



**RESERVE
BANK**

O F N E W Z E A L A N D
T E P Ū T E A M A T U A

Insurance Policy Review: Insurance Prudential Supervision Act

October 2020

Current Information Available

Information about the review, including the Terms of Reference, is available on the Reserve Bank website at:

<http://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/review-of-the-insurance-prudential-supervision-act-2010>

Contact details

Website <http://www.rbnz.govt.nz/regulation-and-supervision/insurers>

Email ipsareview@rbnz.govt.nz

Mail Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
WELLINGTON 6140

Glossary

IAIS	<u>International Association of Insurance Supervisors</u>
IASB	<u>International Accounting Standards Board</u>
IMF	<u>International Monetary Fund</u>
IPSA	<u>Insurance (Prudential Supervision) Act 2010</u>
FMA	<u>Financial Markets Authority</u>
FSAP	<u>The IMF Financial Sector Assessment Programme</u>
MBIE	<u>Ministry of Business, Innovation & Employment</u>
RBNZ	<u>Reserve Bank of New Zealand</u>
Regulations	<u>Insurance (Prudential Supervision) Regulations 2010</u>
IPSA Review	<u>Review of the Insurance (Prudential Supervision) Act 2010</u>

1. Introduction

1. The Reserve Bank is undertaking a review of the Insurance (Prudential Supervision) Act 2010 (“IPSA”).
2. Consultation on an initial [Issues Paper](#) closed on 30 June 2017. The Reserve Bank received 42 submissions from a range of stakeholders, including insurers, industry associations and law firms. Individual redacted submissions are available on the Reserve Bank’s website unless confidentiality was requested¹. An [Issues Paper Feedback Statement](#) was published in October 2017 following the consultation.
3. The Reserve Bank suspended active work on this Review from April 2018 in order to focus on the Reserve Bank Act Review. Work resumed in Q4 2019 but was suspended again in March 2020 due to the COVID-19 pandemic. Work is resuming from October 2020; this will build on the 2017 issues paper and feedback, and take into account more recent developments.
4. In recent years, there have been a number of developments that are likely to provide input to the IPSA Review. These include
 - The IMF FSAP review of New Zealand’s Financial Sector.
 - The Trowbridge/Scholten [review](#) of the Reserve Bank’s supervision of CBL (in liquidation).
 - The FMA/RBNZ Thematic Review of Life Insurer Conduct and Culture.
 - A thematic review of the appointed actuary regime for insurers.
 - A review of insurance contract law being conducted by MBIE².
 - The publication of new insurance accounting standards (IFRS 17) by the International Accounting Standards Board.
 - Recent reviews relating to seismic risk – Treasury’s review of property insurance availability and affordability, and the upcoming review of the Earthquake Commission Act 1993.
5. Much of the input promotes a more active supervisory approach, and we would like IPSA to better facilitate this.

¹ <https://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/review-of-the-insurance-prudential-supervision-act-2010>

The redactions are of personal contact details. Requests for submissions to be kept confidential were made by 2 submitters.

² <https://www.mbie.govt.nz/business-and-employment/business/financial-markets-regulation/insurance-contract-law-review/>

2. Recommencement of IPSA Review

Objectives

6. Best practice regulatory stewardship³ includes monitoring and reviewing existing regulations at appropriate intervals to ensure they are robust and fit-for-purpose. The IPSA review is designed to help the Reserve Bank fulfil its regulatory stewardship responsibility, by evaluating the effectiveness of New Zealand's insurance prudential framework.
7. The IPSA framework requires the Reserve Bank to undertake certain functions and specifies the options available to the Reserve Bank when undertaking those functions.⁴ We propose that the legislation should continue to allow for a risk-based approach to regulation and supervision, and should permit a suitable range of supervisory tools to be used by the Reserve Bank within the limits of its resources and subject to appropriate constraints and accountability mechanisms.
8. The objectives of the IPSA review as stated in the 2016 Terms of Reference were to:
 - Assess the performance of IPSA in light of its purposes to ensure that IPSA provides for a cost-effective supervisory regime that promotes the soundness and efficiency of the insurance sector.
 - Assess the consistency of the regime with international guidance and other legislation administered by the Reserve Bank and consider if further alignment would be appropriate given the nature of the New Zealand insurance sector.
9. We believe those objectives remain suitable for the recommenced project.
10. The Reserve Bank considers that the current regulatory purposes of IPSA as stated in Section 3 of the Act remain broadly appropriate, that is to:
 - promote the soundness and efficiency of the insurance sector; and
 - promote public confidence in the insurance sector.
11. The [Reserve Bank of New Zealand Bill](#) was introduced into parliament in July 2020 and contains provisions related to the governance, operation and objectives of the Reserve Bank. We will consider the implications for IPSA's purposes of the outcomes of Phase 2 of the Reserve Bank Act Review as part of our review of IPSA.
12. A review of the solvency standards issued under Section 55 of the Act will also commence in parallel to the IPSA review. The solvency standard review process is detailed separately in [this paper](#).

2017 Consultation

³ <https://treasury.govt.nz/information-and-services/regulation/regulatory-stewardship>

⁴ Refer to Section 12 of IPSA.

13. The first phase of the IPSA Review targeted the identification of potential issues for the Reserve Bank to consider in more detail during the next phase of the Review. In March 2017 the Reserve Bank published an [Issues Paper: Review of the Insurance \(Prudential Supervision\) Act 2010](#) (“the Issues Paper”) for consultation. The Issues Paper set out, at a high level, areas identified by the Reserve Bank that may warrant further consideration under the IPSA Review. The consultation sought stakeholders’ views on these issues and whether there were any additional areas that should be considered.
14. The [Issues Paper Feedback Statement](#) noted that, in general, the submissions supported the idea that the IPSA framework and the Reserve Bank’s prudential supervision of licensed insurers have improved the soundness of the insurance sector. Furthermore, this has been achieved without unduly restricting competition or innovation, or introducing inappropriate compliance costs. Stakeholders agreed that there are a number of areas where the effectiveness of the framework could be improved or compliance costs reduced, and hence broadly supported the IPSA Review.
15. Stakeholders provided comments and suggestions for consideration in all areas identified in the Issues Paper, as well as a number of additional areas not explicitly raised in the Issues Paper. For example:
 - The definitions of “carrying on insurance business in New Zealand” and “contract of insurance” are not necessarily clear in their application. Some arrangements may appear to the general public or policyholders as being insurance contracts provided by licensed insurers when in fact they are not.
 - There are some concerns that there may be a growing non-licensed insurance sector. An example of activities that currently do not require a licence under IPSA include insurance business written by foreign insurance firms that are not required to register as an overseas company under the Companies Act.
 - The legislation may capture or apply requirements to entities or contracts in a manner that is disproportionate to the risk presented to the soundness of the New Zealand insurance sector or public confidence in the sector.
 - The appropriate application of solvency and other requirements to overseas insurers. These concerns relate both to competitive neutrality and the adequacy of protection of New Zealand policyholders.
 - Whether or not the current statutory fund regime is applied to the appropriate liabilities or is achieving its purposes.
 - Whether or not a more prescriptive approach is needed to the responsibilities of key officers. Clarifications of the Reserve Bank’s expectations of directions and other key officers.
 - The introduction of a wider range of enforcement tools to enable more appropriate and calibrated responses from the Reserve Bank.
 - The range of distress management powers available to the Reserve Bank may not be sufficient. Some submitters cautioned the Reserve Bank on being a participant in the market (i.e. overly involved in management of insurance entities), while others stressed the importance of appropriate regulatory requirements and early interventions as various solvency thresholds are passed.
 - Applying solvency standards through licence conditions was seen to be sub-optimal.

- Submitters explored the idea of replacing the current binary approach to solvency (where a 100% solvency ratio demarks solvency and insolvency) with a ladder of intervention.
 - The Issues Paper also discussed the appropriateness of the Reserve Bank approving changes in control, whether or not there were any gaps in the current framework, and the potential for further alignment with other frameworks (such as the NBDT regime).
 - Current disclosure requirements were seen to be too focused on financial strength metrics, while in reality non-financial measures (such as risk management and governance practices) could also affect the viability of an insurer. Many submitters considered parts of the existing disclosure requirements too onerous relative to the benefit provided to consumers.
 - The Reserve Bank’s regulatory requirements were seen to be fragmented, with some requirements being set out across legislation, regulations and guidance notes. The framework could benefit from consolidation of the requirements and increasing alignment with international benchmarks.
 - Unprompted comments from submitters asked if the IPSA Review should be conducted by an independent agency and raised the possibility of a merits review framework.
16. The Reserve Bank will consider the points raised by stakeholders during the next phase of the IPSA Review. Our intention is to undertake several consultations on different topics, followed by a single legislative process.

Recent Developments

17. The Financial Sector Assessment Programme’s Detailed Assessment Report 5 (“FSAP”) was released in 2017 following an assessment by the IMF of New Zealand’s prudential and supervisory regime for insurance against the IAIS’s Insurance Core Principles (“ICPs”).⁶ Recommendations from the FSAP will be addressed within the next phase of the IPSA Review, to the extent they are appropriate for New Zealand. Key recommendations included the use of a ladder of intervention applicable to the solvency standards; more intensive and better-resourced supervision; and the introduction of group supervision.
18. The liquidation of CBL provided some valuable lessons to the Reserve Bank from both a supervisory as well as a policy perspective, as discussed in the [report](#) by John Trowbridge and Mary Scholtens. In part, the recommendations from Trowbridge and Scholtens echoed those of the FSAP report; however other matters, such as the ability of the Reserve Bank to more effectively challenge the views of appointed actuaries and other professionals, were also covered.

⁵ <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/FSAP/Detailed-assessment-of-observance-Insurance-core-principles.pdf?la=en>

⁶ <http://www.iaisweb.org/page/supervisory-material/insurance-core-principles> accessed 9 Oct 2017. The ICP’s as updated in November 2015 were used by the IMF for assessment purposes.

19. On 29 January 2019 the FMA and the Reserve Bank released the findings from their joint review of conduct and culture in New Zealand life insurers. The review found that “across the sector, governance and management of conduct risks is weak and there is a lack of focus on good customer outcomes”. As a consequence, the Government is introducing a new regulatory regime to govern conduct in the financial sector, with the FMA taking a central role in that regime. Legislation for this was introduced in 2019 and at the time of writing remains before parliament.
20. One of the broader issues for consideration in the IPSA Review is whether the current regime appropriately regulates and encourages best-practice in the governance of insurers generally. The Trowbridge-Scholten Report recommended enhanced standard-setting powers for the Reserve Bank to include, at a minimum, standards for governance and clearer powers over standards for risk management.
21. There is a review in progress of the Reserve Bank Act, which covers a wide range of policy areas including the institutional structure and governance of the Reserve Bank itself, and also the Reserve Bank’s regulation and supervision of New Zealand’s banking and non-bank deposit taking sectors. A bill covering the governance, operations and objectives of the Reserve Bank has now been tabled in Parliament and some provisions may influence future policy development for insurance regulation.
22. In June of this year the Reserve Bank published a report describing its thematic review of the role of the Appointed Actuary in insurance companies. Recommendations of consequence for the IPSA review included having clearer expectations for the role, some potential extensions to the scope of the role, and the possible introduction of an actuarial advice framework to govern, for example, delegations of authority.
23. Other initiatives that are currently in progress, such as MBIE’s review of insurance contract law are likely to have a bearing on the IPSA Review.

3. Outlook

24. Over the next twelve months, we intend to release consultation papers seeking feedback on the following matters falling under IPSA⁷:
 - Scope of the legislation– Which organisations and products should be captured? Do the definitions of “insurance”, “carrying on business” etc. need to be modified?
 - Overseas insurers– How should overseas insurers operate in the New Zealand market? What sort of supervision regime should be in place?
 - Statutory funds– To what extent should statutory funds be a feature of New Zealand regulation? Are the current forms effective and appropriate?
 - Solvency regime– Are the enabling provisions for solvency standards and requirements supportive of good regulation and supervision? Do definitions in IPSA need amending?

⁷ The following questions provide a high level overview of the matters that will be explored in more detail in the consultation papers; we do not expect submissions on these questions.

Indicative Timetable

25. The diagram below indicates a high-level timeline of the consultation process for the IPSA review.

Date ⁸	Modules for Consultation
Q4 2020	Scope, Overseas Insurers
H1 2021	Statutory Funds, Solvency Buffers
H2 2021	Governance/Appointed Actuary, Disclosure
H1 2022	Supervisory Processes, Technical Amendments
H2 2022	Regulatory Tools, Distress Management

26. The consultation modules will be followed by Cabinet decisions, where required, and drafting of the legislation. The legislative process is expected to occur in the second half of 2023 at the earliest.
27. Throughout the process, the Reserve Bank will interact intensively with and seek input from relevant government agencies, industry organisations and professional organisations. We have established a Reference Group, comprising senior staff from other interested government agencies such as Treasury, FMA and MBIE, to ensure that they have full line of sight and the opportunity for full, detailed input into the work

Have your say

28. Comment on this paper is not sought, however stakeholders are welcome throughout the Review to provide comment and information to the Reserve Bank outside of formal consultation periods. Please use this email ipsareview@rbnz.govt.nz to provide comments.

⁸ Q4 means the fourth quarter while H1 and H2 refer to the first and second halves of the year respectively