Non-Technical Summary

Insurance (Prudential Supervision) Act 2010 Review.

Options Paper 3: Enforcement and Distress Management

10 March 2022

Insurance Regulation, the IPSA Review and this Consultation

This consultation is the third of five consultations we are issuing as part of our comprehensive review of the Insurance (Prudential Supervision) Act 2010 (IPSA).[1]

Prudential supervision of insurers is about promoting 'sound' insurers – businesses that are well-run and are in a solid financial position – so they can pay out when their policyholders make claims.[2]

Policyholders pay a premium when they take out an insurance policy. Insurers then promise to provide them with financial compensation if they experience a loss covered by their policy. Insurers are paid in advance to cover uncertain future losses. They need to make careful judgements about policyholders' likely losses so they can charge an appropriate premium for cover and hold enough reserves (cash and investments) to pay claims. Prudential regulation encourages insurers to make careful and conservative assessments of the risks they are insuring and the reserves they need to hold.

It works by:

- setting minimum governance and risk management requirements for insurers;
- making rules for calculating the minimum levels of capital reserves insurers must hold, to underpin the risks they insure;
- requiring insurers to provide financial information to the public and Reserve Bank so outsiders can monitor insurers' financial position; and
- providing for Reserve Bank supervisors to exercise oversight of insurers.

We are undertaking a comprehensive review of the IPSA legislation, which governs our prudential supervision of insurers, to ensure that it is up to date, drawing on our experience of how the legislation operates and on several external reviews.

This consultation looks at the sections of the IPSA legislation designed to identify and deal with problems – either non-compliance with the legislation or insurer financial distress.

The consultation has four main sections:

- enforcement and penalties;
- supervisory powers (powers to gather information and to direct insurers to behave in particular ways);
- distress management; and
- the 'ladder of intervention'.

1 More information about the IPSA review and the two previous consultations can be found here

2 The Reserve Bank is in charge of the 'prudential' regulation of insurers. There is a separate regime to regulate insurers' conduct – the way policies are worded and the way customers are dealt with – looked after by the Financial Markets Authority.

Enforcement and Penalties

A well-designed enforcement and protection regime should create incentives for insurers to comply with their obligations and provide tools to sanction non-compliance.

The existing legislation includes a wide range of offences for non-compliance. However, they take the form of criminal offences, which means that enforcement options are limited either to 'warnings' or very serious sanctions through the criminal court system.

This consultation suggests a range of enforcement tools that could be introduced to give the Reserve Bank a more varied and appropriate set of responses to regulatory breaches. A wider range of enforcement options would make it easier for us to respond to problems in a proportional way and, in the process, make the threat of enforcement more credible.

We propose supplementing criminal penalties with lighter penalties for less serious offences (for example, written warnings or 'civil pecuniary penalties' (fines)). We also suggest some additional tools that are designed to promote compliance rather than sanction non-compliance (enforceable undertakings and remediation plans).

Supervisory Powers

To assist its role as supervisor of insurers, IPSA gives the Reserve Bank various powers to gather information about insurers, to assess their soundness and help identify and understand emerging problems. Under some circumstances, we can also issue legally-binding 'directions' to insurers, requiring them to take action.

The consultation suggests expanding the Reserve Bank's information powers, partly to bring IPSA into line with the other sectors the bank regulates (banks, non-bank deposit takers, and financial markets infrastructures) and partly to facilitate a more proactive approach to supervision.

The consultation discusses a breach reporting system. Alongside the Reserve Bank's supervision, insurers would also be required to monitor their own compliance with regulation and notify the Reserve Bank of any significant breaches as they occur. Minor breaches would also have to be notified but the insurer would be given more time.

The consultation looks at providing supervisors with the power to carry out on-site inspections at insurers' premises including, where necessary, without prior notice.

It also explores expanding the Reserve Bank's ability to demand information from businesses that aren't licensed insurers, which will make it easier to ensure that insurance is not being provided inappropriately by businesses that are not licensed as insurers.

We generally think the current direction powers are appropriate. However, the Reserve Bank can require a troubled insurer to stop issuing new policies but can't prevent it from renewing existing policies. We ask whether we should also be able to prevent renewals.

Distress Management

Distress management is about the way we deal with insurers that are in such financial trouble that we doubt they will be able to continue to pay policyholders' claims. Insurers in this situation will either fail or need to be significantly restructured.

'Restructuring' may involve some combination of selling off parts of the insurer, raising new funding, or agreeing to write-down some of the debt an insurer owes. This can take place through a process called 'voluntary administration' where a formal deal is struck between the distressed insurer and its creditors (the people it owes money to) so that business can continue. Additionally, in some circumstances, the government can appoint a 'statutory manager' to take over the running of the business temporarily and restructure the insurer in a way that protects the public interest. Both of these approaches are described as 'resolution'.

Where resolution is successful, it is likely to be less costly and less disruptive to policyholders than liquidation. However, it can be a controversial process as it involves altering contracts and imposing losses on different groups of people involved.

Where resolution is unsuccessful, an insurer will be placed into liquidation. Its assets will be collated and used to pay as many of its debts as possible. However, some creditors, including policyholders with outstanding claims, may not be paid in full (or at all in some situations).

IPSA already contains special rules for the resolution and liquidation of insurers. In particular, it requires a liquidator to try to maintain cover for life insurance policyholders by selling off policies to a different insurance company. It also allows the courts to write-down the value of some insurance contracts (to spread losses as fairly as possible across policyholders).

In this consultation, we ask whether IPSA's resolution powers should be expanded by making it slightly easier to appoint a 'statutory manager'. We also discuss the oversight of distress management, including: whether there should be an explicit 'purpose statement' to guide the Reserve Bank's role; and how different oversight roles for statutory management (the statutory manager, the Reserve Bank, and the Minister of Finance) might fit together. Finally, we ask whether some insurers should be required to maintain more detailed plans for how they might be resolved in a crisis.

Ladder of Intervention

We operate a risk-based system of supervision where insurers that are in a riskier financial position are subject to tighter oversight and controls.

At the Reserve Bank we have a range of powers at our disposal, ranging from carrying out investigations to asking the court to place an insurer in liquidation. This section explores how we might map the powers the Reserve Bank is able to use, to the amount of capital an insurer holds.

Insurer's capital is an important measure of the risk they hold because capital provides resources to pay future claims, particularly if those claims are larger than expected. As capital declines, the risk that an insurer might not be able to pay claims increases. A shortage of capital then is an indicator that the Reserve Bank should be providing greater oversight and perhaps intervention to help the insurer restore capital.

This part of the consultation asks which levels of capital are risky enough to justify the use of each power.

What Do You Think?

If you would like to contribute to the discussion, we want to hear from you.

Please send us your thoughts by 20 May 2022 to ipsareview@rbnz.govt.nz .