# Review of the Insurance (Prudential Supervision) Act 2010

## Feedback statement for consultation on enforcement and distress management

5 September 2022

Reserve Bank of New Zealand
Te Pūtea Matua

# Introduction

In March 2022, the Reserve Bank of New Zealand - Te Pūtea Matua issued a consultation paper on Enforcement and Distress Management as part of its review of the Insurance (Prudential Supervision) Act 2010 (IPSA). The consultation closed on 20 May 2022.

The consultation discussed:

- enforcement and penalties;
- supervisory powers;
- distress management; and
- ladders of intervention.

In total, we received eight submissions from industry associations and individual insurers. We also hosted a well-attended public webinar.

We would like to thank everyone who took the time to make submissions.

This feedback statement provides a summary of the submissions we received and our feedback on the views expressed.

In preparing this feedback statement, we have had regard to the Financial Policy Remit, issued to us by the Minister of Finance under s.203 of the Reserve Bank Act 2021. In particular, the 'Government's Desired Outcomes for the Financial System'.[1]

# Enforcement and penalties

There was strong support for the general principle that the Reserve Bank should have a more graduated and proportional set of penalties and enforcement tools and support for many of the regulatory tools proposed.

Stakeholders noted that it would be important for the Reserve Bank to provide clear policy guidance about how these tools would be used and how they would interact, both with each other and with the existing power to impose license conditions. They were also concerned to ensure that proper safeguards were in place for the use of powers.

Stakeholders generally agreed that the Reserve Bank should have the ability to issue public written warnings to insurers. However, they were concerned to ensure that the seriousness of this action was given due consideration. Some felt that written warnings should not be published. Others felt that it was appropriate for the Reserve Bank to publish warnings but not appropriate to require insurers to publish those warnings themselves, since that could interfere with their communications with customers and create confusion.

Most submissions questioned whether infringement notices were appropriate for failures to deliver data. They questioned whether there were current compliance problems in this area and whether there was evidence that fines could remedy those problems.

Most submissions did not have strong views on the appropriate level of penalties. Stakeholders felt it was more important to ensure that penalties were appropriate to the

[1] See https://gazette.govt.nz/notice/id/2022-go2497

nature of misconduct. Most submissions did not think it was appropriate to relate civil pecuniary penalties to entity size as other factors were more relevant to the level of penalty though some thought size-related penalties would be a good idea.

**Our response:**

- We agree that it will be important for us to set out a clear policy for using the proposed tools.
- At this stage, we are inclined to recommend the inclusion of public written warnings but will give further consideration to requirements for publication of those warnings.
- We will give further consideration to the inclusion of infringement notices.
- We will give penalty levels further consideration in consultation with the Department of Justice.
- We note that IPSA would establish maximum penalties for offences but it would be up to the courts to determine the appropriate penalty for any particular offence. The courts would take into account many of the non-size related considerations that stakeholders referred to. We will consider including specific legislative instructions on the factors the courts should consider when setting civil pecuniary penalties (sentencing considerations for criminal offences are well-established under criminal law but there is less pre-existing guidance for civil pecuniary penalties).
- We agree with stakeholders' view that procedural safeguards for powers, including appeal rights where appropriate, will need careful consideration before any provisions are drafted. It may be helpful to point out that the general principles of administrative law already apply to Reserve Bank actions, including a requirement to act proportionately, and that these can be enforced through judicial review.

## Supervisory powers

Feedback was supportive of the Reserve Bank having wider information gathering powers. However, some felt the wording proposed in the consultation (information from any person, so long as that information was in pursuit of the Reserve bank's regulatory role) was too broad. Insurers also wanted the right to be told that the Reserve Bank was seeking information from their associated persons due to concerns that information about them provided by others might prove inaccurate.

Stakeholders had mixed views about a breach-reporting framework and wanted more information about how it would work. They noted that it would be important to have clear criteria for materiality so the framework would not become too onerous to operate.

Stakeholders had significant concerns about a power to carry out on-site inspections without notice, where the Reserve Bank did not have grounds to think that there were any issues with an insurer. (The Reserve Bank can already request a search warrant where it has reasonable grounds for thinking that an insurer is failing to supply information or in breach of its prudential obligations). It was pointed out that this was quite a robust power that might have a chilling effect on the relationship with regulated entities. There might also be practical difficulties in accessing the information sought or finding personnel of appropriate seniority to answer questions during a sudden visit, especially given flexible working arrangements.

One submission suggested that on-site inspections should only be conducted voluntarily, which is the practice in Australia, while another suggested on-site inspections should only be

allowed where there were reasonable grounds to think there was a problem that needed investigation.

Our proposal for an ability to question staff under oath also created concerns amongst stakeholders, particularly in terms of the rights that would be granted to the person questioned, their seniority, and their ability to prepare themselves and seek legal representation.

Stakeholders were keen to point out the risks of a power to direct insurers not to renew existing business. They were concerned that this might leave policyholders unable to obtain appropriate cover and that, in some cases, it might be counter-productive to insurers' solvency positions (where there were deferred acquisition costs on the balance sheet). Most felt we should be required to consider policyholder interests in issuing such a direction and some suggested we should also be required to take actuarial advice.

**Our response:**

- If a breach reporting regime were to be introduced, an insurer's duty to monitor compliance would be contained in IPSA but the details of the scheme, particularly materiality criteria, would need to be set out in standards and there would be further industry consultation at that stage.
- We will give the notice periods and other safeguards for an on-site inspection power further consideration. We would like to reassure insurers that, if we were to retain a power to conduct inspections without notice, this would not be the normal way in which on-site visits were conducted and would only be used where absolutely necessary. It is very likely, though, that some form of compulsory on-site inspection power will be included in our IPSA recommendations since cabinet has already decided that the Reserve Bank should have this power for all the sectors it regulates.
- We will carefully consider appropriate safeguards for any power to issue directions not to renew existing business, particularly concerning policyholder interests.
- We will give further consideration to a power to interview under oath and the safeguards that would need to surround any such power.

## Distress management

Most stakeholders felt it would be helpful to have an overall purpose statement to guide our distress management activities along the lines of the wording proposed in the consultation, though some felt the existing clause in IPSA was sufficient.

Most stakeholders were not persuaded that recovery and resolution planning was worthwhile for insurers. They noted important differences between bank and insurance failures, particularly the tendency for insurer failures to be slower with more limited contagion and financial stability effects. They felt that international experience with resolution planning was limited, failures were idiosyncratic and resolution planning could be resource intensive.

Some insurers noted potential overlap between proposals and existing recovery plans and risk management frameworks.

One submission suggested that it would be helpful for us to publish a statement outlining our escalating supervisory response approach from early signs of problems through to resolution.

Most insurers seemed broadly happy with current arrangements for the Reserve Bank's involvement in distress management. There was considerable but not universal support for slightly lowering the requirements for placing insurers into statutory management so that it would not only apply to systemically significant insurers.

There was unanimous opposition to the Reserve Bank becoming the designated resolution authority, directly exercising the powers currently given to a statutory manager.

Most submissions did not have a view on the provisions governing stays on some enforcement rights when an insurer is placed into statutory management.

**Our response:**

- We will consider introducing a 'statement of approach to resolution' as part of the IPSA regime (the draft DTA includes this requirement for deposit takers).
- We will further consider the costs and benefits of resolution planning for insurers.
- We note broad stakeholder comfort with our proposals for the distress management regime but will explore the 'resolution authority' question further.

## Ladder of Intervention

There is broad agreement among stakeholders that it is appropriate for us to move to a system with two solvency control levels. A first solvency control level will be set at a level above which we don't consider capital levels warrant particular supervisory attention – the Prescribed Capital Requirement (PCR). A second, the Minimum Capital Requirement' (MCR), will be set at the point of non-viability.

We proposed that auditors and appointed actuaries should be required to notify the RBNZ of a breach or likely breach of the PCR and that a breach of the PCR should unlock direction and investigation powers.[2]

We then suggested that distress management powers should be unlocked around the MCR. For resolution powers – administration and statutory management – the test should be a breach or likely breach of the MCR. For liquidation it should be a breach of the MCR.

Stakeholders were broadly comfortable with this approach. However, several submissions suggested a power to direct an insurer not to write new business should be unlocked lower than other directions. Another asked whether 'resolution' powers should be unlocked earlier.

Stakeholders noted that we had not yet definitively set the level for the MCR. They also felt it would be helpful to do more to define 'likely' to breach. For example, 'as assessed by the appointed actuary over the next 6 months'. Some felt, given this lack of clarity, an actual breach of the MCR should also be the threshold for statutory management.

Some submissions argued that legally binding recovery plans should not be put in place until the MCR had been breached.

Most stakeholders felt that there shouldn't be a point at which the Reserve Bank was *required* to put an insurer into liquidation. However, some could see the benefit of a pre-determined requirement in preventing losses to policyholders once a recovery plan had failed.

[2] In the consultation paper we referred to the higher requirement as the 'solvency capital requirement' (SCR). Following industry feedback during the solvency standard review, we are now referring to the higher level as the 'Prescribed Capital Requirement' (PCR).

**Our response:**

- We will consider whether a direction not to write new business or any direction not to renew existing business should have different triggers from the standard triggers for the power of direction.
- Given that we intend the MCR to be calibrated to the point of non-viability, we think that recovery plans and resolution measures need to be enabled considerably before that point, since resolution and recovery attempts are unlikely to be successful at very low levels of capital.
- We will consider whether we can come up with ways to more carefully define 'likely to breach' the MCR in a way that will produce an appropriate level of separation between resolution and liquidation powers
- We note that we have yet to specify what the MCR will be – i.e. what capital level represents a broad 'point of non-viability'. (The MCR set in the current interim solvency standard - 80% of the PCR - should be seen as a 'placeholder'). We will set out a clear policy position on what we intend the consequences of a breach of the MCR to be (through the omnibus consultation issued next year) before we consult on an appropriate level for the MCR as part of the second part of the solvency standard review. We can then set a level that is appropriate given the consequences that will be triggered when the MCR is breached.

## Next Steps

This is the third consultation in this phase of the IPSA review.

We will release the fourth consultation *Governance, Supervisory Processes and Disclosure* in October 2022.

Once this stage of consultation is completed, we will produce an omnibus consultation to provide transparency around in-principle decisions on all the issues raised in the consultations so far. We will then proceed to the legislative process, which will provide further opportunity for input.