



Reserve Bank
of New Zealand
Te Pūtea Matua

Review of the Insurance (Prudential Supervision) Act 2010

Options Paper 3: Enforcement and Distress Management

10 March 2022

CONSULTATION
PAPER



General Information

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

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

Submission Contact Details

The Reserve Bank of New Zealand - Te Pūtea Matua invites submissions on this consultation paper by 5pm on 20 May 2022.

Please note the disclosure on the publication of submissions below.

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Publication of Submissions:

All information in submissions will be made public unless you indicate you would like all or part of your submission to remain confidential. Respondents who would like part of their submission to remain confidential should provide both a confidential and public version of their submission. Apart from redactions of the information to be withheld (i.e. blacking out of text) the two versions should be identical. Respondents should ensure that redacted information is not able to be recovered electronically from the document (the redacted version will be published as received).

Respondents who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (OIA). These reasons should refer to section 105 of the Reserve Bank of New Zealand Act 1989, section 54 of the Non-Bank Deposit Takers Act, section 135 of the Insurance (Prudential) Supervision Act 2010 (as applicable); or the grounds for withholding information under the OIA. If an OIA request for redacted information is made we will make our own assessment of what must be released taking into account the respondent's views.

We plan to publish an anonymised summary of the responses received in respect of this Consultation Paper.

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1 Introduction

1.1 Background

- 1.1.1 In 2017, we commenced a review ('the Review') of the Insurance (Prudential Supervision) Act 2010 ('IPSA'). The first stage of the Review, which comprised identification of issues at a high level and an initial public consultation process, was completed in 2017.¹ The Review was suspended in early 2018 to allow resources to be focused on the review of the Reserve Bank Act. We announced the relaunch of the IPSA Review on 1 October 2020.²
- 1.1.2 We are now in the second phase of the review, which involves releasing a series of options papers that work through different sections of the Act.
- 1.1.3 This is the third options paper in the series. It discusses enforcement and distress management.

The IPSA Review Process

- 1.1.4 In this second phase, we are working through the Act, producing options papers on a range of issues initially identified in the 2017 issues paper.
- 1.1.5 These options papers are open and we do not have a fixed policy position prior to the publication of consultation papers. The papers are designed to raise issues, explore ideas and seek input that we will draw on when making decisions. This paper marks the half-way point in this phase of the review (see Table One for an overview of phase 2 of the review).
- 1.1.6 Once all the options consultations have concluded in 2023, we will publish a final omnibus consultation, setting out our recommended reforms to IPSA. We will then seek Cabinet decisions and proceed to drafting legislation to implement the review. We do not expect primary legislation to be in place before the end of 2024.

Table One: Review Timeline

Consultation	Description	Options Paper and indicative date	
Scope of the act and overseas insurers	Does the legislation apply to the appropriate range of entities?	Paper 1 Q4 2020	Completed In process
	Treatment of branches and overseas insurers		
Policyholder security	Financial strength disclosures, solvency requirements, statutory funds, termination values and a policyholder guarantee scheme	Paper 2 Q3 2021	
Enforcement and distress management	Penalties for non-compliance, supervisory tools, and reviewing the distress management provisions available to the Reserve Bank	Paper 3 Q1 2022	Current progress

¹ The first issues paper, published in 2017 can be found [here](#).

² The relaunch paper can be found [here](#).

Consultation	Description	Options Paper and indicative date
Key officers and control functions, supervisory approvals	Responsibilities of directors and key officers and effectiveness of key control functions. Is the system for approving amalgamations, change of control and transfers appropriate?	Paper 4 Q3 2022
Regulatory mechanisms, disclosure requirements and other issues	<p>The use of legislation, standards, regulations and guidance notes</p> <p>Does the legislation enable appropriate disclosure requirements?</p> <p>Any additional issues identified by submitters, including areas of legislation that might be identified as redundant or overly restrictive</p>	Paper 5 Q4 2022

Forthcoming

Considerations Shaping the Options Presented

- 1.1.7 The options for consultation have been developed based on stakeholder feedback from the 2017 issues paper and in light of recent developments in the insurance sector.
- 1.1.8 The 2017 issues paper attracted 42 submissions from a range of stakeholders including insurers, industry bodies and law firms. A high-level feedback statement providing a summary of responses was published in October 2017.³ We have built on these responses to identify the most important issues for reform and shape our discussion of possible options.
- 1.1.9 Additionally, the discussion of options reflects the Reserve Bank's experience of supervision under IPSA and a range of important developments in the regulatory environment.
- 1.1.10 In 2016, the International Monetary Fund (IMF) undertook a comprehensive review of New Zealand's financial sector as part of its global Financial Sector Assessment Programme (FSAP). The FSAP review evaluated New Zealand's alignment with the International Association of Insurance Supervisor's (IAIS) 'Insurance Core Principles' (ICPs). The ICPs are an outcomes-based global benchmark for systems of insurance supervision. The IMF identified a number of areas in which New Zealand's observation of the core principles could be improved.⁴ The ICPs are a key point of reference in developing options for consultation.
- 1.1.11 The events leading to the liquidation of CBL Insurance Ltd also provided some valuable supervisory and policy lessons for us. We commissioned a report from John Trowbridge and Mary Scholtens QC on our supervision of CBL, to identify these lessons and we have indicated our commitment to comply with that report's recommendations⁵. There is considerable alignment between the report's recommendations and those in the FSAP review.

³ The feedback statement review can be found [here](#).

⁴ The IMF's recommendations and assessment, published in 2017, can be found [here](#).

⁵ The Trowbridge /Scholtens report can be found [here](#).

1.1.12 In particular, the Trowbridge/Scholtens report recommended:

- clarifying the Reserve Bank’s ability to challenge the opinions of the Appointed Actuary and other professionals;
- introducing a graduated approach to solvency; and
- strengthening some guidelines that currently do not have the force of law and expanding the Reserve Bank’s power to issue new prudential standards.

1.1.13 The Reserve Bank has conducted two important recent reviews relating to the insurance sector, whose findings will feed into the IPSA review. The Reserve Bank and Financial Markets Authority published the findings of our joint review of life insurer conduct and culture in 2019 and we published the findings of our thematic review of the Appointed Actuary regime in 2020. The Culture and Conduct Review noted that some life insurers were complacent in considering conduct risk, showing weak governance and lack of focus on good customer outcomes. The Appointed Actuary review concluded that the Appointed Actuary role remained valuable but also identified some lack of clarity around expectations.

1.1.14 The International Accounting Standards Board (IASB) has released a new international accounting standard for insurance contracts (IFRS 17 *Insurance Contracts*), which will affect some of the definitions used in IPSA.

1.1.15 Finally, we will seek to align IPSA with the other sectoral acts that the Reserve Bank administer.

1.1.16 Following the Treasury’s review of the Reserve Bank Act 2021, our legislation is being restructured. By the time any amendments to IPSA are introduced, there will be one piece of legislation to shape the Reserve Bank’s institutional structure and governance (the Reserve Bank Act 2021). Then there will be three ‘sectoral acts’ sitting beneath that institutional framework: IPSA, the Financial Markets Infrastructures Act (2021) and a ‘deposit takers act’ (DTA). The DTA will bring together the prudential framework for banking (currently contained in the Reserve Bank Act) and non-bank deposit takers. The DTA has not yet gone through the parliamentary process but an exposure draft has been published.

1.1.17 While there are important differences between the sectors, there are also some core similarities in how financial sector prudential regulation is carried out. We will seek to apply similar rules to each sector unless there are good reasons for different treatment. The contents of this consultation paper are particularly amenable to alignment so our working assumption is that we should amend IPSA to align with the draft DTA and FMI legislation unless there are strong reasons not to.

1.2 This Consultation

Consultation Contents

1.2.1 IPSA is designed to shape how insurers are run in order to promote a sound and efficient insurance sector and public confidence in New Zealand’s insurers. Much of the Act is concerned with positive behaviours that we wish to promote.

1.2.2 In contrast, the sections of the Act we review in this consultation contemplate situations in which problems may emerge. First we look at ways to deal with the possibility of non-compliance, exploring how we can monitor and incentivise compliance with the regulatory framework. Second, we look at situations where (due to non-compliance or adverse external developments) insurers get into financial distress.

Penalties and Enforcement

1.2.3 The consultation begins with offences, penalties, remedial actions and sanctions. The purpose of penalties and enforcement activities is to incentivise compliance with the regulatory framework. Compliance is important both to make regulation effective and to promote public confidence in the sector.

1.2.4 An effective penalty and enforcement framework should provide a range of remedies and sanctions so supervisors can select tools to encourage compliance or sanction non-compliance that are proportional to the harm involved.

1.2.5 Responses that are insufficiently forceful may not provide sufficient deterrence or appropriate sanction. On the other hand, where only severe penalties are available, supervisors may be deterred from using them (since they seem disproportionate) and this may undermine the credibility of the enforcement regime.

1.2.6 At the moment, IPSA includes a wide-range of offences but enforcement options are limited to either written warnings or serious criminal penalties administered by the courts.

1.2.7 We propose introducing a wider range of sanctions that can be employed in a more graduated and proportionate fashion. We propose supplementing criminal penalties with lighter penalties for less serious offences (such as written warnings or civil pecuniary penalties) and providing some additional tools that are designed to promote compliance, rather than sanction non-compliance (enforceable undertakings and remediation plans).

1.2.8 Alongside these main changes, designed to expand our supervisory toolkit, we also explore a smaller technical issue, asking whether there could be greater clarity about the consequences of not complying with conditions for an exemption from IPSA's rules.

1.2.9 Having a wider set of enforcement tools will bring IPSA into line with our newer legislation (Financial Market Infrastructures (FMI) Act and draft DTA) and respond to the findings of external reviews (particularly the IMF's 2016 FSAP).

Supervisory Powers: Information Gathering and Directions

1.2.10 The second section of the paper looks at the powers available to the Reserve Bank to support compliance and enforcement functions and to deal with the early stages of insurer distress. In particular, we look at the Reserve Bank's information gathering powers and its powers of Direction.

1.2.11 In order to monitor compliance, gather evidence for enforcement, or identify early signs of insurer distress, it is important for the Reserve Bank to be able to access appropriate information.

1.2.12 In this section we discuss broadening the Reserve Bank's access to information in ways that bring IPSA into closer alignment with our powers under other sectoral acts.

1.2.13 We discuss:

- broadening the range of entities from which the Reserve Bank can gather information, enabling it to obtain information from entities that may be carrying on insurance business without a license or from parties to whom insurers have outsourced business;
- introducing an on-site inspection power; and
- introducing breach reporting requirements.

1.2.14 The Reserve Bank's investigation powers are also currently confined to licensed insurers and we discuss extending them to entities that might be carrying on insurance business without a license or incorrectly holding themselves out as licensed insurers. We also ask whether an investigator should be able to interview an insurer's staff under oath.

1.2.15 We then go on to review the Reserve Bank's powers of direction.

1.2.16 Powers of direction become important when insurers remain viable but are facing significant difficulties. They are an 'early intervention' tool that can be used to work with insurers to restore their financial strength, improve their governance and/or return them to compliance with regulatory requirements.

1.2.17 The Reserve Bank is able to issue legally binding directions to an insurer, requiring it to take appropriate action to remedy breaches of regulation or change the way it is running its business. Direction powers are wide-ranging from simply requiring the insurer to consult with the bank and propose remedial actions, to the power to require the insurer to alter the way it is conducting business or to remove or replace some of its board.

1.2.18 Our view is that the direction powers currently contained in IPSA are generally appropriately designed. However, we ask whether the Reserve Bank should have an appropriately drafted power to direct insurers not to renew existing contracts (alongside its power to direct that insurers do not contract new business).

Distress Management

1.2.19 Distress management is concerned with situations in which insurers find themselves in such severe financial distress that there are significant doubts about their ability to meet their obligations on an ongoing basis.

1.2.20 At that point an insurer will either need to be wound up or significantly restructured (which might also involve writing down some of the insurer's obligations to creditors).

1.2.21 Restructuring might be achieved through 'administration', in which a company seeks a voluntary agreement with its creditors so that it can return to viability.

1.2.22 Alternatively, under certain circumstances and where required in the interests of the public, policyholders, the financial system or the New Zealand economy, a 'statutory manager' may be appointed to take over the affairs of the insurer and organise resolution.

1.2.23 If no resolution is possible, an insurer will enter liquidation.

- 1.2.24 IPSA already includes provisions shaping the way administration, statutory management and liquidation operate for insurers. In this part of the consultation, we discuss some ways in which these provisions might be enhanced and placed in better alignment with the other sectoral legislation we administer.
- 1.2.25 Since the global financial crisis, global regulatory practice has placed increasing emphasis on entities doing some pre-planning for recovery and resolution when they face stress events. We ask whether IPSA should follow the FMI and draft DTA by requiring at least some insurers to undertake resolution planning.
- 1.2.26 We ask whether IPSA should contain an explicit purpose clause, setting out objectives to govern distress management.
- 1.2.27 We think that the modifications to standard New Zealand procedures for administration and liquidation contained in IPSA are currently appropriate. They give the Reserve Bank some oversight of the process and provide additional powers relevant to the insurance sector. However, we invite input on any provisions that stakeholders think would benefit from modification.
- 1.2.28 The draft DTA significantly modifies the regime for statutory management that applies to banks and other deposit takers. We explore whether similar provisions in IPSA are also in need of modernisation.
- 1.2.29 In particular, we ask whether the circumstances in which statutory management is triggered should be widened to enable resolution in a wider variety of circumstances. We also explore some questions about the statutory manager's powers and about extensions to the moratorium on creditor claims that comes into play when statutory management begins.

Ladder of Intervention

- 1.2.30 As part of earlier IPSA consultations and consultations on the solvency standards, we have indicated that we are likely to move to a more graduated approach to solvency in which the current single solvency control level (the solvency margin) is replaced with two control levels (a solvency capital requirement and a minimum capital requirement).
- 1.2.31 The 'solvency capital requirement' (SCR) is designed to indicate a point above which we do not have significant concerns with an insurers' capital levels. The 'minimum capital requirement' (MCR) sets a level at which an insurer is approaching non-viability. The intention is that there will be an escalating ladder of supervisory intervention between the two control levels.
- 1.2.32 Solvency levels are an important trigger for the Reserve Bank's distress management tools. In this final section we ask whether, with a more graduated and sequential approach to solvency, we should also reconsider the capital-related triggers for some of the distress management tools discussed in this consultation.

Context and Scope

- 1.2.33 The issues discussed in this consultation are largely self-contained. However, there are some areas of overlap with other parts of the IPSA review or with broader Reserve Bank policy that it is worth raising here in order to clarify the scope and intent of this consultation.

Supervisory Stance and 'Enforcement Policy'

- 1.2.34 While the overall impact of the proposals in this consultation is likely to be an increase in supervisory powers and enforcement tools, that shouldn't be taken to imply a significant change in our overall supervisory stance.
- 1.2.35 We remain committed to a co-operative relationship underpinned by the principle of 'te hunga tiaki' –the combined stewardship of an efficient system for the benefit of all, as enshrined in the Reserve Bank's Relationship Charter.
- 1.2.36 However, over time, the Reserve Bank's supervisory stance has shifted in a somewhat more proactive direction. The intention is to ensure that IPSA supports our existing supervisory stance.
- 1.2.37 We also note that the Reserve Bank's enforcement department has recently issued a consultation paper. This paper is concerned with developing a policy for using the enforcement tools available to the Reserve Bank, rather than on what those tools should be (which is the focus of this consultation).

Interaction with Other Parts of the IPSA Review

- 1.2.38 There is some overlap between the proposals discussed here and other aspects of the IPSA review.
- 1.2.39 When we turn to reviewing the regulation of key officers and control functions in the next consultation, we will consider establishing some additional obligations for insurers or their key staff and those obligations may require appropriate penalties or enforcement options. Our intention is to establish a broad framework for compliance and enforcement in this consultation. If new obligations developed later in the review require powers to monitor and encourage compliance, we will introduce those in the light of the framework established here.
- 1.2.40 Similarly, the information gathering and distress management powers discussed in this consultation may need to be adjusted to fit with the decisions we make about group supervision and the treatment of overseas insurers. Again, we will work to establish broad principles in this consultation and then seek to apply and adapt those as necessary when we take final decisions on group supervision and the treatment of branches.

Presumption of Alignment with Other Sectoral Acts

- 1.2.41 Finally, as we noted in the earlier discussion of how consultation options were selected, a revised IPSA will be one of three 'sectoral acts' that the Reserve Bank administers, as part of its prudential regulation and supervision function. Many of the issues discussed in this consultation concern general supervisory powers and actions which should be similar across the sectors that Reserve Bank regulates. We therefore start this consultation with the assumption that IPSA should be aligned with the other sectoral acts unless there are good reasons for departures.

1.3 Submission Questions and Procedures

- 1.3.1 We invite submissions on all of the paper or any of the individual issues and questions it raises.
- 1.3.2 The questions are also reproduced at the end of the paper to assist with making submissions.

2 Enforcement and Penalties

2.1 Introduction: Designing an Effective Enforcement and Penalty Regime

- 2.1.1 Penalties and enforcement tools are designed to incentivise compliance with the regulatory framework.
- 2.1.2 It is important that supervisors have a range of enforcement tools available to them so that they can respond to non-compliance progressively and in a way that is proportional to the harm involved.⁶
- 2.1.3 The IAIS Insurance Core Principles capture this nicely, calling for ‘a range of actions or remedial measures...applied commensurate with the severity of the insurer’s problems...[and] a progressive escalation in actions or remedial measures that can be taken if the problems become worse or the insurer ignores requests from the supervisor’ (ICP 10.2-10.4).
- 2.1.4 IPSA currently establishes a wide range of offences and penalties for breaches of obligations under the legislation.
- 2.1.5 However, sanctions are generally in the form of criminal penalties. Enforcement action is confined to either written warnings or severe sanctions (criminal penalties, accompanied by significant fines and, in some cases, prison sentences).
- 2.1.6 The first part of this section of the consultation discusses a wider range of penalties and enforcement tools, designed to facilitate the kind of proportionate and escalating responses described in the Insurance Core Principles.
- 2.1.7 The IMF’s 2016 FSAP report noted the limited range of enforcement options and suggested the Reserve Bank should consider written warnings, enforceable undertakings and ‘administrative fines’. Our more recent sectoral legislation (FMI and draft DTA) also contains a broader range of enforcement options and our proposals also reflect the content of that legislation.
- 2.1.8 The second part of this section then looks at the level of penalties. IPSA’s criminal penalties were set in 2010 at particular dollar amounts, without allowance for inflation. We ask whether levels of penalties remain appropriate. We also discuss how to determine the level of any civil pecuniary penalties that might be introduced following this review.
- 2.1.9 Finally, we review an enforcement-related issue concerning the consequences that should flow from any failure to comply with conditions that are attached to exemptions from IPSA requirements.

2.2 A Wider Range of Enforcement Tools?

- 2.2.1 A wider range of penalties could potentially allow a greater variety of responses to issues with supervised entities, enhancing the Reserve Bank’s ability to incentivise compliance with prudential requirements.

⁶ ‘Supervisors’ here is used broadly and includes the Reserve Bank’s new enforcement department.

2.2.2 However, the power to impose pecuniary penalties, fines or prison sentences needs robust justification. Enforcement powers should only be introduced where they have a clear rationale in terms of:

- Purpose – what would the powers be used for?
- Need – what do the new powers do that cannot be done with the Reserve Bank's existing powers under IPSA?
- Proportionality – are the penalties imposed appropriate in the context of the harm they seek to deter or sanction?

2.2.3 Additionally, the existence of additional powers and sanctions has the potential to alter supervisory behaviour and relationships with supervised entities. An overly 'enforcement-oriented' approach to supervision has the potential to undermine trust and communication between entities and their supervisors.

2.2.4 This section reviews a range of potential additional tools for enforcement, discussing how each tool might be useful and any risks attached to its introduction. We include both 'sanctions' for non-compliance and tools designed to encourage compliance. We discuss enforcement tools in approximate order of severity.

2.2.5 At the end of this subsection we invite stakeholders to review the overall set of policies they support and consider whether the overall toolkit is appropriate.

Written Warnings

2.2.6 Written warnings provide a way of indicating that the Reserve Bank has serious concerns with an individual or entity's compliance with prudential requirements but that we don't think it is appropriate to pursue any formal penalties (perhaps because of mitigating circumstances or because the breach is not sufficiently material). Warnings would provide a way of taking action that falls short of prosecution.

2.2.7 Warnings could either be used as a private signalling device, to demonstrate seriousness, or as a public reprimand that has the potential to inflict reputational damage.

2.2.8 We are currently able to issue written warnings, as there is nothing legally to prevent us from doing so. We have done so in the past and have, on occasion, done so publicly. However, there might be advantages for transparency in giving the Reserve Bank an explicit power to do so.

2.2.9 In appropriate circumstances, the impact of a written warning could be increased by requiring the insurer being warned to publicise the fact that it had received a warning. Publication might take the form of a notice on the entity's website or the requirement to include the warning in all published literature of particular kinds.

2.2.10 The FMA Act currently contains this type of power and the draft DTA is also expected to include the power to require entities to publish warnings where appropriate.

Q2.2.1 Should IPSA be amended to give the Reserve Bank a specific power to issue written warnings?

Q2.2.2 Should the Reserve Bank have the power to require public disclosure of warnings under some circumstances?

Remediation Notices and Plans

2.2.11 Remediation notices allow the Reserve Bank to require regulated entities to take specific action to remedy breaches of their prudential obligations or to prepare a plan setting out how they intend to remedy breaches.

2.2.12 In some ways, remediation notices are similar to directions in that they give the Reserve Bank the power to require insurers to take particular actions. However, their scope is narrower (they only deal with specific breaches of prudential obligations) and they are more closely targeted to addressing particular instances of non-compliance.

2.2.13 Remediation notices cannot be used to require insurers to pay any compensation for breaches.

2.2.14 IPSA already allows the Reserve Bank to require an insurer to produce a 'recovery plan' (s.138). Although described as a 'recovery plan' it is already possible for the Bank to ask for a plan to remedy any non-compliance or likely non-compliance with regulatory requirements. The Reserve Bank can refuse to approve a plan that it does not believe is adequate but it can't specify particular actions.

2.2.15 We suggest that this existing recovery plan power would be combined with the remediation notice power in a single section of the legislation. Describing it as 'remediation notices and plans' would also make it clearer that it was not only intended to be used in situations of financial distress.

Q2.2.3 Should the Reserve Bank have the power to issue enforcement notices? Are there any safeguards that should be attached to this power?

Enforceable Undertakings

2.2.16 Enforceable undertakings are a tool for creating binding agreements with regulated entities. They may be used as a way of reaching settlements when prosecution is contemplated or in other circumstances.

2.2.17 Enforceable undertakings can be more flexible in outcome than prosecution, since they can specify remedial actions as well as imposing penalties. They avoid the costs and risks of court processes and may provide a useful tool in negotiation.

2.2.18 Enforceable undertakings would involve the Reserve Bank receiving a 'voluntary undertaking' from a regulated entity to:

- pay compensation to a person;
- take specific action to address a contravention of prudential requirements; or
- pay an amount to the Reserve Bank in lieu of a pecuniary penalty.

2.2.19 Entering into an enforceable undertaking would prevent the Reserve Bank from pursuing civil court orders or criminal prosecution for the same conduct.

2.2.20 If the entity subsequently fails to fulfil its undertakings, the Reserve Bank can apply to the High Court for an order to comply with the undertaking and/or to pay compensation or take further action.

2.2.21 Enforceable undertakings provide useful flexibility in negotiations, avoiding litigation. On the other hand, they might facilitate regulatory forbearance by providing an easier alternative when, in fact, prosecution was the more appropriate course of action.

Q2.2.4 Should the Reserve Bank have the power to accept enforceable undertakings? Should there be any safeguards attached to this power?

Infringement Notices

2.2.22 Some New Zealand legislation includes the ability to impose small penalties by issuing an 'infringement notice', requiring payment of a penalty. The recipient of the notice can either pay the fee or request a court hearing to decide the issue. If the offence is proven in court the person is then liable to a fine (which may be higher than the original fee).

2.2.23 Infringement offences need to be specifically established in legislation.

2.2.24 The Reserve Bank Act 2021 contains two infringement offences, one to do with maintenance of bank note handling machines and one for failing to supply information requested by the Reserve Bank. The infringement fees are \$1000 for an individual, \$3,000 otherwise (with potential fines of \$3,000 and \$9,000 respectively if the matter goes to court).

2.2.25 A range of infringement offences are established under the Financial Markets Conduct Act (FMCA), generally relating to record-keeping and financial filing requirements. The fees for most of these offences are set at \$5,000-\$7,500 (under the Financial Markets Conduct Regulations, 2014).

2.2.26 The draft DTA also includes infringement offences, largely for failure to supply timely information, with similar levels of fines to those in the FMCA.

2.2.27 Infringement notices are an efficient way of imposing relatively mild penalties. If any infringement offences were created in IPSA, we would expect them to relate to relatively minor issues such as failure to file appropriate returns or reports.

Q2.2.5 Should the Reserve Bank have the power to issue infringement notices for breaches of some reporting requirements?

Civil Pecuniary Penalties

2.2.28 Civil pecuniary penalties are another option that falls short of the stigma of a criminal conviction. In terms of process, penalties are imposed by a court but the court operates on civil procedures with lower evidentiary requirements and burden of proof.

2.2.29 The 2018 LDAC legislation guidelines⁷ say that pecuniary penalties: ‘may be an appropriate alternative to criminal offences when a monetary penalty would deter breaches of a regulatory regime and the nature of the offending conduct does not warrant the denunciatory and stigmatising effects of a criminal conviction or imprisonment.’

2.2.30 They are not appropriate for offences creating ‘significant harm to property [or] the economy’ or where ‘fault or moral blameworthiness are an element of the conduct’.

2.2.31 Pecuniary penalties might be appropriate as a tool to incentivise good governance and internal controls – i.e. to prevent or sanction ‘harmful technical errors’ where there was not (or could not be proven to be) any self-interested motivation or deliberate deceit.

2.2.32 In the FMI Act and draft DTA, pecuniary penalties are generally used for breaches of Standards, rather than of primary legislation.

2.2.33 In the context of IPSA, they might be appropriate for less blameworthy breaches of financial and solvency reporting requirements and, perhaps, any other standards that may be introduced following the IPSA review.

2.2.34 There is more legal flexibility about how civil pecuniary penalties are defined so, for example, they could be set in ways that are proportionate to the size of the entity being sanctioned (we will explore this possibility further in the next section when we discuss the appropriate level of any civil pecuniary penalties).

Q2.2.6 Should IPSA include provision for the Courts to make pecuniary penalty orders?

Q2.2.7 Please review your answers to all the questions in this section. Taken together, do you think the proposals you have agreed with will deliver an enforcement regime that is able to ensure compliance with regulatory obligations in a flexible and proportionate fashion?

2.3 Level of Penalties

2.3.1 Penalties should be sufficient to deter conduct, particularly conduct that might result in significant financial gains for those involved. However, they should also be sufficiently flexible to be proportionate and should have limits to prevent excessive penalties.

2.3.2 In this section, we ask whether levels of penalty remain appropriate and whether there should be more graduated levels of penalty.

⁷ Legislation Design and Advisory Committee *Legislation Guidelines: 2018 Edition*, Chapter 26

IPSA Criminal Offences, Inflation and Comparison with Other Sectoral Legislation

- 2.3.3 IPSA was drafted in 2010, with maximum penalties set as fixed dollar amounts. For businesses these are most often set at \$500,000 (but with \$100,000 for a few minor offences and \$1,000,000 for a few serious offences). For individuals they are set at \$200,000 with a maximum prison sentence of 3 months.
- 2.3.4 Cumulative CPI inflation since 2010 is about 20%.
- 2.3.5 Meanwhile, the recently passed Financial Markets Infrastructures Act 2021 has a more graduated set of penalties, with 5 levels of severity. For individuals, penalties range from \$20,000 to \$200,000 and prison sentences from 3 to 18 months. Fines for entities range from \$200,000 to \$2,000,000.
- 2.3.6 The current draft of the DTA contemplates 3 levels of penalties. Tier 1 includes fines for a body corporate of up to \$500,000 (\$50,000 for an individual). Tier 2 includes fines of up to \$2.5 million for a body corporate (or for an individual, \$100,000 and/or 1 year imprisonment). Tier 3 up to \$5 million for a body corporate (\$500,000 for an individual and/or 2 years imprisonment).

Q2.3.1 Given inflation and these comparisons, do you think there is a need to review the penalties for offences under IPSA? If so, what kinds of changes do you think should be made?

Civil Pecuniary Penalties

- 2.3.7 As explained above, civil pecuniary penalties are usually attached to breaches of standards or other technical provisions.
- 2.3.8 Breaches of standards can have quite wide-ranging degrees of seriousness.
- 2.3.9 The FMI Act deals with this by providing a single relatively high maximum penalty (\$750,000) but supplemented with quite extensive guidance to the Courts in setting penalties in particular cases.
- 2.3.10 The draft DTA, meanwhile, also contemplates penalties that are related to the size of the institution (0.1% of total assets).
- 2.3.11 The advantage of this approach is that it allows proportionality in the available levels of deterrent, which could be useful given the wide range of licensed insurers in New Zealand. However, for large entities it may result in overly large fines. For example, the maximum fine under the proposed DTA could be over \$100 million dollars.
- 2.3.12 The FMI Act includes a lower level maximum penalty for more minor administrative breaches and we would envisage doing something similar for IPSA.

Q2.3.2 If IPSA was to include provisions for civil pecuniary penalties, should the highest penalties be set on the basis of a fixed sum or in proportion to entity size?

Q 2.3.3 What level of maximum penalty is appropriate?

2.4 Additional Compliance Issues – Terms of Exemption

- 2.4.1 A number of sections of IPISA allow for conditional exemptions to the provisions of the Act. (For example, an exemption from solvency requirements for an overseas insurer).
- 2.4.2 The Reserve Bank can attach conditions to exemptions (for example that the insurer continues to provide the Reserve Bank with relevant solvency disclosure from its home jurisdiction). However, IPISA doesn't explicitly say what the consequences are for a breach of any conditions attached to an exemption.
- 2.4.3 Meanwhile, in the context of regulations under the act, the legislation explicitly states that the consequence of failing to meet an exemption condition is that the exemption does not apply (s.238(2)).
- 2.4.4 We suggest that, for the avoidance of doubt, a similar provision should be added to the general provisions on exemptions included at s.232 of IPISA.

Q 2.4.1 Do you agree that it would be helpful to clarify the consequence of failure to meet the conditions for an exemption in this way?

3 Supervisory Powers

3.1 Introduction

- 3.1.1 This section provides a bridge between the previous discussion of enforcement and the later discussion of distress management. Supervisory powers can both support enforcement and assist distress management (particularly in the early stages of distress).
- 3.1.2 We consider supervisory powers under two headings.
- 3.1.3 First, we look at a range of powers to obtain information, including information powers, breach reporting, on-site inspection and investigation powers.
- 3.1.4 Second, we look more briefly at powers of direction.

3.2 Information Gathering and Investigation

Information Gathering From Non-Licensed Entities

- 3.2.1 IPISA includes a range of information gathering powers so that the Reserve Bank can obtain the information it needs to carry out its prudential role and verify compliance with IPISA and supervisory requirements.
- 3.2.2 The legislation currently gives the Reserve Bank broad powers to request information from licensed insurers, have that information audited or reviewed and require insurers to commission reports. These powers also apply to 'associated persons'.
- 3.2.3 However, at present, IPISA does not enable us to require information from entities that we believe may be carrying out insurance business but are not licensed, which makes enforcement difficult. It also may not give us power to request information from entities with whom insurers have important relationships such as brokers or parties to whom business has been outsourced.

3.2.4 The Financial Markets Authority (FMA) Act gives the FMA the power to request information from any person in the pursuit of its statutory functions. The current draft of the DTA also gives similar powers to the Reserve Bank in relation to the banking sector.

Q 3.2.1 Should the Reserve Bank have a broad power to request information from any person in order to pursue its purposes under IPSA?

Breach Reporting

3.2.5 Breach reporting regimes place an obligation on entities to monitor their own compliance with regulation and report any material breaches or likely breaches to their regulator. They are important because there are significant asymmetries of information between regulators and regulated entities.

3.2.6 Breach reporting regimes impose administrative costs on insurers. However, requiring entities to notify material breaches enhances the enforcement regime and provides regulated entities with incentives to improve their own internal compliance mechanisms.

3.2.7 Breach reporting is a common requirement for financial market regulation regimes. An enhanced breach reporting regime was introduced for the banking system in New Zealand in early 2021 and the draft DTA provides a clearer statutory basis for the system.

Q 3.2.2 Should IPSA introduce a breach reporting regime for insurers?

On-Site Inspection

3.2.8 As part of the government's extensive review of the Reserve Bank Act, Cabinet has already agreed that the Reserve Bank should be given the power to conduct on-site inspections at its regulated entities, including insurers. In this consultation, we are seeking input as to what these powers should look like.

3.2.9 At present, the Reserve Bank can carry out on-site inspections with the consent of the regulated entity. When it is carrying out an investigation into particular problems, under IPSA s.130, it can also apply for a warrant to search premises. Investigation powers under s.130, though, are limited to situations where there are reasonably well-established concerns about an insurer.⁸

3.2.10 'On-site inspection powers' in other jurisdictions usually refer to the ability to enter regulated entities' premises without notice. This allows a proactive and pre-emptive approach to supervision where inspections can be carried out when there is no obvious cause for concern.

3.2.11 The International Association of Insurance Supervisors (IAIS) core principles make it clear that there is an expectation supervisors will conduct onsite inspections as a core part of their oversight (with risk-based criteria for frequency and intensity). The Reserve Bank's limited use of onsite inspection was a significant concern in the IMF's FSAP benchmarking of New Zealand's insurance regime against international standards.

⁸ Set out in s.130(1) – broadly where the Reserve Bank has reasonable cause to suspect that an insurer may be failing or about to fail, may not be conducting business in a prudent manner, may be operating fraudulently or is failing to comply with disclosure obligations or Directions.

- 3.2.12 An onsite inspection power would be most likely to be used as part of routine supervision activities. In which case, it is likely that notice would be given in practice. It is possible that it might also be used for 'spot inspections' without notice in some cases.
- 3.2.13 Some jurisdictions require routine on-site inspections to take place annually. This has the advantage of setting clear parameters for expectations of inspection and ensuring that no insurer is overlooked. However, it is plainly resource intensive. It might be appropriate to provide minimum inspection frequencies for some insurers but not others or to specify a lower frequency.
- 3.2.14 Similar powers in other New Zealand legislation (for example in the AML/CFT legislation) are drafted broadly, although they explicitly exclude access to marae or private dwellings. The Reserve Bank must keep information obtained confidential but can share it with other agencies for other purposes (for example with the FMA for conduct purposes).
- 3.2.15 The main safeguards for an onsite inspection power in IPSA would be:
- that inspections could only be carried out at 'reasonable' times;
 - that they had to be used for carrying out prudential supervision (not for investigations which would continue to be authorised under section 130) in support of the statutory purposes and functions of IPSA; and
 - that inspections must be carried out by appropriately qualified staff (including Reserve Bank staff or other staff by delegation).

Q 3.2.3 Should the Reserve Bank have the power of on-site inspections in some form?

Q 3.2.4 Are the safeguards proposed here appropriate or should additional safeguards be included?

Q 3.2.5 Should there be a prescribed minimum frequency for on-site inspections? If so, what should the requirement be?

Investigation Powers

- 3.2.16 Where the Reserve Bank has reasonable cause to suspect there is a significant problem with an insurer⁹, it can appoint an investigator to investigate the insurer's affairs (ss.130-134). The investigator has powers to request information and to enter and search any place (either by consent or with a warrant) for the purpose of their investigation.
- 3.2.17 These powers provide important tools for investigation where it is likely that there are serious problems with a licensed insurer.
- 3.2.18 However, powers of investigation are limited to licensed insurers and their associated persons. They do not apply to a business or other person that is failing to comply with a requirement to be licensed as an insurer or to entities that are falsely holding themselves out as licensed insurers. (The draft DTA gives the Reserve Bank investigation powers of this nature for unlicensed desposit takers or entities holding themselves out as licensed desposit takers).

⁹ 'Significant problem' here is short hand for the grounds set out in IPSA s.130(1) which include: that the insurer is or is likely to breach solvency standards, the terms of a direction or other prudential requirements; is not being conducted in a prudent manner; is operating fraudulently or recklessly; has failed to supply required information or has supplied information that is materially false or misleading.

3.2.19 The draft DTA also gives an equivalent investigator the power to question employees and directors under oath, which is not a power currently included in IPSA. This power can be very useful where the investigation is designed to prepare a case for subsequent prosecution.

Q 3.2.6 Should IPSA's investigation powers apply to entities that the Reserve Bank has reasonable cause to believe may be carrying out insurance business without being licensed or may be falsely holding themselves out as licensed insurers?

Q 3.2.7 Should IPSA's investigation powers include the right to question employees or directors under oath?

Q 3.2.8 Are there any other changes that might usefully be made to the Reserve Bank's information gathering powers?

3.3 Directions

3.3.1 The power to give directions may be used as part of the Reserve Bank's enforcement toolkit or as an 'early intervention' power to attempt to resolve a distressed insurer's difficulties before it is necessary to put it into resolution.

3.3.2 In this section we provide a brief overview of the powers that the Reserve Bank currently has under IPSA (the full text of the relevant sections of IPSA is set out in Appendix One). We propose one extension of Direction powers,

Existing Powers

3.3.3 Directions enable the Reserve Bank to impose an enforceable requirement on an entity to perform or not perform particular actions.

3.3.4 Directions can only be used under specified conditions, broadly when there is a 'problem' with the insurer (IPSA s.143 (1)):

- failure or likely failure to maintain a solvency margin or comply with licensing conditions or other IPSA requirements;
- where an insurer is not being conducted in a 'prudent manner';
- where an overseas regulator is taking action against an insurer;
- where an insurer's governance structure changes in a way that reduces its appropriateness; and
- where the regulatory and supervisory framework governing an overseas insurer have changed in ways that make them less appropriate.

3.3.5 The Reserve Bank has wide-ranging powers allowing it to direct an insurer to:

- consult with the Reserve Bank;
- cease entering into new contracts of insurance;
- carry on its business or part of its business in specified ways;
- cease to carry on business or any part of its business;
- take action to address a failure to comply with its license conditions or other IPSA requirements;
- ensure that any officer or employee ceases to take part in the management or conduct of the insurer's business; and
- take actions to address any circumstances of financial difficulties.

3.3.6 Generally these powers are well-specified and adequate. However, there is one area where we think it is worth considering a modest extension of powers of direction, concerning the renewal of existing insurance policies.

Direction Not to Renew Existing Policies

3.3.7 The Reserve Bank currently has the power to direct insurers to cease issuing new contracts. However, IPSA explicitly prevents us from directing an insurer not to renew existing contracts (s.144(2)).

3.3.8 This prohibition may be because non-renewal can create significant problems for some types of policyholder, particularly in life or health insurance where policyholders have pre-existing conditions. The prohibition on renewal might be drafted either to ensure that this type of policy was not included or in a way that required the Reserve Bank to have regard to the interests of policyholders when using the power.

3.3.9 The Trowbridge report into the failure of CBL insurance and the most recent IMF FSAP both argued that this was a weakness in IPSA that should be remedied as it reduces our ability to require insurers at risk to reduce their exposure.

Q 3.3.1 Should the Reserve Bank have the power to direct insurers not to renew existing business?

Q 3.3.2 Should this power be accompanied by any safeguards?

Q 3.3.3 Are there any other changes that should be made to the Reserve Bank's powers of direction?

4 Distress Management

4.1 Introduction

- 4.1.1 As an insurer's financial position declines or problems with its governance emerge, supervisors' first tools are the kinds of powers discussed in the previous section (information and investigations or directions).
- 4.1.2 IPSA also enables the Reserve Bank to require an insurer to prepare a 'recovery plan' (s.138) and an insurer is then obliged to take all reasonable steps to comply with the recovery plan (s.140).
- 4.1.3 If an insurer's difficulties cannot be resolved by these means it may become necessary to proceed to voluntary administration, statutory management or liquidation.
- 4.1.4 In this section of the consultation we explore the Reserve Bank's role in these processes.
- 4.1.5 We ask whether there should be a purpose statement to govern the Reserve Bank's involvement in distress management overall. We ask whether insurers should be asked to undertake some form of resolution planning. We suggest that IPSA provisions shaping the Reserve Bank's role in administration and liquidation are appropriate but invite stakeholder feedback. Finally, we look at the regime for statutory management, asking whether the current trigger for statutory management is too demanding, whether the Reserve Bank should be given the powers of the statutory manager and whether the provisions governing stays on certain contractual rights under statutory management are sufficient.

4.2 Purpose Statement for Distress Management

- 4.2.1 The FMI Act and draft DTA bill both contain clauses setting out the explicit statutory purposes that the Reserve Bank should pursue when exercising its distress management powers. These purposes cover the use of directions and the Reserve Bank's role in distress management.
- 4.2.2 Distress management provisions provide authorities with considerable discretion to exercise important powers and make significant decisions. A purpose clause can provide useful guidance to the Reserve Bank for the exercise of the relevant powers and can promote clarity and accountability externally.
- 4.2.3 IPSA does not currently have such a clause although 'principles to be taken into account under this act', outlined in IPSA s.4 include having regard to:
- '(c) The importance of dealing with an insurer in financial distress or other difficulties in a manner that aims to-
- (1) Adequately protect the interests of its policyholders and the public interest; and
 - (2) Ensure that any failure, or possible failure, of the insurer does not have the potential to significantly damage the financial system or the New Zealand economy'.

4.2.4 The draft DTA purpose clause is more extensive. It elaborates on the idea of financial system damage noting the need for continuity of systemically important services and avoiding damage to market confidence. It also includes a primary goal of achieving orderly resolution and a secondary goal of, where possible, minimising the costs of resolution (through preserving value, resolving financial distress as quickly as possible, and managing the need to resort to public funds).

4.2.5 A possible purpose clause for resolution in IPSA might involve the following broad purposes:

1. To enable a licensed insurer in distress to be dealt with in an orderly manner.
2. To avoid significant damage to the financial system or the New Zealand economy.
 - i. By maintaining the continuity of systemically important activities carried out by licensed insurers; and
 - ii. Mitigating or otherwise managing any loss of confidence in the financial system resulting from a licensed insurer that is in financial distress or other difficulties.
3. To protect policyholder interests.
4. To protect the public interest.
5. Where not inconsistent with the other purposes, to minimise the costs of dealing with a licensed insurer in distress.

4.2.6 It might be appropriate to elaborate on the idea of 'costs' in paragraph 5 to include:

- i. Preserving value in the insurer;
- ii. Preserving creditor interests; and
- iii. Limiting financial risk to the Crown.

Q 4.2.1 Should IPSA include a specific purpose clause governing the use of distress management powers (over and above the 'have regard to' principle already included in IPSA)?

Q 4.2.2 Which of the purposes discussed in this subsection do you think should be included in legislation? Should any other purposes be included?

4.3 Resolution Planning

4.3.1 IPSA allows the Reserve Bank to require an insurer to prepare a binding 'recovery plan' when it is already in distress.

4.3.2 However, since the global financial crisis, it has become increasingly common practice for regulators to require financial sector entities to undertake proactive planning for recovery in case they should get into difficulties.

- 4.3.3 Situations of distress are idiosyncratic and some rapid decision-making is inevitable. However, there are also areas where pre-planning can be highly beneficial in reducing the demands of a resolution process, particularly for systemic entities where there may be acute time pressures involved. (For example, due to the potential impact on financial markets of the hypothetical failure of a major New Zealand property insurer with a large market-share).
- 4.3.4 The FMI Act requires FMIs to prepare 'contingency plans', which include both business continuity planning and recovery and orderly wind down plans. The draft DTA requires deposit takers to maintain contingency and recovery plans (roughly speaking, for pre-failure distress) and requires the Reserve Bank to maintain resolution plans (broadly for post-failure resolution). The IMF FSAP also recommended that, given high catastrophe risk in New Zealand, insurers should be required to maintain contingency plans and procedures to use in going and gone-concern situations.
- 4.3.5 The failure of some New Zealand insurers is likely to be less time-critical than that of their FMI or deposit-taking counterparts. Nonetheless, we think it is worth considering whether some sort of resolution planning would be appropriate for insurers, if requirements were developed that were broadly proportionate to the size and complexity of different insurers.

Q 4.3.1 Should some or all insurers be required to maintain recovery plans?

Q 4.3.2 If so, how would this requirement be best designed to ensure that it is proportionate to the risk presented by different insurers and the costs of preparing and maintaining such plans?

Q 4.3.3 Should IPSA also require the Reserve Bank to maintain some form of resolution planning for insurers, as the draft DTA does for deposit takers?

4.4 Schemes of Arrangement, Compromises, Voluntary Administration and Liquidation

Summary of Existing Arrangements under IPSA

- 4.4.1 The arrangements in IPSA for liquidation and voluntary administration generally draw on the normal New Zealand insolvency regime under the Companies Act 1993.
- 4.4.2 However, there are two main modifications. First, IPSA gives the Reserve Bank a range of accompanying powers and rights to ensure that the Reserve Bank has appropriate input into distress management. Second, the act introduces some specific powers relevant to dealing with distressed insurers.
- 4.4.3 The powers and rights given to the Reserve Bank are that:
- it can apply for an insurer to be placed in voluntary administration or liquidation;
 - it has the right to be notified of a range of important matters; and
 - and has various rights to be heard before the Courts when they are making decisions.
- 4.4.4 The Reserve Bank's powers of direction (discussed above) also remain in place.

4.4.5 The additional provisions relating to insurers create explicit mechanisms for writing down insurance contracts; requiring a liquidator to attempt to maintain continuity of cover for life insurance contracts; and procedures for arranging the transfer of an insurer's business.

Overall Assessment

4.4.6 We do not see any major issues with the provisions in IPSA covering liquidation and voluntary administration. However, we welcome any stakeholder input around issues that we are not aware of.

Q 4.4.1 Are there any improvements that could be made to sections 151-169 of IPSA which set out the Reserve Bank's powers in relation to various insolvency and restructuring processes?

4.5 Statutory Management

4.5.1 Statutory management in New Zealand developed in response to a series of complex corporate failures. It allows a 'statutory manager' to take over a corporate body in distress, in order to preserve the public interest by facilitating resolution or an orderly windup. IPSA and the FMI Act contain a regime for statutory management that is a modification of the generic regime contained in the Corporations (Investigation and Management) Act 1989 (CIMA). The RBNZ Act (1989) contains a standalone statutory management regime but with broadly similar features to CIMA.

4.5.2 Statutory management is potentially an important tool for resolution. It provides a mechanism to restructure an insurer in difficulties with a view to both creditor interests and the broader public interest.

4.5.3 During the 2008 global financial crisis, financial institutions in distress sometimes created dilemmas for regulatory authorities. The failure of an institution that provided important services to the public risked disruption to the wider economy or financial system. On the other hand, preserving an entity might necessitate an expensive public sector bailout of a private institution. A robust resolution regime is increasingly seen as an important way to minimise this trade-off by enabling restructuring and resolution in a way that can preserve the public interest and may also avoid the unnecessary destruction of value that can take place in liquidation.

4.5.4 However, statutory management also confers considerable powers on the statutory manager to restructure a private entity, with a significant impact on creditor and shareholder rights.¹⁰

4.5.5 In this section, we review the statutory management regime in IPSA with a view to assessing whether it strikes the right balance in enabling resolution where necessary, while maintaining appropriate accountability. We also propose some technical changes to the moratorium that is established when an insurer is placed under statutory management.

¹⁰ For a critique of the powers involved in statutory management, see 'Insolvency law reform: promoting trust and confidence' *Law Commission Study Paper 11*, May 2001

The Trigger for Statutory Management

- 4.5.6 Statutory management is designed to provide an option for intervention in situations that cannot be dealt with adequately using existing legislation (IPSA and the Companies Act 1993).
- 4.5.7 An insurer is placed under statutory management based on an Order In Council, on the advice of the Minister of Finance, following a recommendation by the Reserve Bank.
- 4.5.8 In this section we ask whether the conditions that must be satisfied before the Reserve Bank can recommend statutory management are currently too tightly drafted.
- 4.5.9 The Reserve Bank can only recommend statutory management where it is satisfied on reasonable grounds:
1. that an insurer is being run fraudulently or recklessly; *or*
 2. that the conditions for issuing directions are met **and the failure of the insurer may cause significant damage to the financial system or the economy of New Zealand** (or both);
- and
3. that the public interest, the financial system or economy of New Zealand or any policyholders cannot otherwise be protected under IPSA or the Companies Act 1993.
- 4.5.10 Criteria 1 & 2 specify the 'situations' that statutory management might need to deal with, while criterion 3 makes sure that it is only used when more 'normal' interventions are unlikely to be adequate.
- 4.5.11 The 'conditions for issuing directions' were discussed earlier (in section 3.3) and are set out in full at Appendix One. For our purposes, the most relevant conditions are failure or likely failure to maintain a solvency margin or comply with other regulatory requirements.
- 4.5.12 The section highlighted in bold has the effect of restricting statutory management to insurers that are systemically significant. We invite stakeholders to consider whether this hurdle is unnecessarily high and should be removed.
- 4.5.13 For example, one might imagine a post-earthquake scenario in which an insurer's failure would cause significant harm to policyholders in a particular area but there might be doubt as to whether that counted as 'significant' for the economy of New Zealand as a whole.
- 4.5.14 CIMA does not contain a similar systemic requirement for other kinds of corporation and nor do the resolution provisions for deposit takers in the draft DTA.
- 4.5.15 Without the systemic significance requirement, the conditions for issuing directions look relatively permissive. However, it is important to note criterion 3 must also apply; the situation must involve a systemic threat, a threat to the public interest, or to the interests of policyholders that cannot otherwise be dealt with using IPSA or the Companies Act.
- 4.5.16 Removing the 'systemic requirement' from section 2 would then effectively shift the test from simply 'systemic significance' to 'systemic significance, or the public interest, or policyholder interests' (of a kind that couldn't otherwise be dealt with).

Q 4.5.1 Should the requirement that the failure of an insurer might create significant harm to the financial system or New Zealand economy be removed from the first part of the test for recommending statutory management?

Q 4.5.2 Alternatively, are there other ways in which the test for initiating statutory management should be modified?

Who Should Exercise Resolution Powers?

4.5.17 In this section, we ask whether the mechanism of statutory management should be altered so that the Reserve Bank (rather than the statutory manager) is the 'resolution authority' empowered to directly exercise resolution powers. That arrangement would follow the way the draft DTA provides for the resolution of deposit takers. This issue is partly about the clarity of responsibility for resolution and partly about the appropriate forms of accountability for a regime that has commercial and public interest elements.

4.5.18 Currently, the Order in Council that places an insurer under statutory management also appoints a statutory manager. The statutory manager is then able to use the powers conferred by IPSA.

4.5.19 The Reserve Bank has considerable input into the statutory management process:

- the statutory manager is required to have regard to Reserve Bank advice, and to consult with and report to the Reserve Bank to the extent that the Reserve Bank requires;
- the Reserve Bank can direct the statutory manager to act in particular ways;
- the statutory manager can only sell the whole or any substantial part of the business under statutory management with the Reserve Bank's consent (and the Reserve Bank must consult with the Minister of Finance); and
- the statutory manager can create a New Zealand body corporate to take over the assets of a branch of an overseas insurer placed under statutory management, but only on the basis of an Order in Council - made on the advice of the Minister of Finance on the basis of a recommendation from the Reserve Bank.

4.5.20 However, the Reserve Bank is generally not formally required under legislation to scrutinise the statutory manager's activities.

4.5.21 Under the draft DTA, in contrast, resolution powers are vested in the Reserve Bank. It can then delegate its powers to a resolution manager in order to take advantage of private sector skill and experience.

4.5.22 In some ways the distinction is a subtle one, turning on how one understands statutory management. Statutory management involves a complex balance between private sector activity and the public interest. Much of the process of statutory management is a commercial matter, drawing on expertise in operating a business. On the other hand, there is an overarching public purpose involved, which justifies the imposition of statutory management in the first place.

- 4.5.23 The current IPSA arrangement tends to place greater emphasis on external professional expertise (the statutory manager), while the resolution authority approach places more emphasis on the Reserve Bank's internal expertise and public interest oversight. Vesting resolution powers directly in the Reserve Bank (with the power to delegate these to a statutory manager/resolution manager) would also create additional clarity that the Reserve Bank is ultimately responsible for resolution (with, for example, the Treasury playing a subsidiary role in shaping any use of public funds).
- 4.5.24 On the other hand, having the Reserve Bank directly exercising resolution powers would mean that the (public sector) Reserve Bank would have considerable operational responsibility for the day to day management of a private sector entity in ways that may not match well with the Reserve Bank's expertise.
- 4.5.25 As we have explained, the Reserve Bank and Treasury ultimately advised Cabinet to prefer the resolution authority route for deposit takers. Cabinet has decided to include this approach in the exposure draft of the DTA but that decision has not been finally settled. We ask whether the same decision should be made for insurers.
- 4.5.26 One view is that similar considerations apply and alignment across sectors would be beneficial.
- 4.5.27 On the other hand, it is also possible to argue that the balance between technical expertise and public oversight is different for the insurance sector, so the *status quo* position of greater reliance on outside input may be appropriate.
- 4.5.28 The technical demands of insurance resolution are, if anything, more significant. Meanwhile, on average, insurance failures are likely to be slower and to have more limited systemic consequences, reducing the need for public oversight. The failure of a bank can trigger rapid 'runs' on other banks or broader collapses in asset values across the economy. That is much less likely in the case of insurer failure since insurers are less interconnected with other domestic financial sector actors and insurers do not generally suffer from liquidity mismatches between assets and liabilities. The public impact of an insurer's failure would be more likely to spring from consequent difficulties in obtaining insurance cover.

Q 4.5.3 Which resolution powers and duties (if any) should be vested directly in the Reserve Bank? Why?

- 4.5.29 Since statutory management or resolution are chosen where there are public interests at stake in need of protection, it is possible that public funds may be contributed to resolution. (That might theoretically take a variety of forms from a subsidy, to a debt or equity investment or some form of contingent guarantee). These public funds may have conditions attached, which are set by the Minister of Finance.
- 4.5.30 As we saw in the previous section, there is some potential for tensions to arise between 'public interest' motivations and the operation of standard insolvency procedures in resolution, including creditor rights.
- 4.5.31 Particularly if the Reserve Bank (rather than a statutory manager) were to be given primary responsibility for resolution, there might be a misalignment of interests between the Reserve Bank and Minister of Finance over the use of public funds.

4.5.32 Given the Minister of Finance’s interest in safeguarding public funding one could argue that the Minister should have powers to intervene in resolution to manage the risks associated with a potential call on public funds. However, the Minister already has the power to attach conditions to the provision of public funding, and indeed to directly manage the failed insurer. Additionally, any intervention power would need to be balanced with the preservation of the Reserve Bank’s independence (which supports political independence and conformity with the broader principles of insolvency law).

4.5.33 The draft DTA includes a power for the Minister of Finance to direct the Reserve Bank’s resolution actions in the interests of reducing risks to public finances. The details of the drafting of this power, though, remain to be settled to work out how this public finance principle is to be reconciled with the other purposes of the legislation.

Q 4.5.4 Should the Minister of Finance have controls, within IPSA, over the use of public funds in resolution – over and above those that the Minister may attach to the provision of public funding? Are any additional forms of accountability necessary?

Impediments to Resolution From Creditor Actions

4.5.34 It is common for resolution regimes to include a moratorium on the enforcement of creditor claims. A moratorium addresses the risk that enforcement of creditors’ claims will hinder the resolution of the insurer (by compounding its shortfall of assets vis-à-vis liabilities during the resolution process). Where an insurer is placed into statutory management, a moratorium of this kind comes into play.

4.5.35 Both the draft DTA and FMI Act contain two additional provisions designed to deal with other ways that creditor actions could impede a resolution:

1. An ‘ipso facto’ provision that provides that other contractual rights (such as terminating the provision of services) cannot be enforced against the entity in resolution solely because it has been placed into resolution/statutory management (even where the contract contains an ‘ipso facto clause’, which would otherwise create these rights); and
2. A short term “stay” on the exercise of close out rights under derivatives contracts against the entity in resolution.

4.5.36 The ipso facto provision helps reduce the ability of third party to, for instance, cease to provide critical services to the entity in resolution.

4.5.37 The stay helps to avoid the disorderly close out of derivatives positions against the entity in resolution (which may compound its existing shortfall of assets vis-à-vis liabilities, and leave it with unhedged financial exposures).

4.5.38 There are good arguments that these provisions would also assist in the resolution of an insurer.¹¹

Q 4.5.5 Should IPSA contain ipso facto provisions and stays on the close out of derivatives contracts equivalent to those in the draft DTA and FMI Act?

¹¹ While insurers are unlikely to use derivatives on the same scale as banks, life insurers do have a significant number of interest rate swaps for example.

5 Ladders of Intervention

5.1 Introduction

- 5.1.1 In this section, we discuss how our range of supervisory, enforcement and distress management powers should fit with our planned ‘ladder of intervention’ approach to insurer solvency.
- 5.1.2 Solvency is an important criterion for evaluating the risk posed by insurers and therefore the level of supervision they are subject to. (Although, there are other criteria such as compliance with the broader set of regulatory requirements, including good governance and risk management).
- 5.1.3 At the moment, IPSA only contemplates one measure of solvency: the solvency margin. As discussed in other recent consultations¹², we are likely to move to a more graduated approach to solvency involving two solvency measures: a solvency capital requirement (SCR) (above which insurers’ capital does not imply a need for enhanced supervision) and a ‘minimum capital requirement’ (MCR) set at a level close to the point of non-viability.¹³
- 5.1.4 Between the two solvency levels, we intend to operate an escalating approach to supervision in response to the increasing risk insurers pose, using the types of enforcement, supervisory and distress management powers discussed in this consultation.
- 5.1.5 In this section, we ask how this ladder approach should be implemented, in terms of the interaction between Reserve Bank policy and the ways in which the Reserve Bank’s powers are unlocked by statute.
- 5.1.6 We note that we have sought broad feedback on our approach to the ladder of intervention in previous consultations. There is a broad consensus within the Reserve Bank and amongst stakeholders that there should be two solvency control levels and that powers should be unlocked sequentially as solvency levels decline. In this consultation we seek feedback on some more concrete proposals for how this would work.
- 5.1.7 It will be important for the Reserve Bank to have a clear policy as to how it will use its range of supervisory, enforcement and distress management tools as an insurer’s financial position declines. Where an insurer’s solvency position remains close to its solvency capital requirement, we would expect action to involve enhanced supervision and dialogue and, perhaps, some use of information powers to understand the roots of an insurer’s difficulty. At lower levels of capital, where risk is higher, we would expect more robust interventions, including binding recovery plans or directions.
- 5.1.8 Usually, this sort of supervisory policy involves assessing the level of risk an insurer presents and mapping this to appropriate supervisory responses. Risk assessments are often carried out based on a combination of capital levels and other criteria (such as governance or breaches of prudential requirements).
- 5.1.9 The details of such a policy would not be contained in statute and need not be worked out for the purposes of this review.

¹² See the previous IPSA consultation on policyholder security [here](#) and our consultation on the structure of the Solvency Standard, [here](#)

¹³ The precise calibration of these levels will be determined through the solvency standard once the solvency standard review is completed.

- 5.1.10 However, we do want to consider how legislation sets out the parameters within which Reserve Bank policy is developed. In particular, whether the legislation should be designed in a way that makes all powers *available* to the Reserve Bank once an insurer is in breach of the solvency capital requirement (even if, as a matter of policy, they are unlikely to be used) or whether powers should only become available to the Reserve Bank at particular solvency levels.
- 5.1.11 We note that while capital is an important criterion for measuring solvency risk, other issues may also signal the need for the Reserve Bank to use its powers. In this section we are only discussing how changes to the way solvency is treated in IPSA should relate to the statutory triggers for various Reserve Bank powers. We don't see a need to revisit the other non-capital related triggers for each of the powers discussed and therefore expect those to remain unchanged.¹⁴ We note, though, that even where solvency levels do not trigger the use of Reserve Bank powers, other compliance issues might do so.
- 5.1.12 In the next subsection, we briefly discuss the interface between statutory triggers and policy guidance in shaping the use of Reserve Bank powers. We then work through the different IPSA powers that are unlocked on the basis of solvency, discussing what appropriate triggers might be going forwards.
- 5.1.13 The main powers unlocked on the basis of solvency are:
- direction powers;
 - powers to initiate various kinds of distress management;
 - intervention powers; and
 - duties for insurers or auditors to report changes in solvency to the Reserve Bank.

5.2 Statutory Triggers and Policy Guidance

- 5.2.1 Statute can be used to prevent the use of powers where doing so would be disproportionate to the harm involved. It can also be used to prevent regulatory forbearance by mandating tough action in appropriate circumstances.
- 5.2.2 However, statutory rules reduce flexibility and judgement. If triggers are defined too tightly, powers may not be available when they are needed. Meanwhile, mandatory requirements to act may prevent the Reserve Bank from paying due regard to mitigating circumstances.
- 5.2.3 Supplementing statutory limits with policy guidance, which can be expressed in more nuanced ways that leave room for judgement, can soften the trade-offs. Policy guidelines also produce greater restraint if they are made public. However, relying on policy reduces the safeguards against inappropriate use of powers and reinstates some discretion that may make tough decisions harder to make.
- 5.2.4 The right place to strike a balance is likely to vary between policies. In what follows, we work through powers that are currently partly enabled on the basis of levels of solvency capital and ask how the capital-related parts of the relevant triggers should be amended to reflect the move to two solvency control levels.

¹⁴ Stakeholders are welcome to comment on other triggers if they believe these also require modification.

5.3 Directions

- 5.3.1 As we explained earlier, directions are an important ‘early intervention’ tool. They are particularly designed to help the Reserve Bank deal with an insurer before it is in serious distress. However, directions cover a wide range of actions from simply requiring a meeting with the Reserve Bank to replacing an insurer’s board. It makes sense then for at least some kind of direction to be ‘unlocked’ once an insurer breaches or is likely to breach the SCR but it might be appropriate for other powers to be unlocked lower down the ladder of intervention.
- 5.3.2 This issue has been considered in the policy work for other legislation, notably the recent review of the legislation governing deposit takers under the draft DTA. The rules for bank capital currently include a two-level framework (with a ‘minimum capital requirement’ and a large ‘prudential buffer’). In the Reserve Bank’s other sectoral legislation, it has ultimately been decided that all directions should be unlocked by the same set of triggers since the triggers are multi-causal and different types of direction do not map well to the ‘seriousness’ of an intervention.
- 5.3.3 The current statutory trigger for directions was discussed in Section Three and is set out in full in Appendix One. Solvency provides one possible trigger for the Reserve Bank’s use of direction powers in terms of a ‘failure or likely failure’ to maintain a solvency margin, but there are also a range of other triggers (including breaches of IPSA requirements, significant changes in governance structure, or in how an overseas insurer is regulated and supervised in its home jurisdiction).
- 5.3.4 Equally, the way the scope of directions is set out in IPSA may not map cleanly onto the ‘seriousness’ of a direction. For example, a direction to ‘take the action specified to address any circumstances of financial difficulties’ or to ‘carry on its business, or any part of its business in accordance with the direction’ could vary widely in content.
- 5.3.5 For those reasons, we are inclined to think that directions should all be unlocked when an insurer has breached or is likely to breach the SCR but that the Reserve Bank should develop and publish guidelines on how it is likely to use different direction powers as solvency levels decline.
- 5.3.6 However, we invite stakeholders to consider whether there are some types of direction that should only be ‘unlocked’ below the level of the SCR. For example, they might be unlocked when an insurer breaches the MCR or when it seems likely that an insurer might be going to breach the MCR. (For the full text of the section of IPSA setting out the scope of directions, see Appendix One).

Q 5.3.1 Should all directions be unlocked once an insurer breaches the SCR or should some be unlocked lower down the ‘ladder of intervention’?

Q 5.3.2 If the latter, which powers should be unlocked later and at what point should they be unlocked?

5.4 Administration, Statutory Management and Liquidation

- 5.4.1 As we saw in Section Four, the Reserve Bank is able to apply to have an insurer placed into liquidation or voluntary administration or to recommend that it be placed under statutory management.
- 5.4.2 In each case, the trigger for the Reserve Bank's role in the process includes a solvency-based requirement.

Liquidation

- 5.4.3 The Reserve Bank can apply to the High Court for an order to place an insurer in liquidation.
- 5.4.4 Before applying to the court, the Reserve Bank must be satisfied that an insurer:
- is unable to pay its debts; or
 - is *failing to maintain a solvency margin*; or
 - has persistently or seriously failed to comply with any direction, condition or other requirement imposed by or under IPSA; or
 - it is just and equitable that the insurer be put into liquidation.
- 5.4.5 Since the solvency control level that relates to non-viability is the minimum capital requirement (MCR), we think it makes sense to change the part of the requirement relating to capital to 'failing to maintain its minimum capital requirement' (rather than its 'Solvency Capital Requirement').
- 5.4.6 Under Solvency II, where an insurer breaches its MCR, it has three months to produce a credible financial recapitalisation plan. If it does not produce a credible plan within this time frame, authorities are *required* to remove the insurer's license. Once an insurer's license is removed, it will either have to be placed in run off or the Reserve Bank would have to apply to the High Court to place the insurer in liquidation.
- 5.4.7 The advantage in this type of requirement is that placing an insurer into liquidation is a difficult decision but, after a certain point, delaying liquidation merely reduces the eventual capital available to pay creditors and policyholders. Having a clear cut-off can prevent further losses. While the 'financial recapitalisation plan' test is solvency II specific, it might be advantageous to include some form of cut off in IPSA that mandates liquidation.

Q 5.4.1 Should the capital part of the trigger for the Reserve Bank's power to apply for the liquidation of an insurer be altered to refer to an insurer failing to meet its minimum capital requirement?

Q 5.4.2 Should there be a mandatory requirement to place an insurer into liquidation at some point after it breaches its minimum capital requirement? What should that test be?

Resolution Tools: Statutory Management and Voluntary Administration

- 5.4.8 Statutory management is a resolution power that should be invoked somewhat earlier than liquidation, since resolution is more likely to be possible where an insurer still has reasonable capital reserves available.
- 5.4.9 We discussed the trigger for statutory management in Section Four above. There is a two stage test in which an insurer must be in difficulties *and* there must be a public interest, policyholder interest or systemic risk that cannot be dealt with using the provisions of IPSA or the Companies Act 1993.
- 5.4.10 One of the types of difficulty that can trigger statutory management is a decline in capital levels. The current test borrows from the test for powers of direction, including that ‘the insurer has failed, is failing, or is likely to fail to maintain a solvency margin’. (Note that second part of the test, inadequacy of other legislation, also applies).
- 5.4.11 We suggest that this should be changed to ‘the insurer has failed, is failing or is likely to fail to meet its minimum capital requirement’. This test is slightly more permissive than the test for liquidation (in that it includes a likely breach of the MCR) but continues to limit statutory management to situations where the insurer is close to non-viability.

Q 5.4.3 Do you agree that the capital-related grounds for enabling statutory management should be a breach or likely breach of the minimum capital requirement (bearing in mind that the necessity test would also have to be satisfied)?

Q 5.4.4 If not, what do you think the capital-related trigger for statutory management should be?

- 5.4.12 Voluntary administration allows companies to come to an agreement with their creditors with a view to resolution.
- 5.4.13 Voluntary administration can be initiated in a number of different ways including by the insurer itself, by order of the court or by certain types of creditor with enforceable obligations.
- 5.4.14 It is also possible (under s.239L of the Companies Act 1993) for the Reserve Bank to apply to the Court for an order for voluntary administration. The court may appoint an administrator where ‘the insurer is failing to maintain a solvency margin’.¹⁵
- 5.4.15 Voluntary administration is also a resolution tool, so should be invoked where an insurer is close to non-viability but there are still some possibilities for resolution. We suggest the appropriate replacement test would be ‘where the insurer has failed, is failing or is likely to fail to maintain its minimum capital requirement’.

Q 5.4.5 Should the solvency-related trigger for the appointment of an administrator be that the insurer has failed, is failing or is likely to fail to maintain its minimum capital requirement?

¹⁵ (Or where ‘it is just and equitable to do so’ or where ‘the court is satisfied that the company is or may become insolvent and that an administration is likely to produce better outcomes for the company’s creditors and shareholders than would result from an immediate liquidation)

5.5 Other IPSA Powers and Duties: Investigation Powers, Reporting Requirements, and Preparation of a Recovery Plan

5.5.1 The solvency margin is also used as part of the test for triggering some other powers and duties under IPSA:

- the power to appoint an investigator (and the other investigation powers that flow from it);
- the power to require an insurer to prepare a recovery plan; and
- the obligation for an insurer or an auditor to notify the Reserve Bank of solvency problems.

5.5.2 We propose that an actual or expected breach of the solvency capital requirement is the right trigger for reporting obligations, since this is plainly an important signal of financial distress that should trigger escalating supervisory responses.

5.5.3 Arguably, powers of investigation and the right to require an insurer to prepare an enforceable recovery plan are more significant powers that make sense further down the ladder of intervention. We invite stakeholders to discuss where on the ladder of intervention they think these powers should be triggered.

Q 5.5.1 Should the solvency capital requirement replace the ‘solvency margin’ as a trigger for insurer and auditor duties to report solvency problems to the Reserve Bank?

Q 5.5.2 What point on the ladder of intervention would be appropriate for a capital-related trigger of investigation powers?

Q 5.5.3 What point on the ladder of intervention would be appropriate for a capital-related trigger of the Reserve Bank’s power to require an insurer to produce a legally enforceable recovery plan?

6 How to Make a Submission, Including Summary of Questions

6.1 Have Your Say

6.1.1 We encourage any interested parties to provide comment throughout the Review. At this time, we are particularly seeking commentary on the questions in this consultation document summarised below but are also happy to receive any other general comments on the enforcement and distress management provisions in IPSA.

6.1.2 Use this email: ipsareview@rbnz.govt.nz to provide comments and include “IPSA Review Enforcement and Distress Management Consultation” in the subject line. Please clearly indicate which question or section your comments relate to.

6.1.3 Comments or submissions should be received by 5pm on 20 May 2022. Submissions received after this date will not be considered.

6.1.4 It is our practice to publish submissions received unless specifically requested not to. We may also publish an anonymised summary of submissions received.

6.2 Summary of Questions

Section 2: Enforcement and Penalties

Section 2.2 Enforcement Powers

- Q 2.2.1** Should IPSA be amended to give the Reserve Bank a specific power to issue written warnings?
- Q 2.2.2** Should the Reserve Bank have the power to require public disclosure of warnings under some circumstances?
- Q 2.2.3** Should the Reserve Bank have the power to issue enforcement notices? Are there any safeguards that should be attached to this power?
- Q 2.2.4** Should the Reserve Bank have the power to accept enforceable undertakings? Should there be any safeguards attached to this power?
- Q 2.2.5** Should the Reserve Bank have the power to issue infringement notices for breaches of some reporting requirements?
- Q 2.2.6** Should IPSA include provision for the Courts to make pecuniary penalty orders?
- Q 2.2.7** Please review your answers to all the questions in this section. Taken together, do you think the proposals you have agreed with will deliver an enforcement regime that is able to ensure compliance with regulatory obligations in a flexible and proportionate fashion?

Section 2.3 Level of Penalties

- Q 2.3.1** Given inflation and these comparisons, do you think there is a need to review the penalties for offences under IPSA? If so, what kinds of changes do you think should be made?
- Q 2.3.2** If IPSA was to include provisions for civil pecuniary penalties, should the highest penalties be set on the basis of a fixed sum or in proportion to entity size?
- Q 2.3.3** What level of maximum penalty is appropriate?

Section 2.4 Additional Compliance Issues – Terms of Exemption

- Q 2.4.1** Do you agree that it would be helpful to clarify the consequence of failure to meet the conditions for an exemption in this way?

Section 3: Supervisory Powers

Section 3.2 Information Gathering and Investigation

- Q 3.2.1** Should the Reserve Bank have a broad power to request information from any person in order to pursue its purposes under IPSA?
- Q 3.2.2** Should IPSA introduce a breach reporting regime for insurers?
- Q 3.2.3** Should the Reserve Bank have the power of on-site inspections in some form?
- Q 3.2.4** Are the safeguards proposed here appropriate or should additional safeguards be included?
- Q 3.2.5** Should there be a prescribed minimum frequency for on-site inspections? If so, what should the requirement be?
- Q 3.2.6** Should IPSA's investigation powers apply to entities that the Reserve Bank has reasonable cause to believe may be carrying out insurance business without being licensed or may be falsely holding themselves out as licensed insurers?
- Q 3.2.7** Should IPSA's investigation powers include the right to question employees or directors under oath?
- Q 3.2.8** Are there any other changes that might usefully be made to the Reserve Bank's information gathering powers?

Section 3.3 Directions

- Q 3.3.1** Should the Reserve Bank have the power to direct insurers not to renew existing business?
- Q 3.3.2** Should this power be accompanied by any safeguards?
- Q 3.3.3** Are there any other changes that should be made to the Reserve Bank's powers of direction?

Section 4: Distress Management

Section 4.2 Purpose Statement for Distress Management

- Q 4.2.1** Should IPSA include a specific purpose clause governing the use of distress management powers (over and above the 'have regard to' principle already included in IPSA)?

Q 4.2.2 Which of the purposes discussed in this subsection do you think should be included in legislation? Should any other purposes be included?

Section 4.3 Resolution Planning

Q 4.3.1 Should some or all insurers be required to maintain recovery plans?

Q 4.3.2 If so, how would this requirement be best designed to ensure that it is proportionate to the risk presented by different insurers and the costs of preparing and maintaining such plans?

Q 4.3.3 Should IPSA also require the Bank to maintain some form of resolution planning for insurers, as the draft DTA does for deposit takers?

Section 4.4 Schemes of Arrangement, Compromises, Voluntary Administration and Liquidation

Q 4.4.1 Are there any improvements that could be made to sections 151-169 of IPSA which set out the Reserve Bank's powers in relation to various insolvency and restructuring processes?

Section 4.5 Statutory Management

Q 4.5.1 Should the requirement that the failure of an insurer might create significant harm to the financial system or New Zealand economy be removed from the first part of the test for recommending statutory management?

Q 4.5.2 Alternatively, are there other ways in which the test for initiating statutory management should be modified?

Q 4.5.3 Which resolution powers and duties (if any) should be vested directly in the Reserve Bank? Why?

Q 4.5.4 Should the Minister of Finance have controls, within IPSA, over the use of public funds in resolution – over and above those that the Minister may attach to the provision of public funding? Are any additional forms of accountability necessary?

Q 4.5.5 Should IPSA contain ipso facto provisions and stays on the close out of derivatives contracts equivalent to those in the FMI Act and draft DTA?

Section 5: Ladders of Intervention

Section 5.3 Directions

- Q 5.3.1** Should all directions be unlocked once an insurer breaches the SCR or should some be unlocked lower down the 'ladder of intervention'?
- Q 5.3.2** If the latter, which powers should be unlocked later and at what point should they be unlocked?

Section 5.4 Administration, Statutory Management and Liquidation

- Q 5.4.1** Should the capital part of the trigger for the Reserve Bank's power to apply for the liquidation of an insurer be altered to refer to an insurer failing to meet its minimum capital requirement?
- Q 5.4.2** Should there be a mandatory requirement to place an insurer into liquidation at some point after it breaches its minimum capital requirement? What should that test be?
- Q 5.4.3** Do you agree that the capital-related grounds for enabling statutory management should be a breach or likely breach of the minimum capital requirement (bearing in mind that the necessity test would also have to be satisfied)?
- Q 5.4.4** If not, what do you think the capital-related trigger for statutory management should be?
- Q 5.4.5** Should the solvency-related trigger for the appointment of an administrator be that the insurer has failed, is failing or is likely to fail to maintain its minimum capital requirement?

Section 5.5 Other IPSA Powers and Duties

- Q 5.5.1** Should the solvency capital requirement replace the 'solvency margin' as a trigger for insurer and auditor duties to report solvency problems to the Reserve Bank?
- Q 5.5.2** What point on the ladder of intervention would be appropriate for a capital-related trigger of investigation powers?
- Q 5.5.3** What point on the ladder of intervention would be appropriate for a capital-related trigger of the Reserve Bank's power to require an insurer to produce a legally enforceable recovery plan?

Appendix One: Relevant Sections of IPSA

Directions

S.143 Bank may give directions to licensed insurer

(1) The Bank may give a licensed insurer a direction, in writing, if it has reasonable grounds to believe that 1 or more of the following apply:

- (a) the insurer has failed, is failing, or is likely to fail to maintain a solvency margin:
- (b) the business of the insurer has not been, or is not being, conducted in a prudent manner:
- (c) the insurer, or a director or relevant officer of the insurer, has failed, is failing, or is likely to fail to comply with any direction, condition, or other requirement imposed by or under this Act or the regulations:
- (d) the governance structure of the insurer has changed, since its licence was issued, in a manner that significantly reduces the extent to which it is appropriate (having regard to the matters specified in section 19(1)(i)):
- (e) the insurer is an overseas insurer and an overseas supervisor has taken, or is taking, regulatory action against the insurer (whether or not that action has been completed):
- (f) the insurer is an overseas insurer and the law, requirements, or supervision referred to in section 19(1)(j) has changed, since its licence was issued, in a manner that significantly reduces the extent to which that law, those requirements, or that supervision is appropriate (having regard to the matters specified in that paragraph).

(2) The Bank must, before giving a direction under subsection (1) to a licensed insurer, consider whether, in the circumstances, it would be more appropriate to give a direction to the insurer to prepare a recovery plan under subpart 1.

(3) In this section, **regulatory action** means

- (a) action to cancel or suspend the licence, registration, or other authorisation of the insurer to act as an insurer (or action equivalent to cancelling or suspending such a licence, registration, or authorisation); or
- (b) a direction to the insurer to the effect of 1 or more of the following:
 - (i) to take specified action to improve its solvency:
 - (ii) to cease to enter into new contracts of insurance:
 - (iii) to cease to carry on its business, or any part of its business, in accordance with the direction; or
- (c) removing or replacing any directors or relevant officers of the insurer (whether by means of a direction or otherwise); or
- (d) civil or criminal proceedings against the insurer.

S.144 Scope of directions to licensed insurer

(1) A direction given under section 143 may require a licensed insurer to—

- (a) consult with the Bank, at the times and in the manner specified by the Bank, about the circumstances of the insurer and the actions or proposed actions of the insurer in respect of resolving any difficulties facing the insurer:
- (b) cease entering into any new contracts of insurance:
- (c) carry on its business, or any part of its business, in accordance with the direction:
- (d) cease to carry on its business, or any part of its business, in accordance with the direction:
- (e) take the action that is specified in the direction to address a failure, or potential failure, to comply with any direction, condition, or other requirement imposed by or under this Act or the regulations:
- (f) ensure that any officer or employee of the insurer ceases to take part in the management or conduct of its business except with the permission of the Bank and so far as that permission extends:
- (g) take the action that is specified in the direction to address any circumstances of financial difficulties.

(2) However, a direction must not require the licensed insurer to cease to enter into contracts of insurance by way of renewal of contracts of insurance that were originally entered into before the direction was given.

Trigger for Statutory Management

s.173 Grounds on which licensed insurer may be declared to be subject to statutory management

(1) The Bank may make a recommendation under section 170 [to the Minister to advise the Governor General to place an insurer under statutory management] in respect of a licensed insurer only if it is satisfied on reasonable grounds that—

- (a) 1 or more of the circumstances specified in section 143(1)(a) to (f) [grounds for directions, see above] apply and the failure of the insurer may cause significant damage to the financial system or the economy of New Zealand (or both); or
- (b) the insurer is, or may be, operating fraudulently or recklessly, and that it is desirable that the insurer be declared to be subject to statutory management for the purpose of—
 - (i) limiting or preventing the risk of further deterioration of the financial affairs of the insurer; or
 - (ii) limiting or preventing the carrying out, or the effects, of any fraudulent act or activity; or
 - (iii) enabling the affairs of the insurer to be dealt with in a more orderly or expeditious way.

(2) However, the Bank must not make a recommendation under section 170 in respect of a licensed insurer unless it is satisfied on reasonable grounds that the public interest, the financial system or economy of New Zealand, or any policyholders of the insurer cannot be adequately protected under the provisions of this Act other than this subpart or under the Companies Act 1993.