Reserve Bank of New Zealand
Te Pūtea Matua

Non-Technical Summary

Insurance (Prudential Supervision) Act 2010 Review.

Omnibus consultation

27 September 2023

CONSULTATION PAPER

Insurance Regulation and the IPSA Review

This is the final policy consultation for our comprehensive review of the Insurance (Prudential Supervision) Act 2010 (IPSA).[1] Once the policy is finalised, we will consult on an exposure draft of an IPSA Amendment Bill; this consultation is likely to commence in early 2025.

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

Policyholders pay a premium when they take out an insurance policy. Insurers then promise to provide them with agreed 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 the right 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

This consultation builds on five previous consultations to lay out a complete set of proposals for amending IPSA.

The proposals are wide-ranging but can be summarised under four main themes:

- supporting a more proactive and intensive approach to supervision;
- treatment of overseas insurers;
- statutory purposes and the scope of the legislation; and
- policyholder security.

1 More information about the IPSA review and the 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.

Supporting More Proactive and Intensive Supervision

The most important purpose of the changes we are proposing is to ensure that our insurance legislation can support our evolving approach to supervision across the sectors we regulate (deposit takers, insurers and financial market infrastructures).

Our approach to supervision has evolved from the light touch supervisory model that was established in the 1990s, to one that meets current day expectations and seeks greater alignment with international best practice.

Our supervisory approach is risk-based, proactive and proportionate. We devote most resources to entities that pose the largest risk to financial stability through their size or the magnitude of the risks they currently present (risk-based). We look to identify risks before they become serious so we can engage with insurers to take steps to improve the situation. We respond in a way that is proportionate to the level of risk in play, from conversations or remedial actions to address weaknesses, through to robust enforcement action in response to significant breaches of regulation.

We propose introducing a range of changes to the legislation that will better support this approach:

- Clearer and more enforceable rules, particularly for governance and risk management (by empowering new enforceable 'standards' in these areas).
- A more graduated approach to assessing solvency (whether insurers have sufficient financial resources to meet policyholders' claims, even in adverse circumstances). We intend to introduce a 'ladder of intervention' of increasing supervisory intervention as an insurer's available financial resources decline.
- A wider set of supervisory and enforcement tools to allow a more proactive and proportional approach to compliance. This would include new supervisory powers (including the power to conduct on-site inspections) and a more graduated set of enforcement tools.
- A more proportional approach to supervising major transactions that allows greater scrutiny to transactions that have greater potential to have an impact on insurers' financial soundness or on policyholders' interests.

Treatment of Overseas Insurers

Overseas-owned insurers play an important role in providing insurance to New Zealanders. However, international business can create a different set of risks that need to be managed.

We propose that the new standards we are planning to introduce set clearer rules for governance and risk management and should contain particular rules for companies in New Zealand that are part of an overseas-owned insurance group. Those rules would give us greater oversight of the kinds of contracts made between the New Zealand company and its parent group (particularly financial commitments and contracts to 'outsource' services to the wider group).

Where an overseas insurance company operates in New Zealand as a branch (without setting up a company in New Zealand), we propose that the CEO of the New Zealand branch should have a legal duty to take reasonable steps to ensure the branch meets IPSA requirements. We are also considering requiring branches to hold some of their assets in New Zealand as, in some cases, doing so may improve outcomes for policyholders if the insurer fails.

Statutory Purposes and the Scope of the Legislation

If an insurer 'carries on insurance business in New Zealand' they must be licensed under IPSA and comply with the legislation.

In previous consultations, we discussed whether current definitions of 'insurance' and 'carrying on business' are still appropriate.

We are proposing only minor changes to these definitions.

Currently, New Zealand insurance companies that only write policies for overseas customers do not need to be licensed. This could create confusion for overseas customers who may assume that these companies are regulated by us. We propose they should be regulated in the future.

We are proposing that branches of overseas reinsurance companies should not need to be licensed under IPSA (though we would carefully supervise how licensed insurers manage their own reinsurance programmes).

IPSA currently gives us the ability to use regulations to declare that some kinds of business should *not* be regulated as insurance. We propose that the legislation should also allow us to declare that some types of business *should* be regulated as insurance.[3]

Finally, the consultation discusses some minor changes to the overarching 'purposes and principles' in the legislation, designed to create consistency with the Reserve Bank's other legislation.

Policyholder Security

In a previous consultation we discussed the possibility of introducing a policyholder guarantee scheme for New Zealand, which would provide consumers with some compensation if their insurer failed. We are not intending to pursue this idea further as part of the IPSA review, though we may consider it again in the future.

However, we are considering elevating policyholders' claims in insolvency so that they are paid ahead of some other creditors. The other changes we are proposing to IPSA will also give us better oversight of insurers and should therefore make it less likely that insurers will fail.

We are proposing that 'yearly renewable term' life insurance policies (the most common type of policy currently sold in New Zealand) should no longer be subject to the 'statutory fund' regime.

3 Though only where that business meets the broad definition of insurance set out in IPSA s.7(1)

'Statutory funds' currently apply to all life insurance business. They are a way to ring-fence assets that will need to be paid out to life insurance policyholders. Statutory funds were introduced because life insurance policies are very long-term and traditional life insurance policies included a savings element. Policyholders paid into their policies over a long period and built up a 'fund' that would pay out if they died or when they reached retirement age. Since life insurers were holding these savings for long periods on behalf of policyholders it made sense to offer particular protections.

Most life policies currently sold in New Zealand now are 'yearly renewable term' policies. With these policies, rather than building up savings over time, policyholders pay for their life cover year-by-year (although insurers have to keep allowing them to renew their policies, even if their health deteriorates in the meantime). Since these policies do not have the same 'savings element' as traditional life policies, we propose that they should no longer be backed by statutory funds.

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 12 December 2023 to ipsareview@rbnz.govt.nz.