Response to "Issues Paper; Review of the insurance (Prudential Supervision) Act 2010" – submitted by Product Care (NZ) Ltd

Introduction

This submission considers two of the issues raised in the review paper, namely the concept of extending the life insurance industry requirement of establishing a statutory fund to general insurance licensees; and the issue of Financial Strength ratings as a means of reducing risk to the economy and to the general public.

The perspective of the paper is both specific – as these issues relate to Product Care (NZ) Ltd – and general, as the issues relate to the wider audience of stakeholders in NZ.

Statutory Funds

The establishment and maintenance of statutory funds in the life insurance market is mature and widely accepted as appropriate to the long-term nature of the policyholder liabilities, and non-cancellable contract conditions in favour of the insured. The statutory fund concept arose in Australia when most life insurance polices related to contracts with significant savings elements and the large majority of assets in the funds were attributable to the policyholders.

General Insurance contracts tend to be annually renewable at the invitation of the insurer, with adverse claims experience potentially resulting in discretionary remedial measures as judged appropriate by the insurer. In addition the assets support the risk carried by the shareholder and are not attributable to the policyholder. The short-term nature of contracts has traditionally rendered the use of statutory funds superfluous, even in the case of long-term employers liability and workmen's compensation claims in the UK and USA.

However, ACC renders such insurances unnecessary, and, across the industry generally, the potential 'claims tails' appear to have been adequately addressed with current reserving and reinsurance arrangement that meet the RBNZ parameters.

Specifically, in relation to Product Care (NZ) Ltd, it is hard to see how the establishment of a Statutory Fund would provide policyholders with any greater security than is currently provided, or how the NZ economy is, or has been, put at increased risk in the continuing absence of such an arrangement for Product Care (NZ) Ltd.

As a niche insurer with a single product, combined with robust sensitivity testing and low per capita exposure, the company's ability to respond to claims variances is closely scrutinised by Board and management.
This structure and agility therefore brings into question the benefit of having a Statutory Fund in place. The prudential management of assets and liabilities would be no different in a statutory fund structure, apart from incurring increased compliance costs.

Financial Strength Ratings

The introduction of the Insurance Companies (Ratings and Inspections) Act 1994, took place in an environment when NZ was beginning the journey to achieve more global alignment in the regulation of its capital markets, insurance, and financial services sector.

In particular, events overseas required more stringent supervision of insurance companies in many jurisdictions, and the NZ response to introduce mandatory rating was entirely prudent, sensible, and appropriate.

Since then, the evolution of the NZ regulatory regime has been significant.

The establishment of a more effective regulatory infrastructure with the establishment of the Financial Markets Authority has been supported by the introduction of the Insurance (Prudential Supervision) Act 2010.

With the introduction of the Insurance (Prudential Supervision) Act 2010, the capital management and financial requirements of licensed insurers brought NZ more into line with international standards, and created supervisory parameters reflective of the consensus of all stakeholders.

The safety margins and financial security measures now provide strong protection for policyholders and lend considerable credibility to the licensees, so that failure to meet policyholder obligations is rendered less likely.

The robust nature of the provisions, combined with the efficient oversight exercised by the RBNZ, make the domestic and international perspectives of the NZ regulatory environment widely acceptable.

This has been reflected in the generally positive response from the recent IMF investigation, and while there are still areas of improvement mentioned, due recognition has been afforded to the progress made.

With the IPSA provisions firmly in place, and further reporting requirements in course of development, the question of the relevance of compulsory financial strength rating by external agencies is raised for consideration.

The expense incurred by licensees in meeting this obligation is considerable and to all intents and purposes is perceived as providing a less stringent, less rigorous examination of financial standing.

There is no evidence to suggest that investigations by the rating agencies, based entirely on data provided by licensees, provide a ***more stringent*** test of financial strength than does the IPSA legislation.

If, therefore, the rating agency research provides ***as stringent*** a test of financial strength, this raises the question why there is additional expense incurred in creating a report that adds nothing to the comfort provided by the IPSA legislation.

Indeed, the view held by some observers that the rating agency research methodology is based on ***less stringent*** parameters, suggests an inevitable conclusion that such activity is superfluous and creates no added value, but merely incurs unnecessary expense.

Finally, there is no evidence from licensees that consumers and policyholders have any real appreciation of the implications of the varying rating standards applied by the approved agencies.

It is therefore reasonable to conclude that little store is placed by the end-user of insurance in the rating agencies measurement of claims-paying ability or financial strength.

Furthermore, it has been stated that RBNZ uses the data from the Rating Houses as an additional source of information. However, might it not be more cost-effective for the RBNZ to extract this data directly from licensees? The total cost to the industry – and ultimately to the consumer – is prohibitive and unnecessary.

We also note that reference to credit ratings on other jurisdictions such as the US and Europe related to the rating of assets rather than the institution itself and these jurisdictions have criticised the reliance of regulators on ratings.

We therefore request that RBNZ give due consideration to removing the obligation on licensed insurers in New Zealand to be rated, and that RBNZ rely on the effectiveness of the robust and prudent legislation appropriately applied in the supervision of licensed insurers in NZ which is consistent with other jurisdictions.

Submitted by David Whyte, Chair, on behalf of the Board of Directors of Product Care (NZ) Ltd.

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