacts (rather than presence) focused. Fewer requirements/greater mutual recognition are appropriate where overseas insurers do not reside in New Zealand and are regulated solely because they offer insurance products from offshore. This is particularly the case for reinsurers and for overseas insurers who provide cover for specialist areas. The test should also be reviewed in light of the need to reflect technology changes, and the increasing development of "Insure-tech" products. As highlighted in our key themes, a broad exemption regime will be necessary to deal with future insurance products and models, and to facilitate innovation in the New Zealand insurance market. This is analogous to the current FMA work to allow the giving of robo-advice in New Zealand.

Question 3: Do you consider that there are entities where the current provisions of the legislation result in inappropriate compliance costs or inappropriate regulatory obligations relative to the risks being addressed by the legislative framework?

While for many of our members the right balance has been struck, the current regime largely relies on a one size fits all approach and has brought an unbalanced cost relative to the risks addressed for some members. We would be supportive of consideration of materiality of risk through the application of a number of areas throughout the legislation with the potential for tiered approaches to compliance (based on risk, size, classes of business etc).

Further, as highlighted in our key themes, we believe the inclusion of a broad exemption regime should be considered as part of the review, and would support the efficacy of the existing prudential supervision regime. A broad exemption regime would allow the Reserve Bank to make class or individual exemptions where compliance with the relevant provision or provisions of IPSA or its regulations would be unduly onerous or burdensome for the applicant; provided the exemption is consistent with the purposes of the Act, promoting the maintenance of a sound and efficient insurance sector and is not broader than what is reasonably necessary to address the matters that gave rise to the exemption.

We also believe the Reserve Bank should review whether the supervision of overseas insurers has added compliance costs for limited practical consumer benefit. The review should consider the inclusion of a mutual recognition regime in IPSA for overseas insurers incorporated or registered as a branch in Australia.

Question 4: Are you aware of any currently non-licensed (under IPSA) insurance business activity in New Zealand that you consider should be within the scope of regulation in some form to enhance the effectiveness of the framework?

No, we endorse the Reserve Bank being empowered to designate certain services as Insurance Services in a similar way to the FMA's designation power to declare that certain products should be regulated under section 562 of the FMCA. This will bring flexibility to the legislation to enable innovation and ensure competitive neutrality is retained. However, any designation determination should be time-bound. Activities considered in scope should ultimately be considered in scope by lawmakers rather than the Reserve Bank in the long-term.

In addition, whilst section 219 of IPSA prohibits the use of restricted words consideration should be given to extending this to prohibiting activity and conduct by non-insurers representing themselves to customers as insurers.

It is important for customers to be fully aware of whether they are engaging with an insurer or non-insurer. We note that similar holding out prohibitions exist under sections 20A to 20C of the Financial Advisers Act.

Question 5: Do you agree that overseas insurers provide valuable support to the New Zealand insurance market? Please provide commentary in support of your view.

Yes, we consider that overseas insurers increase choice and competition within the market and provide specialist services not otherwise available in the New Zealand market.

We do not support offshore reinsurer licencing as that would have the potential consequence of restricting capacity and access to global expertise. Restricting capacity would not be in the best interests of the industry or consumers.

Question 6: Do you consider that the Review should reassess the application of the legislation to insurers operating as branches? Please provide commentary in support of your view.

We support the scope of this review including an assessment of branch operations for overseas insurers. While the exemptions for branches where the overseas insurer is subject to appropriate supervision and regulation in the home jurisdiction drives some efficiency in the regulatory framework, areas of New Zealand policy holder interest must still be adequately protected to ensure the purpose of the prudential supervision regime is upheld. Disclosure alone is not necessarily effective as policyholders may not fully understand the implications of the disclosure. It is important to maintain a level playing field across all entities that have policy holders in New Zealand

However, any review should not consider a requirement for mandatory local incorporation, which would be inappropriate in the context of the New Zealand insurance market. The current ability for overseas insurers to carry on insurance business in New Zealand utilising a branch structure should continue. Having New Zealand branches of large offshore insurers diversifies New Zealand's country risk. A potential consequence of changes in this area is reduced access to capital and competition in the market, which would likely result in increased premiums or loss of available coverage.

We submit it would be timely to consider as part of the review the prescribed jurisdictions included in Regulation 5 of the Insurance (Prudential Supervision) Regulations 2010. We understand that this list was compiled based on individual applications received by the Reserve Bank at the time IPSA was drafted. There are likely to be other European countries and US states with equivalent prudential regulation and supervision to New Zealand which could be considered for inclusion in the Regulations. The level of proof required for those overseas insurers applying for a licence in a non-listed jurisdiction is considerable, and may be a deterrent to market entry.

Question 7: In the context of overseas insurers, what do you consider are the most significant risks posed to the New Zealand economy or New Zealand policyholders that need to be taken into account?

Concern here arises from the risks to New Zealand policyholders where the overseas insurer may have an obligation for policyholder preference in their own jurisdiction (e.g. in the event of distress). This is currently managed through disclosure which we believe is relatively ineffective in alerting NZ policyholders to these risks. The review should consider and address this risk to policyholders and we would supportive of regulatory reform in this area to support the best interests of New Zealand consumers.

Question 8: Do you consider that there is opportunity to clarify or enhance the effectiveness of the statutory fund framework? Please provide commentary in support of your view.

While we are comfortable with the effectiveness of the current statutory fund framework (although note it has yet to be tested), we welcome guidance on:

a. The application of the duties of the life insurer (para 87) and the directors of the life insurer (para 105) in relation to statutory funds. Our experience is that there can be uncertainty in relation to application of these duties, particularly in relation to what qualifies as a 'conflict between the interests of policyholders of life policies referable to a statutory fund, and the interests of shareholders or members of a life insurer' (in which case priority must be given to the interests of policyholders). This clarification would be appropriately addressed through additional guidance from the Reserve Bank, rather than a change to IPSA.

Areas within the Issues Paper where we have concerns about unintended consequences are

a. Paragraph 70, where we see the administrative burden and compliance costs significantly outweighing any benefit to customers in respect of the suggestion to further separate different types of life insurance from each other in the statutory fund. The same comment applies to the suggestion to expand the scope of statutory funds to include some classes of non-life insurance.
b. Paragraph 71, where we are concerned to protect the position of overseas insurers who are reinsurers. We do not want them to be subject to a statutory fund type framework in New Zealand as most will simply leave the market, making it much harder for New Zealand insurers to get competitive access to reinsurance.

Question 9: In the context of overseas insurers, do you consider a statutory fund framework may help protect the interests of New Zealand policyholders? Please provide commentary in support of your view.

Overseas reinsurers increase choice and competition within the market and provide specialist services not otherwise available in the New Zealand market. We do not support legislative changes that have the potential unintended consequence of restricting capacity and access to global expertise. Restricting capacity would not be in the best interests of the industry or consumers.

For overseas insurers, our members consider the problem identified (funds of overseas insurers with offshore policyholder preferences) can be dealt with in a lower-cost, less-interventionist way, although highlight that it depends on what safeguards there are around removal of assets from a statutory fund in event of distress. The key objective is to ensure that New Zealand policyholders would be no worse off in the absence of a fund.

Question 10: Do you consider that the expectations placed on the directors, chief executive officer, chief financial officer or appointed actuary of insurers, would benefit from being considered further within the Review? This may include clarifications of current expectations or expansion of responsibilities.

Rather than changing IPSA, the Reserve Bank should take steps to clarify its expectations of directors through improved guidance and a focus on minimum standards of conduct, capability and governance.

We consider the provision for non-executive board members with independent requirements has been effective. The requirements are working as designed and we do not consider that any further prescription of relevant officer duties is required. We do not support placing expanded responsibilities on directors or senior managers as part of the review. IPSA imposes significant burdens on directors and significant sanctions for contraventions.

Care would need to be taken with any expansion of responsibilities as shown by the Australian experience with Appointed Actuaries. If the Reserve Bank is considering amendments in relation to the Appointed Actuary role, we note some of the function of this role is effectively covered in the NZ Society of Actuary standards, notably some of the detail of the Financial Condition Report, which we suggest should be borne in mind in consideration of any amendments.

One area where we recommend review is that of foreign insurers, where the current roles of 'NZ CEO' and 'NZ CFO' can be quite artificial, especially where key supervisory functions (such as actuarial/solvency) are based overseas and the NZ business is largely a sales/administration arm. It could be more effective to have alternate roles permitted, for example a 'NZ Liaison Officer' for local relationship purposes. The CEO and CFO roles could then be the 'real' positions fulfilled by the foreign-based personnel.

Question 11: Do you consider that the Review should encompass further consideration of an insurer's key control functions (paragraph 84) to promote effective risk management and consistent application of requirements across the sector?

No, the relatively low levels of prescription in the current framework provide a degree of flexibility in the application of the requirements. The Reserve Bank should achieve any desired enhancements to Insurer's risk management programmes and internal control functions by issuing updated guidelines.

We agree with the comment in the Issues Paper (para 88) that any additional requirements the Reserve Bank seeks to impose should be sufficiently flexible to recognise the diversity of insurers within the New Zealand market (both in terms of size and in terms of jurisdiction).

We consider that the additional risk management measures noted in the IMF FSAP Report are unduly onerous – particularly for smaller insurers, and excessively prescriptive – particularly for large insurers, whose risk management frameworks will already contain rigorous processes for risk identification, risk retention, risk management strategies and asset-liability management.[1]

[1] IMF FSAP Report on the New Zealand Insurance Sector at page 97.

Question 12: Do you consider that there may be opportunities to enhance the enforcement framework? Please provide comment in support of your view.

We generally support the Reserve Bank having a wider range of enforcement tools at its disposal and note the principles in paragraph 93 (including 'procedural fairness') should be at the forefront of any potential changes in this area. Availability of enforcement responses that are relative to the materiality of the breach should help strengthen conduct across the industry without the need for involvement of the courts (when not appropriate).

Specific feedback is:

a. The Reserve Bank should reduce some of the maximum penalties for certain compliance failures where the maximum penalties are disproportionate to the significance of the breaches, particularly where the failure may be incurred for administrative errors or compliance with filing time limit requirements. We consider that the following penalties are disproportionate to the magnitude of the potential failure and should be revisited, such as liability upon conviction to fines of up to $500,000:

   - for a failure to comply with the fit and proper requirements under the Act (including failing to obtain the Reserve Bank's approval for a material change to its policy) in section 34 of the Act.
   - for failing to comply with a requirement to provide certificates in time for new directors and officers in section 37 of the Act.
   - for failing to comply with the financial strength rating disclosure requirements in sections 63 and 67 to 70 of the Act.
   - for a failure to comply with any risk management requirement (including failing to obtain the Reserve Bank's approval for a material change to its policy) in section 75 of the Act.

   These disproportionate penalties may also dis-incentivise the Reserve Bank from taking enforcement action for certain 'low level' infringements, given the resources required to prosecute these offences. An administrative penalty regime would be more effective than incurring potentially significant criminal liability for low-level administrative errors.

b. The Reserve Bank should introduce an infringement notice and warning, stop order and direction order regime like the FMCA regime for the lower tier of 'administrative' contraventions. These tools might provide the Reserve Bank with a more appropriate tool to encourage compliance than the excessive criminal sanctions that currently exist in the legislation (on which we comment below).

   The Reserve Bank should ensure that any administrative notice or order regime contains provisions that give the affected party an opportunity to make written submissions and an opportunity to be heard prior to the notice or order becoming effective.[2]

c. The Reserve Bank should align the statutory fund civil liability provisions with all other civil liability provisions in IPSA by imposing a maximum level of civil liability for statutory fund losses

[2] Sections 476 and 477 of the FMCA are an example of such provisions.

by a director. Under sections 107 and 117 of IPSA, directors can become jointly and severally liable for an amount equal to the loss to a statutory fund in the event of a liquidation or receipt of a Reserve Bank notice. There is a limited defence if directors can prove that they used due diligence to prevent the occurrence of a contravention or to ensure that the insurer complied with the Reserve Bank's written notice. This may be proving a deterrent to competent directors entering the market.

There is no limit for director liability in respect of a loss to a statutory fund.[3] Imposing indeterminate liability in this way is unlikely to achieve any additional deterrence benefits, both because directors' maximum liability is unknowable, and because liability may lead to the directors declaring insolvency. The risk of liability under this provision has resulted in some life insurers choosing not to enter, or to entirely exit, the New Zealand market.

Question 13: Do you consider the distress management framework within IPSA could be considered within the Review to enhance the expected effectiveness of the framework, particularly for smaller licensed insurers?

We support effective distress management and additional ability for the Reserve Bank to facilitate good outcomes. In our view, the current IPSA Distress Management Framework is adequate and already contains a wide range of 'top of the cliff' tools for insurers in distress. The Reserve Bank should avoid creating an overly prescriptive framework for distress management to ensure it can flexibly respond to insurers in distress.

If the Reserve Bank does introduce additional distress management tools for smaller insurers, then it should carefully consider including appropriate protections against Reserve Bank overreach. There is a risk that the Reserve Bank's use of enhanced powers in a distress scenario could exacerbate rather than assist with the resolution of a distress management event.

Question 14: Are there any areas of the framework that may pose particular concerns when considering overseas insurers (branch operations)?

We have no unique or specific concerns as to the effectiveness of New Zealand's distress management provisions operating in conjunction with overseas insolvency law or regulatory provisions (beyond those common to any other jurisdiction).

Our members provide three specific areas of feedback:

a. The existing provisions of IPSA and New Zealand's wider corporate and insolvency laws are adequate to protect the interests of New Zealand policyholders in the event of a cross-border insolvency, but will never (and probably can never) perfectly resolve cross-border insolvency and supervision issues. We support the Reserve Bank's existing approach to managing the insolvency risk of overseas insurer branch failure through licensing requirements and by requiring certain overseas insurers – on a case-by-case basis – to deposit a set amount of capital with a custodian. We believe this approach appropriately balances the trade-off between

[3] By contrast, the life insurer is liable, on conviction, to a fine not exceeding $500,000 for any contravention.

freedom of movement for overseas branch insurers as against the need to protect New Zealand policyholders, and should be retained.

b. We do not support the introduction of minimum deposited asset requirements for overseas insurers (beyond the current case-by-case 'condition of licence' regime), because applying a universal minimum deposited assets requirement would increase the cost of doing business in New Zealand, would be inflexible, and may dis-incentivise overseas insurers from offering insurance in New Zealand, with negative impacts to risk concentration, freedom of movement and consumer choice.

c. We do not support the introduction of assets backing insurance liabilities requirements, such as the 'assets in Australia' requirements in the Insurance Act 1973.[4] These requirements have not been implemented in jurisdictions of comparable size to New Zealand, deliver limited policyholder protection relative to their cost, involve making complex distinctions between local and foreign assets (particularly for reinsurance), and impose significant capital burdens on overseas insurers, which would increase costs and may lead to overseas insurers exiting the New Zealand market.

Question 15: Do you consider that the current approach to prudential capital requirements by reference to a solvency margin and conditions of licence should be within scope of the Review? Please provide commentary in support of your view.

Yes, the current approach to prudential capital should be within the scope of the Review. We support a move toward a more transparent regime than the existing use of conditions of licences to apply and vary minimum solvency margin requirements for insurers. This would have the added benefit of allowing consumers to directly compare insurers (for example via information published on company websites). However, insurers will be concerned if any capital proposals result in higher capital requirements. The Reserve Bank should not take steps to change or introduce more burdensome risk based capital requirements.

The introduction of a broad exemption regime to IPSA (discussed in our key themes) would be useful for enabling flexibility in this area when appropriate, without the need to prepare or comply with additional solvency standards (which is time consuming and costly).

Although the solvency standards are out of scope for this review, we submit that consideration be given to reviewing the life solvency standard as soon as possible, in particular in light of implications from the new international financial reporting standard IFRS17 to ensure that changes in such an external standard do not inadvertently affect the level of capital the Reserve Bank requires insurers to hold.

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[4] In Australia, section 116 of the Insurance Act 1973 (Cth) limits the *pari passu* principle by providing that in the winding up of a general insurer, the assets in Australia shall not be applied in the discharge of its liabilities other than its liabilities in Australia unless all the Australian liabilities have first been discharged. [APRA Prudential Standard GPS 120] defines what constitutes 'Assets in Australia' and is designed to ensure that the total value of assets held within the jurisdictional reach of APRA and Australian courts is sufficient to meet a general insurer's Australian liabilities. Section 28 of the Act requires insurers to hold assets in Australia greater than their liabilities in Australia.

Question 16: Do you consider that consideration should be given to clarifying the Reserve Bank's prudential response to deteriorations in reported solvency levels? Please provide commentary in support of your views.

More clarity through published guidance from the Reserve Bank would be helpful, as would early engagement to better facilitate good outcomes for policyholders in the event of distress.

However, we note that the most appropriate action to take place in one distressed scenario might be quite different from the best response in another, and so it may not be possible for the Reserve Bank to give guidance while retaining flexibility for each situation. We therefore caution against a 'one size fits all' approach.

Question 17: Do you consider the Review should reassess the current framework for approval of material transactions and policy changes? Please provide commentary in support of your view.

Alignment with other regulatory approvals seems sensible, however only if it is considered necessary by the Reserve Bank to improve the current framework, which in our members' experience is working well. Given that the Reserve Bank now has examples of industry amalgamations and transfers, we suggest the Reserve Bank refines the 'any other information' requirement to better inform what is required to facilitate an efficient process for all parties.

Question 18: Do you consider that approval by the Reserve Bank is more or less effective than alternative mechanisms e.g. court based systems?

Yes, we consider that approval by the Reserve Bank is more effective than alternative mechanisms, and remains appropriate for the New Zealand insurance market.

Our members comment their experience is that the transfer and amalgamation provisions in sections 44 to 53 of IPSA work extremely well, and the statutory novation provisions are of great assistance, particularly following the increased flexibility introduced following the submission process. The existing approval regime avoids court approval, which can be a lengthy and costly process, and is not particularly effective protection for policyholders.

A court based system (for example, the Australian transfer and amalgamation confirmation regime under the Insurance Act 1973) would increase both the cost and time required to complete transactions in the New Zealand insurance market, with limited benefit to policyholders, and could deter potential participants from entering the market, or existing market participants from growing their existing book through acquisitions.

However, protection of policyholders' interests is the issue, not cost or speed and therefore the continued success of the current approach solution depends on the Reserve Bank having sufficient capacity and capability to approve amalgamation proposals.

Question 19: Are there any aspects of the current disclosure requirements that you consider do not provide useful information or are unduly onerous or costly to prepare? Please provide commentary in support of your view.

This is an area with considerable potential for improvement (see our key themes), bringing benefits for consumers and the industry.

While we appreciate the importance of financial strength ratings, we do not consider they need to be disclosed to policy holders in writing before entering into or renewing a contract of insurance (as required by section 64 of IPSA). We believe it would be sufficient to require policy holders to be referred to a website and free phone number where they can obtain the current rating at any time. The reasons for this are:

a. Customers will receive up to date and accurate information.
b. Financial strength ratings are rarely the primary factor customers consider in choosing an insurance policy. Other important factors are the policy terms, premium amount, insurer reputation for claims management and payment and the financial advice given by the intermediary. There may, however, be scope for better education to consumers by intermediaries, product providers and the Reserve Bank in aiding consumers to understand ratings' importance.
c. There are significant costs incurred by a change in financial strength rating. Forms and documents must be re-printed and replaced for all of an insurer's distribution channels. Significant operational and systems costs also arise when a rating change occurs while an application for a new policy is in progress or during the renewal process. We consider the costs of requiring notification in writing to the policy holder outweigh the benefits of doing so, except in circumstances where the rating change causes significant risk to policy holders – e.g. a downgrade to 'junk' status or material impacts to solvency.
d. Many insurers provide a free-look period, so disclosure after the fact does not harm consumers.

Further, while Financial Strength Rating disclosures are relevant to consumers, the current drafting of the legislation leaves no room for an insurer who may have a downgraded financial strength rating but continue to hold solvency margins well in excess of requirements. In these instances, public notice is required. We would be supportive of some flexibility within the regime here with the response based on the risk to consumers.

Disclosures in relation to statutory funds should also be website based, rather than being required to be included in a policy document as is currently the case. This is not the most important information for policyholders. We submit also that statutory fund disclosure should be required only when a life insurer has more than one statutory fund.

A member provided a tangible example where, during recent financial strength rating change, they undertook the time-bound exercise to notify all customers – both directly and through third parties. The hard time line requirement was challenging and the member estimates it cost at least $40,000, plus the considerable amount of staff time allocated to this exercise. Specifically, the member updated systems, directed third party suppliers, updated application and collateral materials, destroyed and replaced printed stock, re-recorded IVR declarations, updated websites, issued public notices, supported staff and advisers with internal communications and updates to tools, brochures and other collateral such as letter templates. The member is not aware of any cancellations as a result of providing this information to policyholders.

Question 20: Do you consider that there is information that is not currently required to be disclosed that would be beneficial to market participants? Please provide commentary in support of your view.

We believe market participants and consumers currently receive all the information they need through disclosure.

Care needs to be taken when comparing disclosure requirements with banks as the industries are significantly different in terms of their size and, in general, risk to consumers, though there may be exceptions. Disclosure needs to provide consumers with helpful information in plain language, and lengthening the disclosure requirements is likely to be unhelpful in this regard.

Question 21: Do you consider that the Reserve Bank (or other authority) has a role in providing appropriate industry data to the market? Please provide commentary in support of your view.

We believe the Reserve Bank should prioritise important industry issues, such as underinsurance, and request data from the market only when it supports those areas of priority.

Data already provided by industry through other means should be factored in (for example, by the Financial Services Council) to minimise unnecessary duplication.

We note the recent suggestion in the International Monetary Fund's Financial Sector Assessment Program assessment that 'the Reserve Bank and the FMA jointly review the adequacy of current and proposed new published reporting on aggregate data and trends in the insurance sector, working with industry bodies as appropriate, to ensure the availability of appropriate information, for use by policy-makers and private stakeholders.' The Financial Service Council welcomes conversation with the Reserve Bank on how we can best work together in this regard.

Regarding information requests from the Reserve Bank, our members consider it would be helpful if prior consultation is made with the industry to ensure that the information requested can be collected in an efficient manner, and that the information collected will be consistent and meaningful. We are conscious insurers differ in the way they record and organise their data and therefore may differ in how they interpret any information request and how long such requests take to process. It is not uncommon for such requests to result in teams of 10 or more forming within a single organisation to respond to the request – this is a significant burden on insurers.

We are very supportive of the Reserve Bank being resourced appropriately to assist market participants in responding to regulatory requests for industry data.

Question 22: Do you consider that the Review should reassess the manner in which requirements are currently specified and the mix between requirements set out in legislation, standards or guidance? Please provide commentary in support of your view.

In principle, we support streamlining the current requirements to ensure they are easy to follow and avoid circular references. The requirement should be captured consistently in appropriate legislative instruments as they would therefore better support the consistent application of the IPSA regime across insurers.

Our members welcome improvements in the following areas:

a. Statutory fund requirements - updating guidelines in relation to transactions and amalgamations and removing existing fragmentation.
b. Governance requirements – clarifying how these will be applied, provided the current flexibility in application is retained. We do not think a “one size fits all” approach to governance is appropriate for the diverse New Zealand insurance market.
c. Industry updates – which as para 142 notes ‘do not have the force of law’ but have been used to detail mandatory requirements (for example Industry Update, December 2015).

Question 23: Are there any aspects of the current requirements that you consider would be better specified using different regulatory tools?

Our members provide two specific areas of feedback:

a. We consider that following the introduction of prudential regulation and solvency standards for licensed insurers, there may no longer be a strong justification for the 1% asset cap limitation in the banking Conditions of Registration.
b. Specifically, do not use *Industry Updates*, to mandate requirements. These should be best practice and informative on what insurers have been doing well/poorly, but not act as de facto regulations.

Question 24: Are there any further issues you would like to raise that you consider should be within scope of the Review? Please provide commentary in support of your view.

Our members provide two specific areas of feedback:

a. The ability for New Zealand licensed insurers to offer insurance offshore and for New Zealand to be a global insurance hub should be considered as part of the review.
b. Requirements to communicate with all policyholders should all be subject to thorough review. For example, the requirement to notify all policyholders in relation to a financial strength downgrade places a huge burden on an insurer and could be counter-productive, especially if the insurer were stretched financially as complying with notifications to all is neither an easy nor cheap exercise. The policy purpose and policyholder benefit of such requirements needs consideration.

Question 25: Are there any areas of the legislation that you consider are now redundant or you feel could have clearer drafting or require technical corrections?

Yes.

Section 63 of IPSA provides a requirement to obtain certificates from approved ratings agencies of a credit watch warning or change in financial strength rating, after receiving notice in writing of these events. Members are not clear on the benefit of seeking this additional documentation from the ratings agencies when it would seem suffice to pass on the original written notice. If the Reserve Bank requires more information not contained in the notice, then the Reserve Bank could request that an insurer obtains a certificate.

Section 99(2)(c) of IPSA provides that a life insurer must not invest assets of a statutory fund in an associated person that is not a subsidiary of the life insurer, without Reserve Bank approval. It would assist members if the legislation was clearer as to how this applies to the treatment of underlying investments within collective investment vehicles held by insurers.

Question 26: Are there any areas of the legislation that you consider, having regard to the purposes of the legislation, unduly restrict competition or innovation within the New Zealand insurance market? Please provide commentary in support of your view.

No