



Reserve Bank
of New Zealand
Te Pūtea Matua

Review of the Insurance (Prudential Supervision) Act 2010

Omnibus consultation

27 September 2023

CONSULTATION
PAPER



General information

Information about the review is available on the Reserve Bank of New Zealand - Te Pūtea Matua website at:

<https://www.rbnz.govt.nz/regulation-and-supervision/oversight-of-insurers/how-we-regulate-and-supervise-insurers/our-policy-work-for-insurer-oversight/review-of-insurance-prudential-supervision-act-2010>

Submission contact details

The Reserve Bank invites submissions on this consultation paper by 5pm on 12 December 2023.

Please note the disclosure on the publication of submissions below.

Address submissions and enquiries to:

Email:

ipsareview@rbnz.govt.nz

Subject line: IPSA Review – Omnibus consultation

Hard copy:

Reserve Bank of New Zealand
Prudential Policy – Financial Policy
PO Box 2498
WELLINGTON 6140

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 Banking (Prudential Supervision) 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.

Contents

1	Introduction	4
1.1	Purpose and format of this consultation	4
1.2	Feedback sought	5
1.3	Our approach to the IPSA Review	5
1.4	Key themes of the recommendations (Executive Summary)	6
2	Purposes, scope and regulatory boundaries	8
2.1	Overview	8
2.2	Statutory Purposes and Principles	9
2.3	Definition of insurance contracts	14
2.4	Definition of ‘carrying on insurance business in New Zealand’	17
2.5	Group supervision – licensing non-operating holding companies	20
3	‘Overseas’ insurers – branches and subsidiaries	22
3.1	Overview	22
3.2	Subsidiaries	22
3.3	Branches of overseas insurers	23
4	Solvency and ladder of intervention	31
4.1	Overview	31
4.2	Setting solvency requirements and supervisory adjustments	32
4.3	Solvency-related reporting (Financial Condition Reports and section 78 reports)	34
4.4	Ladder of intervention, solvency and statutory powers	35
5	Policyholder security and statutory funds	37
5.1	Overview	37
5.2	No policyholder guarantee scheme at this time	38
5.3	Statutory funds and ‘pure risk’ life policies	39
5.4	Enhanced policyholder security	40
6	Governance, risk management and relevant officers	44
6.1	Overview	44
6.2	New standards for governance, risk management and related issues	45
6.3	Fit and proper regime	46
6.4	Directors’ duties	47
6.5	Actuarial advice and the appointed actuary	48
7	Disclosure and reporting requirements	50
7.1	Overview	50
7.2	Ratings and solvency disclosure	50
7.3	A data and disclosure standard	51

8	Supervisory powers and approval processes	52
8.1	Overview	52
8.2	Supervisory powers	52
8.3	Supervisory approval processes	55
9	Enforcement and penalties	56
9.1	Overview	56
9.2	Enforcement tools	56
9.3	Penalty levels	58
10	Distress Management	61
10.1	Overview	61
10.2	Purpose statement for distress management	61
10.3	Statutory management	62
10.4	Resolution planning for insurers	64
11	Other issues	65
11.1	Small insurer exemptions	65
11.2	Holding out and restricted words	65
11.3	Coordination with other agencies	66
12	Have your say	67
12.1	How to submit or request further engagement	67
12.2	Summary of proposals and questions	68
	Appendix One – Statutory purposes and principles, IPSA and DTA	78
	IPSA	78
	DTA	79

1 Introduction

1.1 Purpose and format of this consultation

1.1.1 This consultation sets out a complete set of Reserve Bank policy recommendations for amendments to the Insurance (Prudential Supervision) Act 2010 (IPSA). We intend this consultation to be the final policy consultation, followed by consultation on an exposure draft of an amendment bill, likely in early 2025.

1.1.2 Most of the proposals in this consultation draw on policy options discussed in the previous five public consultations as part of the IPSA Review (see Table One). The previous consultations were relatively open, discussing a range of options. In this consultation we set out a more focussed set of considered proposals, developed in the light of further analysis and the stakeholder feedback received on the previous consultations. We also bring all our proposals together so that stakeholders can consider proposed changes as a package, including the interactions between them.

1.1.3 In a few places, we introduce new proposals or further detail. The main new areas are:

- a discussion of some modest potential changes to IPSA’s purposes and principles to create greater alignment with the Reserve Bank’s other legislation (section 2.2);
- some additional detail on our proposals for supervision of corporate groups headquartered in New Zealand (section 2.5);
- a more focussed discussion on whether branches of overseas insurers should be asked to hold assets in New Zealand (section 3.3);
- some additional policyholder protection measures to offset our proposal to remove statutory fund requirements for yearly renewable term life business (sections 5.3 - 4).

Table One: previous consultations (with hyperlinks)

Previous consultation and year	Links to relevant documents	Abbreviation used in this consultation document
2017 Issues paper	Consultation document	Not referred to
2020 Scope of the Act and Overseas Insurers	Consultation document Feedback statement	C1
2021 Policyholder Security	Consultation document Feedback statement	C2
2022 Enforcement and Distress Management	Consultation document Feedback statement	C3
2022 Governance, supervisory processes and disclosure	Consultation document	C4

- 1.1.4 This consultation paper may be read as a standalone document. However, it devotes greater space to issues that stimulated greater debate in previous consultations and treats some issues relatively briefly. Readers may find it helpful to refer to earlier consultations which provide more background and further detail of the considerations underpinning some proposals.
- 1.1.5 In each section we indicate which previous consultation is relevant. We refer to previous consultations as 'C1, C2 etc.' as indicated in Table One. We discuss issues in broadly the order of previous consultations, though there are places where it is more logical to change groupings slightly and we signal those places in the text.
- 1.1.6 For most proposals, which build on earlier consultations, we provide a brief problem definition, a concise statement of our proposals and then a longer section that addresses stakeholder feedback, explains our reasoning and provides further detail where relevant. We depart from this structure in a few places, either where decisions are simple or where there is more material to introduce.
- 1.1.7 Following this consultation, we will consider stakeholder feedback and then formulate final policy recommendations.

1.2 Feedback sought

- 1.2.1 We are interested in stakeholder feedback on all the proposals in this consultation. There is no need to repeat feedback provided in response to previous consultations, though it may be appropriate to do so where you feel such feedback requires particular emphasis.
- 1.2.2 For many of the issues in this consultation we provide a single proposal, reflecting our preferences in the light of previous consultation and feedback. We do not provide specific 'questions' for stakeholders on these issues but in each case we welcome comment on the proposals set out.
- 1.2.3 For some issues, though, we also ask specific questions. This is usually because: the material is new (for example, section 2.2 on statutory purposes and principles); or because we have provided added detail on a narrower range of options than in previous consultations but would still value feedback before reaching clear preferences (for example, section 3.3 on the treatment of overseas branches).
- 1.2.4 We gather all proposals and questions together in section 12.2 at the end of this paper to facilitate the preparation of submissions. It would be helpful if submissions could refer to the paragraph numbers of the proposals to facilitate our compilation of responses.
- 1.2.5 Submitters should feel free to comment on as much or as little of the content as they wish.
- 1.2.6 We would also welcome notification of any remaining issues that are not covered in this consultation but that stakeholders think should be considered as part of the IPSA Review.

1.3 Our approach to the IPSA Review

- 1.3.1 In this section we provide a brief outline of the origins of the IPSA Review and the key considerations that have driven our work.
- 1.3.2 The Terms of Reference for the IPSA Review (established by Cabinet in 2016) set two objectives:

- to assess the performance of IPSA against its existing statutory purposes and principles; and
- to assess the consistency of the regime with international guidance and the other legislation administered by the Reserve Bank, including considering whether any further alignment was appropriate given the New Zealand context.

1.3.3 To help us fulfil these two objectives, we have drawn on a range of important recent internal and external assessments of IPSA, including:

- the IMF Financial Sector Assessment Programme report from 2017, which assessed our insurance regulation against international standards;
- the Trowbridge-Scholten report into the failure of CBL Insurance Limited, which raised particular concerns about our oversight of cross-border entities, governance, and the way the appointed actuary regime operates;
- a variety of internal reports and thematic reviews assessing how aspects of the legislation are working including: conduct and culture, appointed actuary and governance thematic reviews.

1.3.4 Over the course of the IPSA Review, there have been changes to the Reserve Bank's governing and prudential legislation. The institutional arrangements of the Reserve Bank were modernised, as set out in the Reserve Bank of New Zealand Act 2021 (**RBNZ Act**). The Financial Market Infrastructures Act 2021 (**FMI Act**) and the Deposit Takers Act 2023 (**DTA**) have both been enacted. Where appropriate, we have sought to align our proposals with the approach taken in the new legislation (in particular, the DTA).

1.3.5 In reviewing the assessments discussed above, four broad themes emerge that have guided our thinking throughout the IPSA Review:

- underpinning a more proactive and intensive approach to supervision;
- greater oversight of overseas insurers;
- enhancing policyholder security in the context of changes to the New Zealand insurance industry; and
- refining the scope of the legislation through greater clarity about the regulatory boundary and minor changes to statutory purposes and principles.

1.3.6 Our work on the review has benefitted from consultation with a cross-agency working group, including representatives drawn from Treasury, the Ministry of Business Innovation and Employment, the Financial Markets Authority, the Earthquake Commission and the Inland Revenue Department.

1.4 Key themes of the recommendations (Executive Summary)

1.4.1 In the previous section (paragraph 1.3.5), we introduced four key review themes that have emerged from internal and external analysis of the existing legislation. In this section, we provide an overview of the main proposals in the consultation organised according to those themes, to provide an overall picture of what our proposals are designed to achieve. (Section 12.2 at the end of this document also contains a brief statement of all the proposals that are included in the consultation).

A more proactive and intensive approach to supervision

1.4.2 The most important goal of the proposals is to underpin our evolving approach to supervision:

‘Our approach to prudential supervision has continued to evolve from the light supervisory model that was established in the 1990s, to one that meets current day expectations and seeks greater alignment with international best practice.’ *RBNZ Statement of Prudential Policy*¹

1.4.3 Our supervisory approach aims to be risk-based, proportionate and proactive. Supervision proactively identifies problems with compliance and uses our full range of regulatory tools to address compliance problems.

1.4.4 The proposals set out here seek to underpin that approach through:

- greater use of standards to set clearer and more enforceable expectations, particularly for governance and risk management;
- a more graduated approach to solvency, allowing an escalating ‘ladder of intervention’ as capital declines and the corresponding risk of being unable to meet obligations increases;
- a wider set of enforcement tools to allow a more proactive and proportional approach to compliance issues;
- the introduction of an on-site inspection power and some other enhancements to supervisory powers (including the ability to overrule insurers’ actuarial calculations) to underpin our ‘trust but verify’ approach to supervision;
- a new approach to approving significant transactions that allows scrutiny to be more proportionate to the risk involved in the underlying transaction.

Overseas insurers

1.4.5 Overseas-owned insurers make an important and valued contribution to the provision of insurance for New Zealanders. However, cross-border arrangements can also create risks that need to be managed.

1.4.6 We propose imposing a duty on the Chief Executive Officer of a New Zealand branch of an overseas insurer to exercise due diligence to ensure that the insurer complies with its prudential obligations under IPSA (echoing the duty we propose imposing on directors of New Zealand incorporated insurers).

1.4.7 We are likely to propose that branches should hold assets in New Zealand at a level equivalent to the Prudential Capital Requirement in the New Zealand solvency standards, though we would welcome greater information on how costly this is likely to be for branches.

1.4.8 We also propose some measures to manage risks of intra-group contagion for New Zealand subsidiaries of overseas corporate groups.

¹ RBNZ Statement of Prudential Policy, dated 22 September 2022. Link here: <https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/prudential-policy>.

Legal definitions, regulatory scope and statutory purposes

- 1.4.9 We do not propose to make major changes to the key definitions that set IPSA's regulatory boundaries: the meaning of 'contract of insurance'² and 'carrying on business in New Zealand'³ respectively. This is because the current definitions are reasonably well understood and align with common law and other existing regulatory regimes.
- 1.4.10 We propose introducing a 'declaration power', which would have the effect of enabling certain boundary cases to be declared insurance contracts via regulation. This may enable us to better address new business models that insurers may adopt in the future.
- 1.4.11 We propose to slightly adjust the definition of 'carrying on business in New Zealand'. Insurers based in New Zealand but with no New Zealand policyholders will be brought within the IPSA regime. Currently, such insurers do not need to be licensed. We propose requiring a license in these cases to avoid reputational risk to New Zealand and to comply with international norms on the cross-border regulation of insurance. We also propose to explicitly exclude overseas captives and reinsurance branches from the need to obtain a license.
- 1.4.12 We propose including the ability to license non-operating holding companies for corporate insurance groups that are headquartered in New Zealand. This will give us better oversight of group-wide risks and help us adequately carry out our role as home regulator of corporate groups carrying out cross-border business. (In keeping with international norms, we will continue to rely on overseas regulators' oversight of group-level risk for corporate groups with a presence in New Zealand that are headquartered overseas.)
- 1.4.13 We also invite comments on some tightly contained changes to IPSA's statutory purposes and principles, designed to create consistency with our other legislation (for example, the place of 'efficiency' and 'policyholder interests' in IPSA's purposes and the relationship of the purposes with the Reserve Bank's overarching financial stability objective set by the RBNZ Act). We have not previously consulted on these issues.

Policyholder security and statutory funds

- 1.4.14 We are not proposing to recommend the introduction of a policyholder guarantee scheme for New Zealand at this time.
- 1.4.15 We are proposing that the statutory fund regime should no longer apply to yearly renewable term (YRT) policies and continue to not apply to non-life policies.
- 1.4.16 We are proposing some compensatory protection for YRT policyholders. We also propose that some of the policyholder protection provided by statutory funds should be extended to all insurance policyholders.

2 Purposes, scope and regulatory boundaries

2.1 Overview

- 2.1.1 This section considers the purposes and principles that underpin IPSA.

² Section 7 of IPSA.

³ Section 8 of IPSA.

- 2.1.2 We have not previously consulted on statutory purposes and principles. While the existing purposes and principles remain broadly appropriate, it is worth considering whether it is useful or necessary to update those purposes and principles to align with those set out in the RBNZ Act and our other prudential legislation (in particular the DTA). Since we have not previously consulted on this issue, section 2.2 asks some relatively open questions about potential changes.
- 2.1.3 Sections 2.3, 2.4 and 2.5 set out some specific proposals on issues discussed in C1: the definition of 'contract of insurance' (2.3), the definition of 'carrying on business in New Zealand' (2.4), and provisions for group supervision (2.5). While we have broadly consulted on these issues before, this consultation provides some additional details on our proposals for group supervision (2.5). We also propose that overseas reinsurance branches should be explicitly excluded from the IPSA licensing regime (2.4). We would particularly value stakeholder feedback on these issues.

2.2 Statutory purposes and principles

Introduction

- 2.2.1 We have not previously consulted on changes to IPSA's purposes and principles (sections 3 and 4 of IPSA) as part of the IPSA Review. For reasons explained below, we now think it is appropriate to do so.
- 2.2.2 Statutory purposes and principles can serve several purposes: to communicate the broad purpose of a regulatory regime, to signal overall policy direction, to set a basis for making and monitoring decisions involving discretion, and to guide interpretation of the legislation.⁴
- 2.2.3 When amending legislation, the Legislation Design and Advisory Committee (LDAC) guidelines recommend checking that the statutory purpose and principles remain fit for purpose in light of the changes that are being made.

Problem definition – why are we consulting on statutory purposes and principles?

- 2.2.4 The original Terms of Reference for the IPSA Review,⁵ set in 2016, asked us to assess the performance of IPSA against its *existing statutory purposes and principles*.
- 2.2.5 The existing statutory purposes and principles continue to reflect a broadly appropriate set of objectives for the prudential regulation of insurance.
- 2.2.6 However, since the Terms of Reference were set, there has been considerable change to the Reserve Bank's legislation. The Reserve Bank's overall statutory objectives have been updated by the RBNZ Act and there is new prudential legislation for other sectors the Reserve Bank supervises (the FMI Act and the DTA). It is therefore timely to consider whether the statutory purposes and principles in IPSA are appropriately aligned with the rest of the Reserve Bank's legislative framework.
- 2.2.7 We are not looking to recommend fundamental changes to IPSA's purposes and principles, but rather to consider the nuance to ensure that there are good reasons for any differences between IPSA's statutory purposes and principles and those in our other legislation.

⁴ For further discussion, see LDAC guidelines 'supplementary material' advice on '[Designing purpose provisions and statements of principle](#)'.

⁵ Review of the Insurance (Prudential Supervision) Act 2010 – Terms of Reference (April 2016). Link: <https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/insurers/regulation/terms-of-reference.pdf>.

2.2.8 For reference, we include IPSA's current statutory purpose and principles and the purposes and principles provisions from the DTA in Appendix One.

Potential changes to discuss

2.2.9 We are interested in stakeholder views on:

- whether IPSA's purposes should explicitly reference the Reserve Bank's broader purpose and financial stability objective under the RBNZ Act?
- whether it should remain a purpose of IPSA to promote the maintenance of a sound and **efficient** sector – i.e., does the promotion of 'efficiency' remain an important and desirable legislative purpose?
- whether a reference to access to insurance is needed?
- whether the purposes of IPSA should refer to promoting the soundness of the **insurance sector** or the soundness of **each insurer**?
- what role policyholder interests should play in IPSA's purposes and principles?

IPSA's purposes and the Reserve Bank's overall mandate

2.2.10 It is a purpose of the RBNZ Act to "promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy".⁶ A main objective of the Reserve Bank under that Act is "the financial stability objective of protecting and promoting the stability of New Zealand's financial system".⁷

2.2.11 The main purpose of the DTA makes it clear that the new deposit-taker regulatory regime is part of the RBNZ's broader mandate under the RBNZ Act: "...to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system."⁸ The main purpose of the DTA is supported by additional purposes.

2.2.12 We think it is worth considering adopting the same framing to the purposes of IPSA, and situating the insurance prudential regulatory regime within the Reserve Bank's overall mandate and financial stability objective.

2.2.13 The soundness of the insurance sector is, *directly*, an aspect of financial stability. Insurers are a part of the financial system specialising in enabling policyholders to manage their financial risk. Soundness and stability of the insurance sector gives the public assurance that such risk management will be effective. New Zealanders' ability to use finance (insurance) to manage risks is one of the ways in which the financial system promotes the prosperity and well-being of New Zealanders. This part of the purposes aligns well with 'microprudential' supervision of the insurance sector, with a particular focus on public confidence and outcomes for policyholders.

2.2.14 Insurance also contributes, *indirectly*, to broader financial stability to the extent that insurance underpins a range of other contracts (for example, the security of residential mortgages or professional indemnity insurance that provides comfort for some investments). Insurance increases the viability of investment projects by reducing the risk

⁶ Section 3 of RBNZ Act. The other purpose is to provide for the continuation of the Reserve Bank.

⁷ Section 9(b) of RBNZ Act.

⁸ Section 3(1) of the DTA.

they entail and the risk premium demanded by investors. Those other contracts (lending, borrowing, investment) are other channels through which a stable financial system promotes prosperity and well-being. This speaks to the more systemic macroprudential aspect of insurance supervision.

2.2.15 Setting IPSA's purposes in their broader context is attractive from a legislative design perspective, in clarifying the relationship between the purposes of IPSA and the broader role of the Reserve Bank. We think that setting out purposes in this way will help our thinking at the margins in difficult cases but do not expect it to have a large impact on our regulation and supervision of the insurance sector in practice. We are interested in stakeholders' comments on this assessment.

'Soundness and efficiency'

2.2.16 The purposes of IPSA are "to promote the maintenance of a sound and efficient insurance sector" and "promote public confidence in the insurance sector".⁹ The question is whether it is appropriate for sectoral efficiency to remain a purpose of IPSA. We note that the Reserve Bank's overall financial stability objective contains no express reference to efficiency.¹⁰

2.2.17 We also note that the equivalent purposes in the DTA are to "promote the safety and soundness of each deposit taker" and to "promote public confidence in the financial system".¹¹ While 'efficiency' is not specifically referenced in the DTA's purposes, components of efficiency are addressed in the statutory principles that the Reserve Bank is to have regard to under the DTA.

2.2.18 The rationale behind this approach is to make it clear that the reason we have prudential regulation is to promote soundness and stability within the financial system. While we are doing so, it is also important to minimise any negative impact regulation may have on efficiency but the legislation gives us few tools to actively *promote* an 'efficient' sector and that is not the legislation's primary goal. Efficiency, then, is an important principle to be taken into account when we try to increase soundness but it is not a *purpose* of the legislation.

2.2.19 We are interested in whether stakeholders think IPSA should follow the RBNZ Act and DTA in this way, by referring to soundness in its purposes but not efficiency. We note that there is some reference to concepts of efficiency in IPSA's principles, such as the need to maintain competition and avoid unnecessary compliance costs.¹²

Accessibility

2.2.20 As part of the Select Committee process, an additional secondary purpose was added to the DTA 'to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector', where that is not inconsistent with the Act's other statutory purposes.¹³ This is a novel addition to prudential legislation.

2.2.21 The provision that was included in the DTA was in response to some quite specific concerns on the part of small deposit takers, catering for underserved populations, who were

⁹ Section 3(1) of IPSA.

¹⁰ Definition of 'financial stability objective' at section 5 of RBNZ Act.

¹¹ Section 3(2) of DTA.

¹² Section 4(g) and (h).

¹³ Section 3.

concerned that a new regulatory regime might make it difficult for them to continue in business.

2.2.22 Section 4 of IPSA already requires the Reserve Bank to have regard to the importance of insurance to members of the public in terms of their personal or business risk management and to the importance of maintaining the sustainability of the New Zealand insurance market.¹⁴

2.2.23 Accordingly, we are interested in stakeholder feedback on whether anything further is required.

'The sector', insurers and policyholders

2.2.24 Generally speaking, the soundness of the sector, the soundness of individual insurers and the prudential protection of policyholders are aligned with each other; to have a sound insurance sector, New Zealand will also need to have a large proportion of financially sound insurers, and their financial soundness will make it more likely that policyholders will have their claims paid.

2.2.25 However, the degree to which our regulatory regime is targeted at 'sector', 'insurer' or 'policyholder' level can signal subtle differences in priority. For example, a sectoral focus might imply more tolerance for the failure of a single insurer, so long as the sector as a whole was sufficiently sound to maintain public confidence. Meanwhile, there might be circumstances in which there was a trade-off between policyholder interests and insurer soundness (for example, where there was some ambiguity about policyholders' legal rights – a slightly less generous treatment for some policyholders might leave the *insurer* in a more financially sound position at the expense of policyholders).

Sector or individual insurers

2.2.26 IPSA's purposes are currently framed at the sectoral level – to promote a sound and efficient insurance *sector* and to promote public confidence *in the sector*.¹⁵ Meanwhile, the DTA purposes include promoting the safety and soundness of each deposit taker and to promote public confidence in the financial system.¹⁶

2.2.27 We are interested in whether stakeholders think IPSA's purposes should include promoting the soundness of *each insurer*.

2.2.28 Since the failure of a single deposit taker is more likely to have impacts on the sector (through bank runs or contagion) than that of a single insurer, the current difference between the two Acts might be taken to imply a relatively low concern for individual insurer failure. (Not only does IPSA only stipulate a concern for the sector but single failures are less likely to have sector-wide impact than the failure of a single deposit taker might have for the deposit taking sector).

2.2.29 The rest of IPSA's purposes and principles currently point to a more nuanced picture. Failure of an individual insurer might be taken to damage public confidence in the sector. Having regard to the importance of insurance to New Zealanders for managing their personal and business risk might also be taken to imply a concern with individual insurers continuing to meet their liabilities, as well as with broad sector soundness. On the other

¹⁴ Sections 4(a) and 4(b) of IPSA.

¹⁵ Section 3(1) of IPSA.

¹⁶ Section 3(2) of DTA.

hand, IPSA's purposes make it clear that it is not a purpose of IPSA to eliminate all risk of insurer failure, and that members of the public are responsible for their own decisions relating to insurance (section 4(d) of IPSA).

2.2.30 In practice, our approach to supervision is risk-based (so we devote more attention to insurers with larger potential systemic impact) and the Financial Policy Remit currently set for us by the Minister of Finance,¹⁷ makes no explicit distinction between the approach to deposit takers and insurers in terms of risk approach.

2.2.31 We do not think a purpose of *promoting* (i.e., not ensuring or guaranteeing) the soundness of individual insurers would conflict with continuing to operate a non-zero failure regime. We also think that it would still be compatible with our supervision of some insurers on a 'portfolio' basis but are interested in stakeholder views on this question.

Policyholder security

2.2.32 Insurance regulation overseas often has 'policyholder protection' as its primary purpose. The International Association of Insurance Supervisors' Insurance Core Principles (ICPs), which are the insurance equivalent of the Basel framework for banks, say that policyholder protection should be one of the statutory purposes of insurance legislation and legislation in both the UK and Australia (for example) is framed primarily in terms of policyholder protection.

2.2.33 Policyholder protection is not currently a purpose of IPSA. While policyholder interest is referenced in the principles of IPSA, it is strictly in the context of distress management. Section 4(c) provides that the Bank must have regard to "*the importance of dealing with an insurer in financial distress or other difficulties in a manner that aims to adequately protect the interests of its policyholders and the public interest*". We are likely to propose removing this principle from IPSA's overall principles provision (section 4) and setting it in Part 4 (*Distress Management*) of IPSA,¹⁷ so there would no longer be any mention of policyholders in IPSA's primary purposes and principles.

2.2.34 We note that the ICPs are standards for insurance regulation as a whole. We have a twin peaks system in New Zealand, so the conduct aspects of 'policyholder protection' will sit with the Financial Markets Authority (FMA) under the relevant conduct legislation. IPSA offers protection for policyholders' financial security, but our regulatory and supervisory role is not primarily concerned with broader policyholder fairness. However, external reviews, including the IMF FSAP and the Trowbridge Scholtens report, have raised questions about the place of policyholder protection in the IPSA regime, underlining the fact that no mention of policyholder protection in IPSA's statutory purposes is unusual by international standards.

2.2.35 The legislation itself clearly is designed to provide some protection for policyholder financial interests, given the inclusion of a statutory fund regime. It is also difficult to understand why the stability of the sector is ultimately desirable, except to enable policyholders to purchase financial security. Concern for policyholders can be read-off from the existing principles and purposes, particularly promoting public confidence in the sector and the importance of policyholder interests in dealing with insurers in distress. On the other hand, the principles

¹⁷ We consulted on including a separate purpose clause for distress management (following the FMI Act and DTA which each have such a clause) as part of the third IPSA consultation on 'enforcement and distress management'. Stakeholders were supportive of the idea, we return to this issue in section 10.2 below.

also explicitly note consumers' responsibility for their own decisions and that IPSA is intended to be a non-zero failure regime.

2.2.36 We are interested in whether stakeholders think it would be valuable to actively include some reference to policyholder interests in IPSA's purposes or principles. If so, should that take the form of an additional purpose of IPSA, or a principle that the Reserve Bank should have regard to under IPSA?

2.2.37 We are also interested in views on how a purpose or principle might be described. We have some concerns that the most common international language of 'policyholder protection' might blur the boundaries between our prudential regime and conduct concerns and might sit in tension with IPSA's status as a non-zero failure regime. We think 'policyholder security' might better capture our prudential role.

2.3 Definition of insurance contracts

Problem definition

2.3.1 The definition of 'contract of insurance' (alongside the definition of 'carrying on business in New Zealand') determines which entities are required to obtain a licence under the IPSA. The question is whether the definition of insurance contracts remains sufficiently broad to cover new forms of business that should be prudentially regulated as insurance and whether it is clear enough to provide industry the guidance it needs.

2.3.2 Under section 7 of IPSA, a 'contract of insurance' is a contract involving the transference of risk under which, in return for a premium, one person agrees to pay another person a sum of money (or its equivalent) on the happening of one or more uncertain events. Reinsurance is specifically included, while a number of arrangements are excluded under section 7(3). The insurance contract definition is intended to reflect the common law position.

2.3.3 We considered the definition as part of C1. Some stakeholders argued that the current definition was difficult to apply and probably too narrow. Questions were also raised as to whether the definition was sufficiently flexible to incorporate new forms of business including those stimulated by insurtech innovation.

2.3.4 Some stakeholders raised some particular boundary issues including parametric insurance (sometimes called index insurance), discretionary benefit mutuals, and some types of guarantees and waivers. In each case, they argued that insurance-like products were not being captured by IPSA.

Proposals

2.3.5 We considered stakeholder views carefully, with particular focus on the boundary cases raised. We have kept in mind that we should be slow to depart from the existing definition, given it aligns with the common law definition. Overall, we conclude that the existing definition is appropriate and should not be changed significantly.

2.3.6 We **propose** that IPSA be amended to include a power to declare by regulations that certain types of transaction or matters *are* insurance contracts for the purpose of IPSA (a 'deeming in' power). This would be additional, and complementary, to the existing power to

declare by regulations that transactions or matters are not by way of insurance.¹⁸ The 'deeming in' power is intended to provide clarity and transparency that certain 'boundary' products are insurance.

Reasoning, stakeholder views and additional information

- 2.3.7 Overall, we are comfortable that the existing definition appropriately sets out the boundaries of business that should be prudentially regulated as insurance. We are also concerned that altering a definition that is well-established and aligned with the common law definition would create legal risk and uncertainty.
- 2.3.8 In terms of specific boundary issues raised by stakeholders, we group our responses into three categories: discretionary benefit mutuals, parametric insurance, and issues around guarantees and waivers.

Discretionary benefit mutuals

- 2.3.9 Discretionary benefit mutuals offer products with insurance-like features. Members pay into a fund. Where a member suffers a contractually defined loss, they are entitled to ask the trustees of the fund to indemnify them for the loss. The trustees then have discretion whether or not to do so, depending on the interests of the members as a whole (which is likely to include reflection on the present size of the fund).
- 2.3.10 The key difference between discretionary benefit products and insurance is that there is no contractual *right* to an indemnity.
- 2.3.11 Prudential regulation under IPSA is precisely designed to underpin the contractual promises of payment made by the insurance sector.
- 2.3.12 If we were to require discretionary benefit providers to be regulated under IPSA, we would be treating them as though a contractual right was in place when it is not. That would effectively remove the potential for discretionary benefit providers to provide a cheaper, simpler, but less secure form of financial protection. We do not think limiting consumer choice in that way is appropriate. We note that providers of this kind appear to occupy a small but valued market niche.
- 2.3.13 The main risk of not regulating discretionary benefit mutuals is the risk that they create confusion amongst consumers who might think they were buying 'true' insurance. We consider this risk to be low. We surveyed some websites of these types of providers and found that they were extremely clear that they were *not* offering insurance. We also note the holding out provisions in section 16 of IPSA, which makes it an offence for such providers to hold themselves out as licensed insurers.

Parametric insurance

- 2.3.14 Parametric (sometimes referred to as 'index') insurance is another type of product that some stakeholders have raised as a 'boundary case'. In this case, policyholders purchase the right to a fixed payment if some indicator or index reaches a specified level (or a payment determined as a function of the level of change in the underlying index). Examples include crop insurance following certain kinds of weather event or earthquake insurance following a

¹⁸ Section 7(3)(h) of IPSA.

quake of a particular magnitude. Since this is non-indemnity insurance, there is no need for a claims assessment process, which can make pay-outs quicker and cheaper to administer.

2.3.15 Our view is that the definition of insurance contract is broad enough to capture at least some types of parametric insurance. This is likely to be the case where, in addition to the trigger event occurring, there also needs to be proof of loss and then cover is provided for that loss. If there is pay-out without proof of loss, then the product appears more derivative-like and excluded from being an insurance contract.¹⁹

Guarantees, warranties, payment waivers

2.3.16 Guarantees, warranties and payment waivers are each a type of contingent liability contract, which are excluded from the definition of 'contract of insurance'.²⁰

2.3.17 The Insurance Council of New Zealand noted that these exclusions create overlaps in which contracts could be written as insurance by an insurer (and effectively regulated as insurance), while other providers might also write contracts with similar economic effect without attracting the same regulatory burden.

2.3.18 We accept that is the position in some cases but do not think it necessarily suggests problems with the IPSA regime. A key distinction here concerns issues of risk and control.

2.3.19 Warranties provide a good example. Warranties are offered as part of many contracts as a way of distributing risk between the buyer and seller of a product (or provider of a service). When they form part of a larger contract, the seller or provider can mitigate their risk either by making financial provision for it or by improving their quality control. If a warranty is provided on a financial basis by a third-party insurer, though, the quality control option is not available making the business proposition somewhat different (even if the outcome is broadly similar for the consumer). Similar considerations apply to guarantees or payment waivers in credit contracts. Where a waiver or guarantee is provided by the lender, they can mitigate their risk through credit control, monitoring and lending criteria. However, an insurer taking on these obligations (though payment protection insurance or surety contracts) is entering into a purely financial relationship.

2.3.20 The issue is not primarily one of regulatory burden but rather of whether insurance is an efficient way of providing these kinds of services, relative to alternative mechanisms.

2.3.21 Additionally, we note that including warranties or repayment waivers in the definition of insurance would mean that a very wide range of contracts became insurance contracts, many of which should not be regulated under IPSA as a matter of policy.

2.3.22 We therefore propose to retain the current exclusions from the IPSA regime which currently apply to guarantees, warranties, and payment waivers.

The flexibility benefits of a 'functional' definition

2.3.23 The current definition of insurance contracts is functional in nature. (In some other jurisdictions, insurance is defined by a list of insurance activities). A functional definition has important advantages in catering for new business models. The IPSA definition is

¹⁹ Section 7(3) of IPSA.

²⁰ Section 7(2) of IPSA.

technology-neutral and so well-placed to cater for technological change that may alter the types of products offered in insurance markets.

2.4 Definition of 'carrying on insurance business in New Zealand'

Problem definition

2.4.1 Under section 15 of IPSA, every person who carries on insurance business in New Zealand must hold a licence. Section 8 defines what it means to 'carry on insurance business in New Zealand'.

2.4.2 In this part of the consultation, we are interested in the geographical aspect of this definition. We are concerned with two issues: whether the definition is sufficiently clear on jurisdictional boundaries, and the 'policyholder in New Zealand' test.

Definitional clarity

2.4.3 In previous consultations, some stakeholders argued that the current definition lacked clarity and suggested it might be too narrow, allowing too many overseas insurers to write contracts covering New Zealand risk without acquiring a licence.

2.4.4 The situation is very clear for a New Zealand-incorporated insurer that is liable under contracts of insurance to New Zealand policyholders.

2.4.5 Some stakeholders were concerned about the treatment of branches of overseas-incorporated entities. To assess whether such entities are 'carrying on business in New Zealand', it is necessary to apply the test under section 332 of the Companies Act 1993. The test specifically notes that entering into a single contract of insurance as an insurer is not sufficient evidence on its own that an insurer is carrying on business in New Zealand.²¹ There is no guidance on how many contracts *would* be sufficient.

2.4.6 In practice, the Reserve Bank has established procedures for considering this question as part of its licensing process. Where a firm has registered as an overseas company under the Companies Act 1993, we conclude that they are carrying on business in New Zealand. In other cases, we will consider an insurers' degree of connection to New Zealand, which includes having a physical presence (premises or staff) but may also include specific marketing to New Zealanders.

Policyholder in New Zealand

2.4.7 Currently insurers do not need to be licensed unless they are liable under a contract of insurance to at least one New Zealand policyholder.²² An insurer incorporated in New Zealand that only writes policies to foreign policyholders does not need to be licensed. However, we are concerned that such an insurer might escape regulation under any jurisdiction, creating reputational risk for New Zealand. Although such insurers are prohibited from holding themselves out as a New Zealand licensed insurer,²³ we are concerned that overseas policyholders might still, incorrectly, assume that a New Zealand incorporated insurer is regulated by the New Zealand authorities.

²¹ Section 332(b)(x) of Companies Act 1993.

²² Section 8(1)(c) of IPSA.

²³ Section 218 of IPSA.

Proposals

- 2.4.8 We **propose** modifying the 'carrying on insurance business in New Zealand' definition in section 8 of IPSA, to remove the requirement that a person must be liable under a contract of insurance to a New Zealand policyholder. This means that all New Zealand-incorporated insurers will need to be licensed, whether or not they issue contracts to New Zealand policyholders.
- 2.4.9 We **propose** explicitly excluding overseas-incorporated captive insurers and overseas companies that only act as reinsurers in New Zealand from the definition, making it clear that such entities do not need to be licensed under the IPSA.

Reasoning behind the proposal

Definitional clarity

- 2.4.10 There are considerable difficulties in establishing the 'carrying on business in New Zealand' boundary through law in a way that is transparent, objective, practical and reasonably simple.
- 2.4.11 Generally speaking, insurers that carry out a significant amount of business in New Zealand should be regulated in the interests of policyholder security and competitive neutrality.
- 2.4.12 However, there are advantages, for example, in permitting overseas insurers to offer niche products that are unavailable in New Zealand. 'Niche' implies that the scale of business is sufficiently small for it to be unreasonable to expect insurers doing this type of business to meet the regulatory and practical costs of establishing a more formal, licenced, presence here. However, without access to niche overseas insurance, New Zealanders would not be able to obtain cover. More generally, it may not be proportionate to require full compliance with the IPSA regime where insurers are only writing a very small amount of business in the New Zealand market.
- 2.4.13 Some stakeholders suggested that, in a digital age, it might be more important to think in terms of New Zealand risk rather than an insurers' physical presence in New Zealand. However, we don't think this accurately captures the distinction we are looking for when deciding whether an insurer should be licensed. For example, we would not want to regulate overseas travel insurers that cover travellers' risk in New Zealand or global policies issued to businesses engaged in cross-border activity. There are also practical limitations to the extent to which we can monitor and enforce regulation of insurers in other jurisdictions. Meanwhile, our existing interpretation of the carrying on business requirement does not solely rely on physical presence, as we also ask whether insurers are actively marketing to New Zealanders.
- 2.4.14 We considered setting an objective premium threshold to signal an 'upper boundary' for the value of New Zealand business, above which we would automatically deem an insurer to be 'carrying on business in New Zealand'. However, the threshold would need to be relatively high to avoid capturing insurers writing a small number of niche commercial contracts. Meanwhile, setting a high threshold might then imply tolerance for a relatively high volume of small consumer contracts. Submissions showed considerable stakeholder discomfort with a premium threshold for these and other practical reasons.

- 2.4.15 We also considered following the Australian legislation,²⁴ which says that where overseas insurers use local intermediaries to sell and market business, they can still be deemed to be carrying on business in Australia. However, the Australian model initially captures too much business (for example the niche products discussed above). It is only made practicable by requiring brokers to certify that some relevant overseas products are 'niche products', which requires a level of oversight of brokers that we do not have in New Zealand. The Insurance Brokers Association of New Zealand particularly requested that we don't follow the same path, arguing that it was problematic for brokers.
- 2.4.16 Overall, we consider that the risks of changing the definition outweigh the benefits. We note that substantially the same test will be applied to deposit takers under the DTA,²⁵ and note that it aligns with requirements under the Companies Act 1993.
- 2.4.17 However, we believe there would be benefits to the industry, in us issuing supplementary guidance to clarify how we interpret the 'carrying on business in New Zealand' test.
- 2.4.18 We also felt that there were two areas of perceived ambiguity where we could create greater certainty. These relate to overseas captives and overseas reinsurers.
- 2.4.19 **Overseas captives** are overseas-incorporated insurers that only provide cover to their parent or other subsidiaries of their parent (at least one being New Zealand-incorporated).²⁶ They are unlikely to have staff or premises in New Zealand but most of their business is New Zealand related. On policy grounds, we do not think we should require overseas captives to obtain an IPSA licence and are content to rely on the regulation provided by their home jurisdiction. However, in terms of the statutory definition of 'carrying on business in New Zealand' their position may be somewhat ambiguous. We think it would add certainty and help to bolster the integrity of the current definition to explicitly exempt overseas captives from IPSA requirements.
- 2.4.20 **Overseas reinsurance** is another area where practice varies, with reinsurers having varying levels of presence in New Zealand. We considered the value-add that comes from the Reserve Bank supervising reinsurance branches. Our current view is that it would be more efficient to concentrate on our oversight of how insurers are managing their own reinsurance programmes than it is for us to directly supervise reinsurance branches. We are therefore proposing amendments to the legislation so that overseas entities that only provide reinsurance do not need to be licenced in New Zealand. We have not consulted on this aspect of our recommendations before and so particularly welcome stakeholder feedback on this part of the proposal.

Policyholder in New Zealand

- 2.4.21 The existing definition was designed so that, if an insurer had no New Zealand policyholders, it would not need to be licensed under IPSA. An insurer based in New Zealand but only writing policies for overseas policyholders therefore is not currently required to be licensed in New Zealand.
- 2.4.22 This situation creates some reputational risk for the Reserve Bank as regulator. The international convention for regulating cross-border financial business is that regulation is carried out by the home regulator. Based on its place of incorporation, overseas

²⁴ Section 3(6) of Insurance Act 1973 (Aus).

²⁵ Refer clauses 1 and 2 of Schedule 2 of DTA.

²⁶ Refer definition of 'captive insurer' at section 6 of IPSA.

policyholders of an unlicensed New Zealand-based insurer might incorrectly assume that it is regulated in New Zealand (even though the insurer cannot hold itself out as a New Zealand licensed insurer). If such an insurer was not being run prudently and became distressed, that could reflect badly on our regulatory regime and potentially undermine public confidence in the New Zealand insurance sector.

2.4.23 Changing the rule will create some additional regulatory costs in supervising the small number of insurers in this category but our view is that these are less significant than the reputational risk. Stakeholders were comfortable with this change when we discussed it as part of C1.

2.5 Group supervision – licensing non-operating holding companies

Problem definition

2.5.1 There is growing international consensus about the risks that can arise through interactions between different legal entities within a corporate group structure (i.e., between holding companies and subsidiaries or amongst subsidiaries). Both the 2017 IMF FSAP and the Trowbridge-Scholten report recommended that we consider an appropriate form of group supervision for New Zealand.

2.5.2 As discussed in further detail in C1, group supervision is important because an insurance company's relationship with its broader group of companies (its holding company and subsidiaries) can alter the risks that an individual entity is exposed to. The main avenues of potential risk are:

- intra-group contracts or transactions that may facilitate contagion across the group when difficulties emerge (for example, intra-group reinsurance) or prevent the timely redeployment of capital;
- group-wide concentrations of risk that are not apparent when considering the group from a single entity perspective (for example, different entities in the group each of which carries exposures to particular risks or investments that do not appear concentrated until they are aggregated at group level);
- subordination to group-level policy decisions.²⁷

2.5.3 These risks can be present within a single country or in the context of cross-border groups. Existing controls in IPSA provide sanctions for the consequences when these risks materialise (for example, where they result in a breach of solvency standards). However, a more proactive supervisory approach to group supervision would seek to assist insurers in identifying risks before they materialise.

2.5.4 As discussed in C1, it is potentially possible to exercise some group supervision 'indirectly' using information obtained from an insurer about its intra-group transactions and related parties. Existing provisions in IPSA could facilitate this approach. In particular, our information gathering powers (including the additional powers proposed in s.8.2) enable us

²⁷ In the New Zealand case, section 221 of IPSA provides important protections here. It makes it clear that a group constitution must not permit directors to act in a holding entity's best interests when that is not in an insurer's best interests. However, there is still a place for supervisory monitoring to ensure that incentive structures are not established in a way that might create incentives to depart from this principle.

to obtain a wide-range of information that could be used to identify and assess group-wide risk.²⁸

- 2.5.5 However, international consensus is increasingly that this approach is extremely demanding on supervisors and that a 'direct' approach that places risk assessment responsibilities on the head of group provides useful incentives for good governance of the group, is simpler and results in a more reliable detection of risks.²⁹
- 2.5.6 The international convention for cross-border groups is that the 'head of group' is responsible for group-level risk management (consolidated solvency requirements, identification of group-level risk concentration, identification of risks presented by intra-group transactions etc). Host supervisors in countries where subsidiaries operate should then rely on home country supervision to ensure that group-level risks have been considered. For overseas groups with insurance subsidiaries in New Zealand, primary oversight of group level risk will continue to be carried out by the overseas regulator and supervisors.
- 2.5.7 At the moment, though, our ability to require groups headquartered in New Zealand (either purely domestic groups, or those with overseas subsidiaries) to identify and manage intra-group risks is limited.
- 2.5.8 We consider it would be useful to have the ability to apply a licensing regime, supplemented by appropriate standards,³⁰ to non-operating holding companies (NOHCs) of insurer entities. It is relatively common for a group to be headed by a NOHC. A licensing regime for NOHCs would ensure that we are able use standards to place obligations on a head of group to identify, manage and report on intra-group risk.

Proposals

- 2.5.9 We **propose** recommending IPSA be amended so that we will have the ability to require licensing for a non-operating holding company, for corporate insurance groups headquartered in New Zealand (whether operating only domestically or across borders). Broadly speaking, the licensing regime is proposed to operate as follows:
- A separate licensing regime for NOHCs, similar to the existing licensing regime for insurers but omitting those obligations which are not relevant to NOHCs. We will set out the details if we publish an exposure draft.
 - Particular provisions for groups within standards for risk management and corporate governance. The standards would include requirements for the head of group to provide appropriate group-wide governance and risk management.
 - Standards to impose requirements for the management of outsourcing and of related-party exposures (section 6.2 below) would also promote the management of intra-group risk.³¹

²⁸ For example, IPSA sections 121 to 123 give us the ability to obtain information on an insurer's associated persons including holding entities and subsidiaries.

²⁹ There is strong international consensus on the need for group supervision. See (amongst others) Borselli, A 'Insurance Group Supervision in the European Union' in Marano, P and Siri, M (Eds) 'Insurance Regulation in the European Union: Solvency II and Beyond' (Palgrave 2017), Trowbridge, J 'The Architecture of Group Supervision' in Kempler C, Flamee, M, Yang, C and Windels, P *Global Perspectives on Insurance Today* (Palgrave 2010). We provide some additional elaboration in C1.

³⁰ See section 6.2 of this paper for discussion of standards.

³¹ We note that IPSA already enables us to impose rules on related-party exposures using licence conditions. However, since our broader proposal here is to move to setting more prudential requirements through Standards, we think it would be advantageous for IPSA to empower a Standard for this purpose. (which would provide greater parliamentary oversight and closer alignment with the Reserve Bank's other legislation such as the DTA and Financial Markets Infrastructures Act 2021).

2.5.10 We will continue to follow the international convention of relying on overseas regulators for group supervision of corporate groups headquartered overseas. For example, we rely on the Australian Prudential Regulation Authority (APRA) to supervise Australian-based insurance groups that have subsidiaries in New Zealand).

Reasoning, stakeholder feedback and additional information

2.5.11 When we consulted on this matter in C1, stakeholders felt that more detail was required in order for them to provide in-depth feedback. We also discussed questions about whether we need to manage any risks that subsidiaries' position in a group might pose for New Zealand supervision in the same section. In this consultation, we have separated that question out and discuss it in the section on overseas insurers below.

2.5.12 The key proposal here, from the perspective of the IPSA Review, is that we recommend an amendment to IPSA to give us the power to licence NOHCs. It will also be important to ensure that the empowering provisions for standards are sufficiently broad to allow us to include requirements for managing group risk where appropriate.

2.5.13 The details of group-level risk and governance requirements will need to be worked out through the consultation process on developing new standards.

3 'Overseas' insurers – branches and subsidiaries

3.1 Overview

3.1.1 New Zealand is a small open economy that benefits significantly from the presence of insurers that are based overseas. They are essential for the 'sustainability of the New Zealand insurance market' and in light of the 'importance of insurance to members of the public'.³²

3.1.2 However, cross-border business can also create complications and therefore risks.

3.1.3 In C1, we discussed the advantages and risks of branch and subsidiary structures for overseas insurers operating in New Zealand, noting that regulation needs to balance the advantages of foreign presence with appropriate controls for any risks involved.

3.2 Subsidiaries

Problem definition

3.2.1 The main potential concern with subsidiaries is that their relationship with their parent group may create risks (as well as advantages).

3.2.2 The primary risk is that intra-group transactions might facilitate contagion where the group runs into financial difficulties. For example, a group may wish to extract resources from the subsidiary to bolster the group capital position. Where a subsidiary is dependent on its group for outsourced service provision, failure of the group may also impair the subsidiary's ability to operate.

³² See sections 4(a) and 4(b) of IPSA.

3.2.3 The main ways to mitigate this risk (in addition to the general requirements imposed under IPSA such as solvency requirements) are oversight over or restrictions on intra-group financial transfers and oversight over outsourcing arrangements.

Proposals

3.2.4 We **propose** introducing an outsourcing standard to ensure that insurers have identified and considered the prudential and business continuity risks presented by outsourcing arrangements. (See also section 6.2).

3.2.5 We **propose** introducing a standard to regulate connected exposures and concentrated exposures. (See also section 6.2)

3.2.6 We are considering **proposing** dividend restrictions as part of the ladder of intervention approach to solvency. Dividend policy must take into account solvency requirements in any case but dividend restrictions where an insurer's capital position is weak provide additional safeguards when an insurer or its group are under stress.

Reasoning, stakeholder feedback and additional information

3.2.7 This consultation considers the scope and purpose of proposed standards, with the detailed content to be subject of a separate consultation (should the IPSA be amended to empower such standards). Our overarching approach, though, would be to ensure that we were aware of channels that might allow contagion where an insurer's parent group was in difficulties.

3.3 Branches of overseas insurers

Problem definition

3.3.1 Branches of overseas insurers create significant advantages for the provision of insurance in New Zealand but also create some challenges from a regulatory, supervisory, and crisis management perspective. These are discussed below and relate particularly to difficulties imposing New Zealand solvency requirements, limited RBNZ access to and influence over the board, and a reduction in the level of control and influence that can be exercised in a crisis management situation.

3.3.2 The ability of overseas insurers to carry on business in New Zealand as branches provides some important benefits. For example, branches provide automatic cross-border risk diversification, and the ability to operate as a branch can also facilitate market entry for overseas providers.

3.3.3 However, insurers carrying on business in New Zealand as branches also create some risks. In particular, since the legal entity carrying on business in New Zealand as a branch is incorporated overseas, there are limitations on our ability to regulate and supervise it. For most branches, we place considerable reliance on regulation by a branch's 'home' jurisdiction (the country in which it is incorporated). So, if appropriate conditions are met, branches may be exempt from fit and proper requirements, New Zealand solvency requirements or the requirement to hold a New Zealand statutory fund for life business.³³ Each exemption has its own conditions (reviewed in more detail in C1, section 3.2) but,

³³ IPSA sections s.38, 59 and 119 respectively.

broadly, exemptions are conditional on the home jurisdiction's rules and supervision regime being at least as satisfactory as those in New Zealand (regulatory equivalence).

- 3.3.4 Although it is often not difficult to assess regulatory equivalence in broad terms, detailed requirements may vary between jurisdictions. For example, it is inherently difficult to compare solvency requirements across jurisdictions since the impact of different rules can be felt differently by insurers with different business models. Alongside that variation, there are some areas where New Zealand's requirements are likely to be higher than those in most other jurisdictions, particularly in relation to seismic risk.
- 3.3.5 Additionally, while home country regulation and supervision may be high quality, home supervisors' incentives may differ from those of a New Zealand supervisor. Home regulators and supervisors may not be incentivised to:
- apply a high level of scrutiny to a branch's operations in New Zealand (if those operations are a small part of the business as a whole); or
 - take into account the potential economic, fiscal and social impact in New Zealand of a default and/or failure of the insurer.
- 3.3.6 Where a branch forms a relatively small part of an overseas entity, the entity's board may also have reduced incentives to monitor the branch. There may also be practical limits to the extent to which the Reserve Bank can effectively hold an overseas Board accountable for the operation of a New Zealand branch.
- 3.3.7 Finally, the cross-border insolvency regime is highly complex but, in some circumstances (discussed below), the absence of assets in New Zealand may place New Zealand policyholders at a disadvantage in the event of the insurer's insolvency.
- 3.3.8 As part of C1 we asked some open questions about the appropriate regulatory regime for overseas branches, ranging from requiring incorporation for at least some branches through to maintaining the status quo.
- 3.3.9 There was broad consensus that we should avoid imposing any new restrictions on branches of overseas reinsurers that might hinder access to global reinsurance markets.
- 3.3.10 Beyond that, opinions differed, partly reflecting insurers' differing interests but also the fact that the treatment of branches inevitably involves trade-offs.
- 3.3.11 We are still considering appropriate treatment for branches. We are particularly interested in finding solutions that provide some risk reduction without undermining the benefits branches provide to the New Zealand economy. The risks presented by branches increase with the size of the branch, so we are also interested in tailoring approaches relative to branch size where possible.
- 3.3.12 Since this issue remains relatively unsettled, this section of the consultation includes some particular questions for stakeholder feedback.

Proposals

- 3.3.13 Elsewhere in this consultation (section 6.4) we propose imposing a duty on an insurer's directors to ensure that the insurer complies with its prudential obligations under IPSA. In the context of overseas branches, we **propose** that the same duty should be imposed on

the chief executive officer of the New Zealand branch. This aligns with the approach adopted in the Deposit Takers Act 2023.³⁴

- 3.3.14 We are considering a **proposal** that branches hold assets in New Zealand equivalent to the New Zealand solvency standard prudential capital requirement for their risk exposures, and that life insurance branches should hold New Zealand statutory funds, with a *de minimis* exemption for small branches. We are still considering the costs and benefits of this proposal and would particularly value stakeholder feedback to inform this analysis.
- 3.3.15 We **propose** that overseas reinsurers should no longer be required to be licensed under IPSA in order to do business with New Zealand policy holders (and so won't be required to hold assets in New Zealand).
- 3.3.16 We are not outlining a preferred option on whether branches over a particular size should be required to incorporate at this time. Existing powers under IPSA could be used to require incorporation for large insurers so we do not need to consider this issue as part of the IPSA review. Whether or not we think incorporation is desirable will depend in part on our completed assessment of the costs and benefits of assets in New Zealand requirements.

Reasoning, stakeholder feedback and additional information

Due diligence duty for NZ Chief Executive Officer

- 3.3.17 As noted elsewhere in this paper (section 6.4), we are proposing to impose a duty on directors of New Zealand incorporated insurers to carry out due diligence to ensure that the insurer complies with prudential obligations under IPSA.
- 3.3.18 In a branch structure, formal responsibility for compliance sits with the entity's board. However, day-to-day compliance monitoring is likely to be delegated to the New Zealand Chief Executive Officer and other staff of the New Zealand branch.
- 3.3.19 We had also considered whether it would be appropriate to impose a due diligence obligation on the directors of the overseas insurers. However, in the analogous context of deposit takers, we received feedback that it would be difficult to apply impose rules of this kind extraterritorially (in another jurisdiction), and that overseas directors might be too distant from operational matters to be the appropriate bearers of this type of duty in any case. On the assumption that these arguments are equally applicable to insurers, we think imposing duties on the NZ Chief Executive Officer of the branch (which is the approach taken in the DTA) is more likely to have the correct incentive effects. However, we welcome stakeholder feedback on whether this approach would present particular problems.

Assets in New Zealand

- 3.3.20 One option to address the risks associated with cross border insolvency is to require that overseas general insurers hold assets in New Zealand equivalent to the Prudential Capital Requirement that the New Zealand solvency standard would require for their New Zealand business (and potentially that overseas life insurers hold the assets in their New Zealand related statutory funds in New Zealand). This would be accompanied by a provision in IPSA to say that, in insolvency, these assets should be applied to meet New Zealand liabilities

³⁴ Section 93, Deposit Takers Act 2023.

before those to other creditors. We are interested in stakeholder feedback on this option, in particular the costs and benefits associated with it, to assist in finalising a policy proposal.

3.3.21 We note that local asset holding requirements exist for branches of general insurers operating in Australia³⁵ (there are no equivalent rules for branches of life insurers, but in practice branches of life insurers do not appear to be permitted in Australia). Such requirements were also common throughout Europe before Solvency II was introduced.

3.3.22 We would also expect to accompany any such requirement for general insurers with a provision in IPSA saying that the assets in New Zealand should be applied to meet liabilities to New Zealand policyholders before other creditors. This provision would not need to apply to statutory funds held in New Zealand by life insurers, because statutory fund rules already contain a preference to distribute assets to the policyholders of the policies referable to that fund ahead of most other creditors.

3.3.23 There are two potential benefits of local asset holding requirements: facilitating policyholder access to assets in insolvency under some circumstances; and some enhanced competitive neutrality and comparability between insurers operating in the New Zealand market.

Cross-border insolvency, branches and New Zealand policyholders

Background

3.3.24 The legal framework around cross-border insolvency is very complex, and depending upon the circumstances may include:

- General rules in common law or civil law jurisdictions relating to cross border insolvency and/or co-operation with foreign courts;
- Bilateral frameworks between jurisdictions given effect through domestic legislation (for example, the Trans-Tasman Proceedings Act 2010, and equivalent legislation in Australia);
- International frameworks given effect through domestic legislation (for example, the UNCITRAL Model Law on Cross-Border Insolvency (the model law) incorporated into New Zealand law by the Insolvency (Cross-Border) Act 2006).

3.3.25 Broadly speaking, the legal framework focuses on:

- Deciding on the jurisdiction in which the insolvency proceeding, or main part of the insolvency proceeding, should occur; and
- Where there are concurrent insolvency proceedings in different jurisdictions, co-operation between the insolvency practitioner and courts in each jurisdiction with the insolvency practitioner and courts in the other relevant jurisdictions. However, it is difficult to generalise across jurisdictions, and different circumstances can result in different outcomes (for example, the model law applies to insolvency proceedings of an insurer in New Zealand but not in Australia).

3.3.26 The discussion that follows is a simplified analysis that is broadly correct in most circumstances. We believe it is a sufficiently representative account to underpin a broad assessment of the costs and benefits of assets in New Zealand requirements. However, it

³⁵ Section 28, Insurance Act 1973 (we note that this requirement applies to locally incorporated general insurers as well).

should not be taken as a comprehensive or definitive guide to policyholder rights in all contexts.

Analysis

- 3.3.27 To begin with, we note that where an overseas insurer became insolvent, the main insolvency proceeding would likely take place in that insurer's home jurisdiction.
- 3.3.28 However, where there were assets in New Zealand, it would often also be possible to bring New Zealand insolvency proceedings. Those proceedings would likely only apply to assets and liabilities that were in New Zealand when the insolvency proceedings are initiated (along with any other assets that it was necessary to administer when coordinating or cooperating with a foreign court or foreign representative).
- 3.3.29 Although proceedings in relation to the branch's assets in New Zealand would be managed by the New Zealand courts, it would still be possible for a foreign insolvency practitioner to take the view that distributing the assets in New Zealand to New Zealand policyholders was inappropriate (if, for example, a disproportionate share of the insurers assets were in New Zealand).
- 3.3.30 In this case, there are various forms that co-operation across jurisdictions might take. For example, it is possible that the foreign insolvency practitioner could apply to the New Zealand courts for some assets in New Zealand to be transferred to them, so they could realise and distribute those assets as part of the main insolvency proceeding in the insurer's home jurisdiction. For example, this is possible under Article 21 of Schedule 1 of the Insolvency (Cross-Border) Act 2006 where a foreign proceeding has been recognised by the New Zealand Courts (although before making such an order the court must be satisfied that the interests of creditors in New Zealand are adequately protected). It is difficult to predict whether or not such an application would be successful as it would depend on the specific circumstances. For example, the nature of the preference regime in the home jurisdiction of the insurer.
- 3.3.31 The issue may be complicated further by the existence of policyholder preference that favours policyholders in the home jurisdiction. Specifically, New Zealand policyholders will be disadvantaged if:
- The overseas insurer does not have sufficient assets in New Zealand to cover the entitlements of New Zealand policyholders; and
 - New Zealand policyholders' claim on the assets of the overseas insurer in its home jurisdiction rank behind the claims of policyholders in that jurisdiction.
- 3.3.32 In this case we consider there are strong reasons for thinking that having assets in New Zealand (and possibly requiring that statutory fund assets be held in New Zealand) will, on average, improve the position of New Zealand policyholders in insolvency.
- 3.3.33 In relation to statutory funds, we are still exploring the degree to which statutory funds held overseas by an overseas life insurer present risks for New Zealand policyholders. New Zealand law provides preference for policyholders in respect of policy liabilities referable to a statutory fund.³⁶ There is a potential risk this preference may not be recognised in respect of assets of the statutory fund held in a jurisdiction other than New Zealand On the other

³⁶ Section 116, Insurance (Prudential Supervision) Act 2010.

hand, New Zealand policyholders may – in some cases – benefit from being part of a statutory fund in the insurer’s home jurisdiction that is larger than a stand-alone New Zealand fund would be. We continue to undertake analysis on this issue, including considering where there could be unintended consequences of an assets in New Zealand requirements in respect of statutory funds.

3.3.34 In other circumstances (in general insurance cases where there is no overseas policyholder preference), it is less clear that a potential problem exists. However, a requirement to hold assets in New Zealand has the potential to make the insolvency process slightly easier for New Zealand policyholders to navigate in practical terms, when compared with having to enforce a claim in another jurisdiction, for example, it may make it easier and cheaper to obtain information and resolve disputes using the insolvency process (although outcomes might still be dependent on interactions with foreign insolvency practitioners and courts in some circumstances).

3.3.35 We note that domestic asset requirements are relatively common internationally (including in Australia), suggesting that there is some international consensus on their efficacy.

Conclusion

3.3.36 Overall, we think that a requirement to have assets in New Zealand would significantly improve policyholders’ position where the general insurers’ home jurisdiction’s insolvency laws include preference for home-country policyholders. A requirement might also provide some benefits in other circumstances, but these are more uncertain. We think there is also a potential issue around whether the preference afforded to policyholders in respect of policies referable to statutory funds in New Zealand would be recognised if the assets of the statutory fund are held in another jurisdiction, but we need to carry out further work on this issue.

3.3.37 As set out above, there are legal complexities associated with an assets in New Zealand requirement that may make it preferable to simply require the overseas insurers that pose the greatest risk to incorporate in New Zealand. We are interested in stakeholders’ views on the relative merits of different options to address the risks identified above.

Capital, comparability and disclosure

3.3.38 Requiring general insurers to hold ‘assets in New Zealand’ equivalent to the prudential capital requirement under the solvency standard would mean that branches were no longer exempt from New Zealand capital requirements in respect of their New Zealand business.

3.3.39 They could be required to disclose solvency data in terms of capital held in New Zealand for the branch business, which would facilitate market assessments of insurers’ profitability and financial strength to some extent.

3.3.40 However, the implications for an overseas general insurer’s financial strength and cost of capital are not straightforward.

3.3.41 Since the branch is one part of a larger entity, the overall solvency capital requirements for the entity would still be set by its home regulator. Even if New Zealand solvency requirements were in fact more onerous than those in the home jurisdiction, an insurer could respond by holding a larger proportion of its capital in New Zealand and a correspondingly smaller amount in its home jurisdiction, without altering its overall capital.

- 3.3.42 The Reserve Bank would not be able to control how the home regulator would respond to this situation.
- 3.3.43 On the other hand, the requirement to hold assets in New Zealand would provide a transparent indication of the Reserve Bank's view of the risk attached to the branch's New Zealand operations. That assessment might colour how insurers and markets assessed the competitiveness and profitability of the New Zealand branch and might also influence either overseas regulators' policy or an insurers ICAAP/ORSA process.
- 3.3.44 As noted above, it is difficult to compare solvency requirements across jurisdictions. However, to the extent that stakeholders are correct in their view that New Zealand solvency requirements may be higher than those in other jurisdictions, an assets in New Zealand requirement may provide some enhanced competitive neutrality and comparability between insurers (but it is important to note that how much difference it would make depends on the response of insurers and overseas regulators).
- 3.3.45 If we were to require that overseas branches had New Zealand statutory funds, the New Zealand solvency standards would apply to those statutory funds, providing clear comparability with statutory funds held by New Zealand incorporated life insurers.

Design considerations and options

- 3.3.46 If we were to introduce assets in New Zealand requirements for general insurers, it would make sense to set the level of assets as equivalent to the prudential capital requirement imposed by the New Zealand solvency standard for the entity's New Zealand business. If we set assets at another level (for example as equal to liabilities), there would be less likelihood that the assets were sufficient to meet liabilities to New Zealand policyholders. Given that the costs of an assets in New Zealand requirement are largely administrative, in setting up the asset holding arrangements, it is not clear that a lower requirement would significantly reduce costs.
- 3.3.47 We also think that it only makes sense to introduce asset holding requirements in conjunction with a stipulation that the assets held are to be distributed preferentially to meet liabilities to New Zealand policyholders.
- 3.3.48 We are still considering how to define what it means to hold assets in New Zealand.
- 3.3.49 The aim of asset holding requirements would be to ensure that assets would be recognised as "New Zealand assets" in the context of the cross-border insolvency regime. We would not be trying to influence insurers' investment decisions (in other words 'assets in New Zealand' would not mean that insurers must invest in 'New Zealand assets' such as New Zealand property or equities).
- 3.3.50 Our initial thinking is that we should follow the equivalent rules in Australia. Under the Australian regime for general insurers, assets in Australia are made up of:
- Reinsurance payments that are paid in Australia and relate to a policy held by an Australian policyholder³⁷
 - Real property (i.e., land) in Australia;³⁸

³⁷ Section 116A, Insurance Act 1973 Insurance Act 1973.

³⁸ Paragraph 27 of *Prudential Standard GPS 120: Assets in Australia*.

- Premiums receivable due to the branch (other than any premiums receivable outstanding for more than six months from the date when the premiums receivable became due and payable);³⁹
- Cash held in the branch's bank account in Australia (provided that any withdrawal from the bank account requires authorisation by the branch's agent in Australia);⁴⁰ and
- Other assets held by an Australian custodian or agent in Australia (for example an equity of bond portfolio), subject to certain conditions.⁴¹

3.3.51 Before we can make a decision on whether to introduce assets in New Zealand requirements, we will need to assess the costs of those requirements against the benefits described in the previous two sections (after some further work to gain assurance on the potential benefits in terms of the insolvency regime). We are therefore interested in how expensive insurers think it would be to calculate solvency requirements on a New Zealand basis and to set up and maintain appropriate asset-holding mechanisms.

3.3.52 We are also interested in any legal difficulties that stakeholders can envisage arising from asset-holding requirements of this kind (for example, are there any assets that couldn't easily be held through a trustee or custodianship arrangement?) including, for overseas life insurers, from a requirement to hold statutory funds in New Zealand.

3.3.53 Given that the benefits of assets in New Zealand requirements are clearer where a general insurer's home jurisdiction has overseas policyholder preference, we are considering whether requirements should only apply to those jurisdictions. We note that other jurisdictions do not appear to make this distinction and that the distinction could have an impact on the competitive position of branches from different jurisdictions. We are interested in any comments stakeholders might have on this question.

3.3.54 Finally, we think that, if we were to introduce assets in New Zealand requirements it would make sense to exclude smaller branches. Smaller branches present lower overall risk. Setting up an asset-holding structure would be likely to have fixed costs that would be more significant relative to the size of a smaller business. Additionally, a good deal of the market entry that we see in New Zealand takes the form of overseas branches. We would not want to discourage overseas insurers from establishing business in New Zealand.

3.3.55 Our initial thinking is that the threshold for assets in New Zealand requirements should be set at around \$3 million gross premium. The exemption would reflect the lower risk posed by smaller branches and the relative cost of setting up an asset holding structure for a smaller business. The \$3 million figure is based on comparisons with incorporated subsidiaries on the basis that if it is economically viable to set up a subsidiary, it should also be possible to keep assets in New Zealand. Again, we would appreciate stakeholder feedback on whether a \$3 million threshold is appropriate.

³⁹ Paragraph 27 of Prudential Standard GPS 120: Assets in Australia.

⁴⁰ Paragraph 27 of Prudential Standard GPS 120: Assets in Australia.

⁴¹ Paragraph 25 of Prudential Standard GPS 120: Assets in Australia.

3.3.56 We note that if we were to introduce a requirement for statutory funds to hold assets in New Zealand further thought would have to be given to the design of that requirement (for example, whether similar definitions of what constitutes assets held in New Zealand, and similar exemptions from the requirement to hold assets in New Zealand could be used for both an assets in New Zealand requirement for branches of general insurers, and for a requirement for statutory fund asserts to be held in New Zealand).

Supplementary questions:

- 1) To what extent do you think it would be valuable to require branches of overseas general insurers to hold assets in New Zealand?
- 2) To what extent to you think it would be valuable to require branches of overseas life insurers to hold statutory funds in New Zealand?
- 3) If we were to introduce assets in New Zealand requirements, would it be appropriate to follow the Australian approach to defining what is meant by assets being “held” in New Zealand? If not, what approaches might be preferable?
- 4) How costly would it be for branches to hold assets in New Zealand? What are the nature of these costs?
- 5) Are there any legal problems that you can envisage arising from the assets holding proposals set out here?
- 6) If we were to introduce assets in New Zealand requirements, would it be appropriate to include an exemption for small branches? Do you think that a threshold of \$3million of gross premium would be an appropriate threshold for this exemption?
- 7) Do you have views on the relative merits of an assets in New Zealand requirement versus a targeted requirement to incorporate in New Zealand, or other options to address identified risks?

4 Solvency and ladder of intervention

4.1 Overview

4.1.1 This part of the consultation is concerned with the way solvency requirements are established in primary legislation and the way solvency metrics are used to unlock certain powers in IPSA. The details of the solvency capital regime for insurers are the subject of a separate review of the Solvency Standards that are issued under IPSA, and are out of scope of this Review.

4.1.2 Previously, we separated our discussion of solvency arrangements between:

- C2 (policyholder security): consideration of how solvency requirements are established and reported on; and
- C3 (enforcement and distress management): the ‘ladder of intervention’ which sets out how solvency control levels ‘unlock’ certain distress management powers.

This section considers the discussion on solvency arrangements as a whole.

- 4.1.3 In C2, we had also discussed possible changes to the way solvency is described and measured. However, we agree with stakeholders that the risk of confusion to those familiar with current terminology is likely to outweigh any gain from changes. The main terminology changes we will introduce are those required to move to a system of two solvency control levels, which we will call the ‘prescribed capital requirement’ and ‘minimum capital requirement’. These new terms are already defined in the new Interim Solvency Standard that came into force in January 2023.

4.2 Setting solvency requirements and supervisory adjustments

Problem definition

- 4.2.1 Currently the Reserve Bank imposes solvency capital requirements on insurers via a licence condition that specifies the ‘solvency margin’ an insurer must maintain (as defined further by, and calculated according to, the relevant solvency standard) for its overall business and for any statutory funds.⁴²
- 4.2.2 The solvency margin is the amount of ‘solvency capital’ an insurer holds above the ‘prescribed capital requirement’.
- 4.2.3 The prescribed capital requirement is specified by the solvency standard and is designed to be sufficient surplus capital for an insurer to hold so that it can meet its obligations to policyholders, even under adverse circumstances. ‘Adverse circumstances’ are defined as a 1:200 year adverse event for most risks and a 1:1000 year event for seismic risk over a 12 month period.
- 4.2.4 In most cases, the required ‘solvency margin’ for insurers is \$0 – that is to say licence conditions require insurers to hold the prescribed capital requirement. However, where the Reserve Bank feels that an insurer is exposed to risks that are not well captured by the solvency standard or faces particular vulnerabilities, it can impose a higher solvency margin.
- 4.2.5 In C2 we made two proposals for altering these arrangements. First, we argued that it would make sense for the prescribed capital requirement to apply to insurers automatically, without the use of a licence condition. That would marginally reduce the risk that a licence condition was omitted. It would also make it clearer that the prudential capital requirement is the ‘default’ solvency requirement and that any variation reflected particular circumstances. Second, we suggested an alternative mechanism for imposing varied capital requirements for specific insurers where necessary.

Proposals

- 4.2.6 We **propose** that the prescribed capital requirement should apply automatically to non-exempt insurers, without the need for a specific licence condition.
- 4.2.7 We **propose** that the Reserve Bank should have the power to impose supervisory adjustments to the way the solvency calculation is carried out.

⁴² Sections 21(b) and 21 (c) of IPSA

Reasoning, stakeholder feedback and additional information

- 4.2.8 The first proposal was not controversial with stakeholders and we propose proceeding to recommend that change.
- 4.2.9 The second proposal was that the Reserve Bank should not only be able to impose a capital overlay where doing so was necessary in the light of specific risks, but also be able to impose changes in the way an insurer carried out its solvency calculations.
- 4.2.10 There would be three advantages to this additional power.
- 4.2.11 Some types of risk are difficult to capture through a simple capital overlay, since the level of capital required depends on an insurers' changing exposure to risk over time. An alteration to capital calculations, which might include an alteration to formulae or levels of risk adjustment, is a more effective way of reflecting these risks.
- 4.2.12 In some cases, being able to specify aspects of the solvency calculation may be the most effective way to deal with differences in actuarial judgement between the insurers' actuaries and the Reserve Bank's actuaries or to compensate for an identified risk that the solvency standard does not deal with but that will vary over time with insurers' exposures.
- 4.2.13 Finally, this change, along with changes already made to the Interim Solvency Standard, will alter how solvency information is disclosed. Under revised arrangements, solvency margins will be declared relative to the Reserve Bank's view of what should be prescribed for an insurer (rather than relative to the standard PCR produced as an output from the solvency standard as generally applied). Some stakeholders suggested this might impair transparency as insurers would be declaring solvency margins against a different baseline. However, we think the solvency margin is best interpreted as a measure of excess capital over that required to meet a 1:200 risk appetite. Reserve Bank imposed adjustments would be designed to bring an insurer back to that level of financial strength, so we think capital requirements, as adjusted by licence conditions, remain the most useful point of comparison.
- 4.2.14 An alternative way to achieve disclosure that reflected our assessment of appropriate capital requirements for an insurer might be for us to publicly disclose when we had imposed special licence conditions on insurers. However, we think that approach would create greater risk of provoking inappropriate market reaction when conditions are imposed. Our preferred proposal keeps the imposition of licence conditions confidential.
- 4.2.15 The ability to over-rule an insurer's own judgement as to the risk held on its balance sheet, including actuarial judgement, is an important power for regulators. Both the IMF FSAP and Trowbridge-Scholten report recommended that the Reserve Bank should ensure it has the clear legal power to do so. (The Australian insurance legislation gives APRA the explicit power to over-rule an insurer's actuarial judgement.)
- 4.2.16 In submissions on C2, some stakeholders were interested in how they might challenge the Reserve Bank's determinations and suggested the possibility of a tribunal. However, our view is that the appropriate remedy would be judicial review.

4.3 Solvency-related reporting (Financial Condition Reports and section 78 reports)

Problem definition

- 4.3.1 In C2, we sought feedback on aspects of the current solvency reporting regime: the financial condition report and the appointed actuary's report required under section 78 (commonly known as 'section 78 reports').
- 4.3.2 We asked whether requirements for financial condition reports should continue to be defined within solvency standards or whether they should be set in a separate standard. Stakeholders did not have strong views on this matter. We will consider this as part of our development of any exposure draft, alongside considering how to simplify the process of setting insurer reporting requirements across the IPSA regime.
- 4.3.3 We also asked for views on the value of section 78 reports. These reports are produced by the appointed actuary as part of reviewing the actuarial information relating to the insurer's financial statements,⁴³ and accompany the financial statements.

Proposals

- 4.3.4 We **propose** no change to the requirement to produce section 78 reports.
- 4.3.5 We will consider the appropriate instrument for setting out requirements for financial condition reports, as part of producing any exposure draft.

Reasons, stakeholder feedback and additional information

- 4.3.6 There is some potential overlap between section 78 reports and both the financial condition report and auditors' review of the financial statements, so we asked stakeholders for their views of the reports.
- 4.3.7 We received mixed responses. Some insurers thought that the financial condition report was much more useful and questioned the overlap between section 78 reports and auditors' duties. Other stakeholders noted that section 78 reports are externally facing and more widely available than financial condition reports. While audit of financial statements is essential and auditors should have actuarial expertise available, the appointed actuaries' more detailed knowledge was felt to provide useful additional assurance.
- 4.3.8 Overall, we propose that section 78 reports should stay in place in their current form. Unlike financial condition reports, section 78 reports are publicly available. They provide an additional layer of comfort in the quality of financial accounts, drawing on appointed actuaries' detailed knowledge of an insurer's actuarial judgements, that sits alongside auditors' duty to satisfy themselves of the integrity of financial statements.
- 4.3.9 We also asked whether requirements for financial condition reports should remain in the solvency standard or be set out in a separate standard. Stakeholders did not have strong views and we reserve this question to consider as we prepare an exposure draft.

⁴³ Section 77 of IPSA.

4.4 Ladder of intervention, solvency and statutory powers

Problem definition

- 4.4.1 In C3 and C4, we proposed changing the way solvency requirements are set in IPSA to introduce a more graduated and risk-based approach to solvency, enabling a 'ladder of intervention' as insurers' capital levels decrease.
- 4.4.2 We are proposing that IPSA should operate based on two solvency control levels. At the 'top' of the ladder there will be a 'prescribed capital requirement' (PCR), which marks the boundary above which we have no particular capital-related concerns about insurers. At the 'bottom' of the ladder we will set a 'minimum capital requirement' (MCR) at what we consider to be the point of non-viability for an insurer.
- 4.4.3 As insurers breach the PCR, we will begin a 'ladder of intervention': escalating supervisory responses as capital levels decline, beginning with a breach of the PCR and increasing in intensity until resolution or liquidation options are considered around the MCR.
- 4.4.4 The Interim Solvency Standard issued in January this year already sets two capital levels and adopts this terminology. However, the current setting for the MCR (at 80% of the PCR) is currently a 'placeholder', as there is currently no reference to the MCR in IPSA. We are planning to determine the consequences of breaching the MCR as part of the IPSA Review. We will then go on to calibrate a level for the MCR that we think is appropriate given the actions we are considering.
- 4.4.5 Our responses along the 'ladder of intervention' will be governed in two overlapping ways. We will develop internal supervisory policy for risk-based responses as capital levels decline and publish corresponding guidance for industry. The legislation will also delineate some 'hard' boundaries via the way different statutory powers are enabled at different capital levels.
- 4.4.6 This dual governance creates a balance between objective transparent boundaries (legislation) and the flexibility to accommodate different circumstances (supervisory policy).
- 4.4.7 Our current concern is with rules for enabling supervisory powers under IPSA. It is important to be aware that these hard rules will be supplemented by supervisory requirements and, where relevant, our enforcement framework. Supervisory policy and enforcement policy will be consulted on, transparent to industry and constrained by standard administrative law requirements of reasonableness and proportionality.
- 4.4.8 It is also important to note that many of the relevant powers have multiple possible triggers, since we may need to take action in response to declining capital measures or to other issues (fraud, non-compliance, failure to conduct business in a prudent manner and the like). This discussion relates solely to the capital-related triggers for supervisory powers. We propose to leave the additional triggers unchanged.

Proposals

- 4.4.9 Given that statutory triggers will be supplemented by supervisory and enforcement policy, we prefer simplicity in setting statutory triggers. We **propose** anchoring the capital triggers for various powers closely to the MCR and PCR. We propose some powers or requirements should be unlocked when insurers breach the MCR/PCR and some should be unlocked

when insurers are 'likely to breach' the MCR/PCR. That creates a framework with four trigger points.

4.4.10 We **propose** that powers should be unlocked as set out in table 4.4. Note that we are only discussing the capital aspects of conditions for use of powers here. Some of these powers can also be triggered for other reasons. In some cases (notably statutory management), a capital-related trigger is a necessary but not sufficient condition for authorising the use of powers.

Table 4.4: Solvency triggers and Reserve Bank powers

Solvency capital trigger ⁴⁴	Power enabled
Likely to breach prescribed capital requirement	Appointed actuary and auditor duty to inform Reserve Bank requirement
Breach prescribed capital requirement	Direction powers Investigation powers Power to require a recovery plan
Likely to breach minimum capital requirement	Reserve Bank can apply to Court for voluntary administration order Reserve Bank can seek statutory management
Breach minimum capital requirement	Reserve Bank can apply to the Court for liquidation

Reasoning, stakeholder feedback and additional information

4.4.11 The general logic here is that information, investigation, and corrective powers should be unlocked at the 'top' of the ladder, while resolution and liquidation powers should be unlocked toward the bottom of the ladder.

4.4.12 Stakeholders were comfortable with this broad schema but there were some disagreements about the detail.

4.4.13 Some stakeholders argued that a direction not to write new business (or renew existing business) should be enabled lower down the ladder of intervention than other directions. We understand the reasoning here. However, it is difficult to identify additional 'points on the ladder' between the prescribed capital requirement and minimum capital requirement. While the 'ladder' sets out statutory limits, our policy interventions will still be constrained by general administrative law which would require interventions to be proportional to the risk or harm involved. In practice, then, a direction not to write new business would be seen as far more significant than some of the other direction powers.

⁴⁴ Note that some of these powers can also be triggered for other reasons, we are only discussing capital-related triggers here. We propose leaving other triggers unchanged.

- 4.4.14 Several stakeholders asked whether 'likely to breach the prescribed capital requirement' was sufficiently well-defined as a trigger for resolution or administration. Some therefore proposed that the minimum capital requirement would be a more appropriate trigger.
- 4.4.15 Resolution is an intervention that is designed to address an insurer in significant distress or at risk of failure (albeit perhaps after restructuring or sale of some or all of the business). It is intended to ensure continuity of cover for policyholders and to avoid the loss of value that occurs as a business switches from a going concern to a gone concern. It is therefore important that resolution is enabled before an insurer reaches the point of non-viability.
- 4.4.16 We think it is still appropriate to include 'likely to breach' as a trigger for resolution actions.
- 4.4.17 Stakeholders pointed out that we have yet to arrive at a calibration for the MCR in the Interim Solvency Standard. Our planned approach is that, for the purposes of the IPSA Review, we will think of the MCR as the point of non-viability for an insurer and set out appropriate statutory consequences to take place as an insurer becomes non-viable. As part of the solvency standard review, we will then discuss how the point of non-viability should be calibrated (bearing in mind the statutory consequences set as part of this review).

5 Policyholder security and statutory funds

5.1 Overview

- 5.1.1 We are unlikely to propose a policyholder guarantee scheme for New Zealand at this time. We are also likely to propose removing yearly renewable term (YRT), and other life policies with no surrender value from the statutory fund regime.
- 5.1.2 These two decisions have consequences for how we think about other aspects of policyholder security. This proposals and considerations in this section are therefore more detailed than those in C2, so we particularly welcome stakeholder feedback on this section.
- 5.1.3 C2 also discussed some aspects of policy disclosure but for this consultation we are grouping all discussion of disclosure in section 7 below.
- 5.1.4 This section begins with an explanation of our proposal not to continue work on a policyholder guarantee scheme (section 5.2) and on removing YRT business from statutory funds (section 5.3).
- 5.1.5 We then go on (section 5.4) to discuss some proposals to enhance aspects of policyholder security. These enhancements generally involve extending some of the benefits statutory funds provide across all insurance policyholders but generally in a weaker form. Doing so:
- reduces the implications for YRT policyholders of no longer having statutory fund protection,
 - makes treatment of YRT and health policyholders more similar reflecting their similar exposure; and
 - slightly narrows the differences in protection between life and non-life policyholders.

5.2 No policyholder guarantee scheme at this time

- 5.2.1 As part of C2, we asked an open question about the possibility of introducing a policyholder guarantee scheme. We did not have a strong position about whether to introduce a scheme, but felt it was important to consider this issue given that a depositor compensation scheme will be implemented under the DTA.
- 5.2.2 We do not recommend a policyholder guarantee scheme at this time, though we may consider it again in the future.
- 5.2.3 Policyholder guarantee schemes provide compensation to policyholders if their insurer should fail. (In some circumstances, they may also contribute to resolution costs or facilitate the transfer of books of business to a new provider).
- 5.2.4 The most common way to fund such a scheme is through levies on the insurance sector to build up a fund that can then be used if required. In some cases, this fund is backed by a government guarantee in case it is insufficient in the short-term, with the deficit made up by increased future levies.
- 5.2.5 It is likely that costs levied on the industry would be passed on to insurance policyholders (depending on levels of competition in the insurance market).
- 5.2.6 Essentially a scheme would require policyholders to pay more for safer insurance – i.e. insurance that would still deliver a payout even if their insurer failed. How expensive a scheme would be would depend on the generosity of cover offered (would it pay full claims or only some proportion?).
- 5.2.7 There are close analogies with a depositor guarantee scheme for banks. However, there is an important difference. Depositor compensation schemes provide consumer protection *and* have important financial stability benefits. The financial stability benefit comes from the risk that a loss of confidence in banks or deposit takers will create contagious ‘bank runs’ where nervous depositors withdraw their funds unnecessarily. There is far less risk of this type of effect in insurance because the customer relationship is more long-term and it is harder to shift providers.
- 5.2.8 It is still possible for an insurer failure to have systemic consequences. The most obvious example would be the failure of a large insurer or several large insurers. Under those circumstances there could be a macro-economic impact due to the shortfall of funds relative to policyholders’ claims. It might also become difficult or expensive for New Zealanders to obtain cover due to reduced capacity in the sector. Under those circumstances the government might face pressure to provide public financial assistance. A scheme could help to reduce fiscal risk in these circumstances.
- 5.2.9 However, the most likely scenario for very large insurer failure with systemic consequences is a very significant earthquake. New Zealand insurers are already required to hold sufficient capital or reinsurance to meet claims following a 1:1000 year earthquake event. Once events exceed that level of severity, costs increase very rapidly. It is unlikely that it would be cost effective to hold a guarantee fund sufficiently large to meet this type of eventuality. Creating a formal right to compensation from a scheme would reduce the government’s flexibility under these circumstances. There would also be considerable overlaps between a scheme designed to meet this eventuality and existing provision through EQC.

- 5.2.10 It is still possible to justify a scheme on consumer protection grounds. Insurance is very important to personal financial security and the complexity of insurer balance sheets may make market discipline challenging for consumers.
- 5.2.11 However, there is a trade-off between the cost of insurance and the level of protection that is offered.
- 5.2.12 Many other OECD jurisdictions do have policyholder guarantee schemes, but coverage varies. The types of policies that are most likely to be covered are less relevant to New Zealand than they are in other jurisdictions. Schemes are particularly common where insurance is compulsory, for example to ensure third party personal injury protection (motor or hunting insurance). However, we have ACC coverage in New Zealand. Some jurisdictions protect pension cover, but New Zealand insurers are much less heavily involved in pension provision. Finally, the most likely scenario for insurance failure would be overwhelming claims following a major earthquake. New Zealand solvency standards already require insurers to hold sufficient capital to deal with a 1:1000 year earthquake event and EQC provides an additional safety net.
- 5.2.13 Under the circumstances, we did not assess the case for a scheme was strong enough to justify the costs of implementation and ongoing administration at the present time. We do not rule out reconsidering the issue in the future.

5.3 Statutory funds and 'pure risk' life policies

Problem definition

- 5.3.1 Currently, insurers need to have statutory funds in respect of their life insurance business.⁴⁵
- 5.3.2 Statutory funds are a way of 'ring-fencing' life insurance assets. They are particularly designed for long-term and savings-type policies where policyholders make payments to insurers, who build up and invest a pool of assets on their behalf to fund (often distant) future payments. The statutory fund rules control how premium payments are used and invested and give policyholders preferential access to the fund's assets in the event of insurer insolvency.
- 5.3.3 In C2, we asked whether it was appropriate to apply statutory fund discipline to all life policies but not on other policies.
- 5.3.4 We note that currently most life policies written in New Zealand are pure risk policies, particularly YRT policies. Policyholders contract for a benefit if they die (or, in some cases, suffer some serious illness). However, they do not build up savings as part of their policy in the way that statutory funds envisage.
- 5.3.5 We also note that some general insurance policies may require setting aside reserves for a considerable period of time (either because liability can emerge over a long period, for example in professional indemnity policies, or because claims may take a long-time to settle, for example where they fund construction).

⁴⁵ Section 82 of IPISA.

Proposals

- 5.3.6 We **propose** there should no longer be a requirement to hold statutory funds in relation to YRT policies (Or, more precisely, for policies that have no surrender value other than the 'underwriting asset' discussed in the next section).
- 5.3.7 However, since this will reduce policyholder protection for some policyholders, we are also **proposing** some compensatory enhancements to policyholder protection detailed in the next subsection.
- 5.3.8 Although there is a theoretical case for extending statutory fund discipline to a small set of general insurance situations (as discussed in C2), we think the complexity and administrative burden involved outweighs any benefits, so do not **propose** to extend statutory funds to any general insurance lines. We also do not **propose** extending statutory fund requirements to health insurance.

Reasoning, stakeholder feedback and additional information

- 5.3.9 The decision here is based on matching the kinds of protection statutory funds offer to the risks underlying particular types of insurance, bearing in mind the costs of the statutory fund regime.
- 5.3.10 This decision should be seen in the context of some offsetting enhancements to policyholder protection across all classes of insurance discussed in the next section.

5.4 Enhanced policyholder security

Problem definition

- 5.4.1 There is some existing provision for recognition of policyholder interests in IPSA.⁴⁶ We are considering proposing some additional policyholder security across the IPSA regime, for two main reasons:
- The proposal to remove YRT policies from the statutory fund regime (as discussed in the previous section) would otherwise somewhat weaken the protection provided to those policyholders under IPSA, so we are considering mitigating the impact of this change;
 - We are considering narrowing the existing differences between the protection offered to life policyholders through the statutory fund regime and the protection offered to general insurance policyholders.
- 5.4.2 As we explained in C2, IPSA already offers a wide range of measures to improve policyholder security across all classes of insurance.
- 5.4.3 The statutory fund regime then provides additional protection to life insurance policyholders by:
- restricting financial flows into and out of the fund to ring-fence assets;

⁴⁶ For example, we are required to consider (amongst other principles) the importance of dealing with a distressed insurer in a manner that aims to adequately protect the interests of policyholders and the public interest (section 4 of IPSA). We are also required to have regard to policyholder interests when considering whether to approve a proposed assignment of an insurer's liabilities in a licence cancellation scenario (section 32 of IPSA) and deciding whether to approve a transfer or amalgamation under IPSA (section 48 of IPSA).

- providing that, if an insurer becomes insolvent, policyholders have the first claim on statutory fund assets ahead of other creditors (policyholder preference in insolvency);
- imposing duties on an insurer's directors to put policyholder interests first in the administration of the fund;
- making directors personally liable to make good losses to statutory funds in some circumstances where statutory fund rules have been breached.

5.4.4 Most of the proposals in this sub-section involve extending similar benefits in a weaker form across all policyholders.

Proposals

5.4.5 We are considering **proposing** the introduction of the following new policyholder protections (each of which is explained in more detail below):

- protection of the 'underwriting asset' involved in YRT and health policies;
- policyholder preference in insolvency;
- tighter restrictions on investments in related parties for all insurers;
- an ability for the court to order that some of a civil pecuniary penalty imposed on key officers should be paid to policyholders;
- a requirement for policyholders' contractual rights to be documented where they are changed as a result of a section 53 transfer.

Protecting the 'underwriting asset'

5.4.6 Many life and health insurance products are for a one-year term but also involve a long-term element. The long-term element is the right to renew a policy on the same terms even if the policyholder has acquired health conditions during the term of the policy.

5.4.7 This right has an economic value to the policyholder. If a policyholder were to shift to a different insurance provider, they are likely to face either higher premiums or additional exclusions due to their new health status. We refer to the economic value of the arrangement as a policyholders' 'underwriting asset'.

5.4.8 We think it would be helpful to include a clear statement in IPSA that the underwriting asset should be considered as a liability owed to policyholders by the insurer when considering policyholder rights under any restructuring proposals (including resolution or liquidation).

5.4.9 We are not proposing any change to the current situation in which policyholders lose the entitlement to the 'underwriting asset' if *they* choose to terminate their policy or move to another provider, since this is an important part of the existing business model for these types of policy (including in controlling lapse rates).

Policyholder preference in insolvency

5.4.10 We are considering proposing that policyholders' claims in insolvency⁴⁷ should have preference over the claims of other unsecured creditors (but not ahead of 'preferential

⁴⁷ Including non-New Zealand policyholders.

claims⁴⁸). This means that, if an insurer fails and does not have sufficient assets to pay all its creditors, policyholders will receive payment before other general creditors do and therefore have a higher chance of receiving everything they are owed.

- 5.4.11 This change would disadvantage other general creditors relative to policyholders (i.e. it is a redistribution of resources; policyholders' gain is creditors' loss).
- 5.4.12 It is relatively common in other jurisdictions to provide policyholders with preference in insolvency and this preference over other creditors is usually justified on two grounds.⁴⁹ Firstly, doing so reflects the particular importance of insurance to individuals' financial security (i.e. policyholders may be less able to bear losses than other creditors). Secondly, it may be more difficult for policyholders to exercise market discipline over their insurers than it is for customers of some other businesses. That is particularly clear in the case of life and health insurance policyholders, because of the risk they will lose what we have referred to as the 'underwriting asset'.
- 5.4.13 Policyholder preference can also facilitate resolution in some circumstances (again, with policyholders gaining at the expense of creditors). Under current arrangements, any losses in insolvency must be shared by policyholders and other creditors on an equal basis. Where the value of an insurer's capital is uncertain and close to zero, a statutory manager or liquidator may not be able to transfer a book of business to another insurer if they do not know whether policyholders should be getting a 'haircut'. If preference is in place, though, it may be clearer that policyholders will not be exposed to loss, making swift transfers of books of business possible so that policyholders' cover can be maintained.
- 5.4.14 Broadly similar arguments might apply to deposit takers, but it was decided not to include depositor preference in the DTA.
- 5.4.15 We consider there are three broad reasons why the decision should be different for insurance. We discuss each in turn.

Existing coverage and changes to the statutory fund regime

- 5.4.16 Firstly, the statutory fund regime currently offers life insurance policyholders preferential access to statutory fund assets in insolvency. We are proposing to remove that protection from YRT policyholders, yet their ability to exercise market discipline may be limited by the difficulty of acquiring cover on similar terms from another provider where they have developed a health condition. It might therefore be reasonable to 'compensate' them by providing them with policyholder preference.
- 5.4.17 When we considered statutory fund coverage, we noted that health insurance creates similar issues in terms of market discipline. If it is logical to extend policyholder preference to YRT policyholders, it seems unreasonable not to extend the same preference to health insurance policyholders.
- 5.4.18 This issue of long-term commitment does not apply for most general insurance policyholders but the broad considerations that underpin policyholder preference in other jurisdictions do still apply.

⁴⁸ Preferential claims are set out in Schedule 7 to the Companies Act 1993. They include fees owed to liquidators and administrators, employees' salaries and taxes that are owed.

⁴⁹ The IMF FSAP from 2017 invited us to consider policyholder preference in insolvency alongside considering a policyholder guarantee scheme.

Deposit insurance but no policyholder guarantee scheme

5.4.19 While the DTA will not introduce depositor preference in insolvency, it will introduce a depositor compensation scheme. We do not propose to introduce a policyholder guarantee scheme for insurance, though. The argument for consumer protection through preference in insolvency may therefore be stronger in the case of insurance.

Different liability structures – insurers have less short-term debt

5.4.20 Finally, banks usually have considerably more short-term debt than insurers, so other creditors are a more important part of banks' balance sheets.

5.4.21 Policyholder preference for insurers will generally have less distributional impact (i.e. it will distribute fewer resources from other general creditors to policyholders) and will result in less impact on insurers' cost of borrowing than would be the case for deposit takers.

5.4.22 By the same token, though, policyholder preference will provide fewer benefits to policyholders as there are fewer creditors to bear losses.

Summary

5.4.23 Overall, our preliminary recommendation is that policyholder preference in insolvency is extended to all policyholders, however would value further input from stakeholders on this issue.

Investments in related parties

5.4.24 The statutory fund regime requires a life insurer to give priority to the interests of life policyholders in making investments for the referable statutory fund.⁵⁰ This includes giving priority to the interests of life policyholders ahead of the interests of shareholders or members, in event of conflict between those interests. The restriction is put in place because statutory funds envisage investments being made 'on behalf of policyholders'.

5.4.25 A requirement for insurers to put policyholder interests ahead of those of shareholders in relation to all of an insurer's investment decisions would plainly not be appropriate.

5.4.26 However, for several reasons, we are proposing introducing a standard that would create rules on connected exposures. A connected exposure standard would limit investments in related parties and ensure that those investments take place on market terms. In this context, the aim of these restrictions would be to help ensure that investments are made in the interests of the legal entity that is backing liabilities to policyholders (i.e. the insurer) rather than the interests of related parties. (We discuss other benefits of this standard in the section on subsidiaries and the section on governance).

Recourse to directors following a breach of statutory duty

5.4.27 Currently, directors have personal liability to replace statutory fund assets in some circumstances where their failure to comply with statutory fund rules has led to a loss.⁵¹

5.4.28 It would not be appropriate to impose unlimited liabilities on directors for losses from an insurer's assets as a whole.

⁵⁰ Section 87 of IPSA.

⁵¹ Section 105 of IPSA.

5.4.29 However, we propose giving the courts the power to consider whether it was appropriate for all or some proportion of civil pecuniary penalties imposed due to a breach of due diligence duty (by a director or appointed actuary) to be paid to policyholders. What we have in mind is a situation in which a civil pecuniary penalty was imposed due to a breach of duty that resulted in loss to policyholders. The courts could then consider whether it was equitable for the penalty to be paid to policyholders as a group.

5.4.30 This would mean that policyholders received some compensation where directors' breach of duties had led to a loss although, given the limits on civil pecuniary penalties (see section 9 below), it would not provide the same level of recourse as is currently available under the statutory fund regime.

5.4.31 It would not alter directors' potential liability but would alter who penalties were paid to.

Requirement for policyholders' rights to be documented under section 53 novation rules

5.4.32 Section 53 of IPSA is designed to facilitate the transfer of policies between insurers, once the Reserve Bank has approved a transfer of business under section 44 of IPSA. The provision makes it clear that there is no need for policyholders to individually consent to their transfer of the policies to a new insurer (known as novation). These contracts will automatically be effective between those policyholders and the new insurer.

5.4.33 Section 53(2), though, says that the two insurers can also agree (with Reserve Bank approval) to allocate liabilities in respect of the transferring contracts. We propose amending this provision to make sure that the Reserve Bank takes into account policyholder interests in deciding whether to approve an apportionment and to ensure that policyholders are entitled to written confirmation of the impact of any allocation so that they have a clear legal record of what has taken place.

6 Governance, risk management and relevant officers

6.1 Overview

6.1.1 A significant part of C4 was devoted to governance, risk management, and oversight and accountability for relevant officers.

6.1.2 The consultation proposed:

- Using standards to clarify our expectations around governance and risk management;
- Some changes to the scope and operation of the fit and proper regime;
- Directors' duties;
- Appointed actuaries' duties.

6.2 New standards for governance, risk management and related issues

Problem definition

6.2.1 IPSA provides for some oversight over governance and risk management.⁵² However, the detail of requirements is largely set out in non-binding guidance issued by the Reserve Bank. The 2017 IMF FSAP and the Trowbridge-Scholten report both recommended using standards to set more detailed and clearly enforceable requirements in these areas.

Proposals

6.2.2 We **propose** empowering standards that allow the Reserve Bank to introduce rules covering:

- Corporate governance;
- Risk management;
- ICAAP/ORSA (to the extent those rules are necessary on top of what is already in the solvency standard);
- Outsourcing policy;
- Connected / related party exposures.

6.2.3 The above headings indicate the scope and coverage of the standards. The detailed content would be assessed and consulted on at a later stage, if progressed. Overall, we are intending to propose that the legislation gives us sufficient discretion to be able to implement appropriate governance and risk management rules in response to emergent risks (for example in the face of rising climate or cyber risk).

Reasoning, stakeholder feedback and additional information

6.2.4 Stakeholders were broadly comfortable with our proposal to empower new standards under IPSA that would allow us to set rules for governance and risk management. Feedback was mainly around the likely content of the standards.

6.2.5 We agree that it will be important to consider the resources available for developing and implementing standards (at both insurers and the Reserve Bank) and to ensure that new requirements are applied in a way that considers the variety in the size and business models of different insurers across a diverse sector.

6.2.6 We are also aware that we will need to coordinate with the FMA when drafting and implementing these standards to ensure they do not conflict with FMA conduct requirements and to minimise reporting burdens where possible.

6.2.7 Some insurers operating as branches asked whether we would exempt branches from any new requirements on the basis that, their governance and risk management were already supervised by home regulators.

6.2.8 The structure of branches means that not all requirements we might impose on a New Zealand subsidiary will be appropriate in a branch context. However, we do still have a

⁵² See C4 for a discussion of the arrangements in greater detail.

responsibility to promote the soundness of the insurance sector in New Zealand. We are therefore likely to impose some requirements on branches (though some principles-based requirements may well echo those of their home regulator and therefore not imply increased compliance costs). We will need to work through what is appropriate in the context of each standard, but branches should expect reasonable oversight of branch governance and risk management, whilst minimising unnecessary compliance burdens.

6.3 Fit and proper regime

Problem definition

- 6.3.1 Under IPSA, licensed insurers are required to develop and implement a fit and proper policy,⁵³ and to provide the Reserve Bank with fit and proper certificates for directors and 'relevant officers' (the chief executive officer, chief financial officer and the appointed actuary).⁵⁴
- 6.3.2 In C4, we invited consideration of expanding the scope of the fit and proper requirements to a wider range of personnel. We also discussed moving from post-appointment notification to RBNZ pre-approval of appointments.
- 6.3.3 Finally, we discussed a requirement for insurers to notify us of any information they receive that could reasonably cast doubt on a relevant officer's fitness and propriety.

Proposals

- 6.3.4 We **propose** extending the definition of 'relevant officers' to include the chief risk officer but not any other senior managers. We consider 'chief risk officer' could be defined as the person occupying the position of chief risk officer by whatever name called.⁵⁵ This is on the basis that the position of chief risk officer is well-understood; otherwise the definition could refer to the person with overall responsibility for oversight of risk management for the entity.
- 6.3.5 We **propose** introducing a requirement for licensed insurers to seek approval of the appointment of relevant officers from the Reserve Bank *before* appointments are made. The Reserve Bank would be required to decide whether to approve within 20 days of receiving all required information.
- 6.3.6 We **propose** introducing a requirement for licensed insurers to notify the Reserve Bank if they obtain information that could reasonably lead them to form the opinion that a relevant officer is not a fit and proper person to hold their position.

Reasoning, stakeholder feedback and additional information

- 6.3.7 Stakeholders were generally not in favour of expanding the scope of fit and proper requirements. They were concerned that pre-approval would create practical difficulties and might imply that the Reserve Bank intended to become far more involved in candidate selection in ways that were inappropriate. Some concerns were raised about clarity on the types of information insurers might be expected to provide where new issues came to light

⁵³ Section 34 of IPSA.

⁵⁴ Sections 18 and 37 of IPSA. The Reserve Bank may exempt overseas insurers from the requirement to provide fit and proper certificates for new directors under, and in accordance, with section 38 of IPSA.

⁵⁵ Similar to how 'chief executive officer' and 'chief financial officer' are defined under IPSA.

(the third proposal) and how this might interact with other legal duties the insurer might owe its employees.

- 6.3.8 The intent of replacing post-appointment notification with pre-appointment approval is not to promote inappropriate RBNZ involvement in an insurer's recruitment practices. RBNZ approval would be based on an assessment of whether the candidate met minimum *fit and proper requirements*, not on any broader evaluation of their merit or suitability to the insurer's business. The reason we are recommending the change is that there have been a small number of cases where problematic appointments have been made. Dealing with this type of situation before an appointment is finalised has significant benefits for all parties involved.
- 6.3.9 We do not consider pre-approval requirements for relevant officers will create major problems for recruitment given suitable communication with candidates. In other jurisdictions with similar requirements, we are aware of appointments being made but conditional on regulatory approval.
- 6.3.10 We agree with stakeholders that it is important to keep the fit and proper regime manageable by not unduly extending its coverage. As prudential regulator, our interest is in senior officers or employees that are particularly central to ensuring compliance with our prudential requirements. We propose that the only addition to the current list of 'relevant officers' should be a chief risk officer since that role is central to insurers' compliance and risk management activity.
- 6.3.11 Some stakeholders suggested that the requirement to notify us where insurers became aware of information that cast doubt on an officer's fitness or propriety might conflict with confidentiality requirements under employment law. A carefully drafted statutory obligation should be able to avoid significant problems in this situation by making it clear the reporting obligations under the Reserve Bank override any constraints created by employment legislation. We note that this notification requirement is specifically required under IAIS ICP 7.

6.4 Directors' duties

Previous consultation

- 6.4.1 In C4, we proposed introducing a statutory duty for directors to exercise due diligence to ensure that a licensed insurer complies with its prudential obligations in connection with IPSA. Due diligence would include taking reasonable steps to ensure that the insurer requires its employees and agents to follow appropriate procedures, assesses the procedures in place, and promptly remedies any deficits discovered.
- 6.4.2 This duty is closely modelled on one set out in the DTA.
- 6.4.3 In response to the consultation, insurers argued that directors already have a wide range of duties and this new duty was unnecessary. Some stakeholders also asked how this regime would apply to branches.

Proposals

- 6.4.4 We **propose** introducing a new duty for directors of New Zealand-incorporated licensed insurers, to exercise due diligence to ensure that the insurer complies with its prudential

obligations under IPSA and its regulations, standards, conditions of licence and directions. A breach of the duty may be sanctioned with a civil pecuniary penalty (see section 9.3 of this paper for proposed levels of civil penalties).

- 6.4.5 We **propose** imposing the same duty on the chief executive officer of an overseas licensed insurer (i.e. New Zealand branches).
- 6.4.6 We do not **propose** introducing any additional specific requirements for directors to consider policyholder interests.

Reasoning, stakeholder feedback and additional detail

- 6.4.7 We acknowledge that directors have a range of pre-existing duties. However, our interest here is in ensuring that directors have appropriate incentives and public accountability *for their role in the oversight of an insurer's compliance with our prudential requirements*.
- 6.4.8 As noted in C4, we are aware that directors already have some accountability under IPSA. In particular, directors have potential criminal liability where an insurer is convicted of an offence under IPSA if it can be proven that the relevant act took place with their authority, permission or consent; or that they knew (or could reasonably be expected to have known) that the offence was committed and failed to take reasonable steps to prevent it.⁵⁶
- 6.4.9 However, existing accountabilities do not include a positive duty to ensure that the insurer complies with its prudential obligations. There are also problems with a regime that only provides criminal penalties, since it may be difficult to impose proportionate penalties for breaches that are significant but do not meet the level that would require criminal penalties. We think a due diligence duty to ensure compliance with prudential requirements is not unreasonable given directors' role in overseeing an insurer's compliance. We note that the DTA imposes a similar duty on directors of deposit takers.⁵⁷
- 6.4.10 We considered how similar incentives could be imposed for the governance of branches operating in New Zealand. We are proposing following the DTA in imposing an equivalent duty on the chief executive officer of a New Zealand branch.
- 6.4.11 In C4, we discussed whether it was appropriate to introduce some form of director duty to policyholders but have concluded that, in keeping with practice in other jurisdictions, a duty to comply with prudential obligations is sufficient protection for policyholders.

6.5 Actuarial advice and the appointed actuary

Problem definition

- 6.5.1 As part of C4, we discussed two changes to the governance of actuarial advice.
- 6.5.2 We discussed using standards to set out clearer expectations for the responsibilities of the appointed actuary and to require insurers to produce their own actuarial advice framework.
- 6.5.3 We also discussed imposing a statutory due diligence duty on actuaries.

⁵⁶ Section 216 of IPSA.

⁵⁷ Subpart 3 of Part 4 of DTA

Proposals

6.5.4 We **propose** that IPSA empower an actuarial advice standard which would:

1. require licensed insurers to develop and document their own actuarial advice framework, setting out when actuarial advice was required for internal decisions;
2. set out clearly the appointed actuary's duties under IPSA in a single document (potentially cross-referring to detail contained in other standards).

6.5.5 We **propose** that IPSA should impose a duty on appointed actuaries to exercise due diligence in the performance of the duties required of them under the actuarial advice standard.

Reasoning, stakeholder feedback and additional information

6.5.6 Stakeholders were generally positive about the idea of an actuarial advice framework.

6.5.7 Stakeholders were less convinced of the need for an appointed actuary standard or an actuarial due diligence duty, and the New Zealand Society of Actuaries expressed significant concerns.

6.5.8 Our key concern here is that a variety of different parties rely on actuarial advice (the insurer's board, markets, and the Reserve Bank). Meanwhile actuaries' primary legal responsibilities are to the insurer, though they are also self-regulated by professional standards.

6.5.9 The purpose of standards and an actuarial due diligence obligation would be to ensure that actuaries' outward-facing duties are clearly articulated through standards and that actuaries are accountable to the public for exercising those duties via the proposed statutory due diligence duty. Clear legal accountability may assist actuaries in having robust, but potentially 'difficult', conversations with insurer boards where doing so is necessary.

6.5.10 Although the statutory duty would create new liability for actuaries, we are proposing that liability would be capped at a maximum of \$500,000 (see 9.3 below, which sets out levels for civil pecuniary penalties), which is considerably less than the broader contractual liability many actuaries are likely to be exposed to in the usual course of their work.

6.5.11 While we are not aware of other jurisdictions imposing a duty in precisely this form, actuaries in other jurisdictions do have forms of legal accountability that are at least as onerous. For example, the Australian legislation explicitly requires actuaries to comply with prudential standards⁵⁸ and enables APRA to apply to the court for an order to disqualify actuaries from acting for a general insurer, class of general insurers or any general insurer for failure to adequately and properly perform their prudentially defined functions.⁵⁹

⁵⁸ Section 41 of the Insurance Act 1973 (Aus).

⁵⁹ Section 44 of the Insurance Act 1973 (Aus). Compare this with section 39 of IPSA. Under section 39, the Reserve Bank does have powers to remove a director or relevant officer, but only where it has reasonable grounds to believe that the director or relevant person is not a fit and proper person to hold the relevant position (after having regard to the Fit and Proper Standard).

7 Disclosure and reporting requirements

7.1 Overview

7.1.1 In C2, we discussed making some minor changes to policyholder-facing disclosure (ratings and solvency information). In C4, we discussed empowering a data and disclosure standard that could be used to consolidate our requirements for data and reporting as far as possible and could also facilitate additional disclosure in the future if required.

7.2 Ratings and solvency disclosure

Problem definition

7.2.1 It is clear that IPSA is not intended to be a zero-failure regime.⁶⁰ The principles of IPSA make it clear that members of the public are responsible for their own decisions relating to insurance, while noting the desirability of ensuring that the public is provided adequate information to enable members of the public to make those decisions.⁶¹

7.2.2 In practice, though, insurer balance sheets are highly complex and there are transactions costs for consumers in attempting to evaluate financial strength based on public information. The principle of policyholder responsibility needs to be interpreted realistically and in the context of the broader regulatory framework.

7.2.3 Currently, IPSA requires insurers to disclose financial strength ratings,⁶² some summary solvency information⁶³, and information on any overseas policyholder preference⁶⁴ prominently on their websites and in some communications with policyholders.

7.2.4 In C2, we discussed a range of possible changes to the current requirements to try to make the information provided more accessible to members of the public.

Proposals

7.2.5 We **propose** expanding the requirements on disclosing overseas policyholder preference so that disclosure requirements are not confined to preference in insolvency but also cover any other situation in which overseas policyholders may be given preference (for example in allocating bonuses to relevant life policies).⁶⁵

7.2.6 We do not propose other changes to these arrangements as part of the IPSA Review but will consider future options for improving public and market-facing disclosure facilitated by the new data and disclosure standard discussed in section 7.3 of this paper.

Reasoning, stakeholder feedback and additional information

7.2.7 We considered a range of technical changes from altering solvency terminology to changing the arrangements for rating agencies.

⁶⁰ Section 4 of IPSA.

⁶¹ Section 4 of IPSA.

⁶² Section 60 and 64 of IPSA.

⁶³ Paragraphs 144-147 of the Interim Solvency Standard.

⁶⁴ Sections 61 and 73 of IPSA.

⁶⁵ Sections 61 and 73 of IPSA.

- 7.2.8 Overall, we agree with stakeholders' view that these changes would only improve policyholder understanding at the margins and might risk creating confusion amongst those familiar with current arrangements.
- 7.2.9 We think that it is reasonable to expect policyholders to broadly consider the relationship between premium and financial stability, using some high-level metrics such as ratings. However, we do not think there is much value in providing more complex data to potential policyholders, given the difficulties of evaluating insurer balance sheets.
- 7.2.10 We also note that policyholders draw on other information in making their insurance decisions such as brand perception that are, in turn, indirectly influenced by other market commentators. Providing better information to markets may, therefore, indirectly help policyholders.
- 7.2.11 We agree with stakeholders that the most effective way to improve market discipline would be through better financial education and through enabling comparisons between insurers on a single website. There may also be benefit in disclosing further market-oriented information that can assist investors, consumers, brokers and commentators assess insurer soundness, providing indirect information to policyholders. In the future, we could develop some form of insurer 'dashboard' along the lines of the Bank Financial Strength Dashboard⁶⁶ but this is not a current priority due to resource constraints.

7.3 A data and disclosure standard

Problem definition

- 7.3.1 IPSA provides broad powers for the Reserve Bank to gather information from insurers for prudential supervision purposes, via notice⁶⁷ or condition of licence. Such information is subject to statutory confidentiality provisions,⁶⁸ which permit the Reserve Bank to disclose and publish the information in limited prescribed circumstances.
- 7.3.2 The current drafting and operation of the information-gathering provisions creates significant administrative burdens. Standard reporting is obtained by way of issue of notice to individual insurers under section 121 of IPSA. This means that, when standard reporting requirements change, these changes must be applied individually to each insurer (rather than by way of, say, class notice or standard).
- 7.3.3 On the question of publication, if, for example, we were to introduce a dashboard, there are some standard financial metrics and other information that we might require insurers to publish on a regular basis. While the current confidentiality provisions would permit publication in some limited circumstances, we believe it would be useful for both industry and the public to have a clear, standardised statement of what information should, and will, be published.

Proposals

- 7.3.4 We **propose** that IPSA empower a data and disclosure standard that would be used to require insurers to provide information to the Reserve Bank or to the public, in pursuit of

⁶⁶ The Dashboard can be found here: <https://bankdashboard.rbnz.govt.nz/summary>.

⁶⁷ Sections 121 to 126 of IPSA.

⁶⁸ Sections 135 to 137 of IPSA.

our purposes and functions under IPSA. This standard would be used to set out our regular data gathering and disclosure requirements.

- 7.3.5 There would be no change to the Reserve Bank’s existing suite of information gathering powers (e.g., via notice, conditions of licence), so that we can continue gather idiosyncratic data (e.g., of the type we temporarily gathered during the COVID pandemic).

Reasoning, stakeholder feedback and additional information

- 7.3.6 Stakeholders were generally comfortable with this proposal. Some concerns were raised about whether it would lead to unnecessary demands for information or disclosure.
- 7.3.7 The intent of the standard would be to facilitate a simpler approach to setting out reporting requirements, and greater transparency about which information is likely to be published.

8 Supervisory powers and approval processes

8.1 Overview

- 8.1.1 This section discusses changes to supervisory powers (consulted on in C3) and processes for supervisory approval of major transactions (consulted on in C4).

8.2 Supervisory powers

- 8.2.1 As part of C3, we proposed a range of new supervisory powers. These powers would provide the Reserve Bank with a broader range of tools for verifying insurer compliance with prudential obligations, facilitating a more proactive approach to supervision that identifies issues before they become serious problems.
- 8.2.2 Stakeholder feedback was primarily about the safeguards that would be needed around such powers. The ‘reasoning and additional information’ section outlines proposed safeguards for each power (though some detail will need to await any exposure draft).

Proposals

- 8.2.3 We **propose** to introduce all the powers discussed in the earlier consultations:

- extending investigation powers (currently set out in sections 130 to 134 of IPSA) to cover entities that are not licensed insurers but which might be failing to comply with a requirement to obtain a licence or falsely holding themselves out as licensed insurers;
- wider information gathering powers – the ability to require information from any person (not just licensed insurers and other specified persons) in pursuit of our prudential purposes under the IPSA;
- an on-site inspection power;
- the ability to require an insurer’s staff to answer questions ‘on notice’ as part of an investigation (as defined in IPSA section 30);
- a breach reporting regime;
- a power to direct insurers not to renew existing insurance contracts, in addition to the existing power to direct insurers not to write new business.

Reasoning, stakeholder feedback and additional information

Investigation powers

8.2.4 Stakeholders were comfortable with the extension to investigation powers.

Information powers

8.2.5 Stakeholders had two concerns about the scope of our proposed power to request information from 'any person', in pursuit of our prudential purposes.

8.2.6 The first was a concern that the power was overly broad.

8.2.7 We note that the power is not unusual in New Zealand financial services legislation. It is very similar to the power set out in section 99 of the DTA and to the powers the FMA has under section 25 of the Financial Markets Authority Act 2011. The information-gathering power would be subject to an appropriate threshold (such as, the Reserve Bank would need to form the view that it is necessary or desirable for the purposes of performing or exercising its functions, powers, or duties under IPSA).

8.2.8 Insurers also had some concerns about the Reserve Bank obtaining inaccurate information about them from third parties and requested a requirement that insurers should be notified if any information was sought about them from third parties. This power could be used in a variety of ways, for example in gathering sector-wide data. We do not therefore think that it is appropriate to include statutory provisions requiring that insurers are notified of information sought from other parties. However, where information can be obtained from a licensed entity itself, that would always be our preferred route for data gathering. In keeping with our relationship charter principles, we would seek to discuss or confirm information with insurers where necessary.

On-site inspection powers

8.2.9 Stakeholders expressed a variety of concerns about on-site inspection powers. They were particularly concerned about the proposal for a power to conduct on-site inspections without notice. However, they were also interested in the wider safeguards that would apply to on-site inspection powers.

8.2.10 In the vast majority of cases, on-site inspections would be carried out as part of ordinary supervisory activity. They provide an opportunity for face-to-face exchange and more sustained engagement with regulated entities. They are a common mechanism in many overseas jurisdictions. Insurers would be given notice and informed about the kinds of information supervisors were interested in.

8.2.11 A power to conduct on-site inspections without notice would only be used in unusual circumstances, where the insurer was reluctant to voluntarily accept the inspection. As with the Reserve Bank's other powers, they could only be used where it was reasonable and proportionate to do so.

8.2.12 An on-site inspection power is not the same as the kind of search powers that are available with a warrant under section 132(2) of IPSA. For example, there is no power to seize documents or obtain entry by force (and, because the powers are more limited, the safeguards of the Search and Surveillance Act 2021 do not apply).

8.2.13 The DTA provides two important safeguards for this power: that the Reserve Bank can only carry out inspections at reasonable times and at a regulated entity's place of business. We suggest the same safeguards should apply to a power under IPSA.

Interviews 'on notice', during investigations

8.2.14 This proposal was that, as part of an investigation, the Reserve Bank should be able to give notice that staff must answer questions, including potentially after administering an affirmation or oath.

8.2.15 Stakeholders wanted reassurance that staff would have proper legal representation and that inappropriately junior staff would not be required to give interviews.

8.2.16 We do not propose to give reassurance as to who would be questioned, since we would want to speak to the most appropriate person to provide the information sought. However, the expectation is that there would be formal interviews, with advanced notice, with appropriate safeguards and a full opportunity for legal representation. Interviewees' rights, including the right to legal representation, would be protected by the general law and the Reserve Bank would need to ensure that interviewees were aware of those rights.

8.2.17 We also note that interviews would only be possible in the context of a formal investigation, which is limited to the situations set out in section 130 of IPSA.

Breach reporting regime

8.2.18 A breach reporting regime would involve introducing:

- an explicit requirement for insurers to monitor their compliance with prudential regulation; and
- a requirement to notify the Reserve Bank where an insurer believes it has or is likely to breach a prudential obligation in a material respect.

8.2.19 Stakeholders were concerned to ensure that materiality was clearly defined and defined in a way that would keep the process manageable. We agree with this feedback and would develop and publish guidance if any amended legislation is enacted.

Direction not to renew existing policies

8.2.20 IPSA contains a power for the Reserve Bank to direct insurers to cease entering into any new contracts of insurance.⁶⁹ Currently, however, IPSA specifically prevents the Reserve Bank from requiring a 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.⁷⁰

8.2.21 The Trowbridge report recommended that we should have the power to prevent insurers from renewing existing contracts. We consulted on this issue as part of C3.

8.2.22 When issuing such a direction, it would be important to consider whether it would be difficult for some life and health insurance policyholders to obtain replacement cover if an

⁶⁹ Section 144(1)(b) of IPSA.

⁷⁰ Section 144(2) of IPSA.

insurer was directed not to renew their policies. Set against that, is the risk of having policies renewed with an insurer in significant financial distress.

8.2.23 In C3, we discussed coupling this direction power with an explicit requirement to consider policyholder interests to ensure due attention was given to this risk. However, we note that, since the directions powers are included in the distress management section of IPSA, the Reserve Bank is already required to consider policyholder interests in these circumstances by IPSA s.4(c), which requires the Reserve Bank to take into account the importance of dealing with an insurer in financial distress or other difficulties in a manner that aims to adequately protect the interests of policyholders and the public interest. We therefore propose not to add a specific requirement to consider policyholder interests to this power.

8.3 Supervisory approval processes

Problem definition

8.3.1 Regulators have an interest in providing scrutiny of major transactions to ensure that they do not weaken insurer soundness. IPSA currently has different requirements for oversight for different transactions.

8.3.2 In C4, we proposed a consolidated process that would allow more flexibility so that supervisory scrutiny could be tailored to the risk presented by each transaction.

Proposals

8.3.3 We **propose** leaving the current arrangements for Reserve Bank approval of the restructure of a statutory fund unchanged.

8.3.4 We **propose** combining the statutory tests for other significant transactions (including obtaining significant influence,⁷¹ change of corporate form,⁷² transfers and amalgamations⁷³) into a single approvals process.

- The Reserve Bank will be able to decide whether or not to approve a transaction before the transaction takes effect and will be able to attach conditions to approval.
- When making that decision the Reserve Bank may have regard to:
 - whether or not the insurers involved in the transaction will continue to meet licensing requirements once the transaction is completed;
 - policyholder interests; and
 - any other factors the Reserve Bank considers relevant.
- The Reserve Bank will be required to make its decision within a reasonable time after receiving all necessary information.
- The restructuring approval process should apply to situations where a licensed insurer acquires business from a non-licensed insurer.

⁷¹ IPSA currently refers to a 'change of control' (section 26). As discussed later in this section, we are proposing to lower the threshold for our approval of changing levels of control and, to reflect that, we propose describing this requirement in terms of 'obtaining significant influence', which echoes the wording in the DTA.

⁷² Section 27 of IPSA.

⁷³ Section 44 of IPSA.

- The threshold for ‘obtaining significant influence’ should be set at 25% of voting rights or the ability to appoint 50% of directors.

Reasoning, stakeholder feedback and additional information

- 8.3.5 Stakeholders were generally comfortable with the overall proposal. Feedback was concerned with the detail.
- 8.3.6 It will be important for the Reserve Bank to provide enhanced guidance about how this new process will work in practice, including clearer guidance on the information we need to receive on a transaction, the criteria adopted for decision-making on different kinds of transactions, and the likely timeframe for different sorts of transactions.
- 8.3.7 As explained in C4, we do not think the current threshold for change of control (a majority of voting rights) is appropriate. The reason is that, where shareholdings are diffuse, a smaller proportion of shares can make a significant change to how a company is run. Where a change met this threshold but was unlikely to have an impact on how an insurer is governed, we would imagine that Reserve Bank approval would be a straightforward process. We note that this proposal would align IPSA with the equivalent regime for deposit takers under the DTA.
- 8.3.8 We carefully considered the appropriate time limit for Reserve Bank approval of transactions. The main difficulty here is that transactions are highly variable. Setting a time limit that was adequate for the most complex transactions would produce an unreasonably long limit for simpler transactions. We think a ‘reasonable time’ requirement imposes some constraint while recognising this difficulty.

9 Enforcement and penalties

9.1 Overview

- 9.1.1 We consulted on enforcement and penalties in C3.
- 9.1.2 Generally, stakeholders were comfortable with our broad approach, which is to provide a wider set of enforcement tools to allow a more proportional and graduated approach to enforcement. However, some stakeholders raised concerns about particular proposed tools and about safeguards to ensure that enforcement powers were used appropriately and proportionately. In section 9.2, we concentrate on addressing these concerns.
- 9.1.3 In C3, we asked a very open question about appropriate penalty levels. We are now in a position to set out our proposal for the broad structure of IPSA penalty levels, which is the main content of section 9.3. We also provide an indication of how the maximum penalties set in legislation interact with the court process for particular offences. We reserve the detailed mapping of offences to penalties for an exposure draft.

9.2 Enforcement tools

Proposals

- 9.2.1 We are **proposing** to introduce all the tools discussed in C3:
- An explicit power to require insurers to publish a written warning issued by the Reserve Bank.

- Remediation notices, which enable the Reserve Bank to specify actions an insurer must take to remedy breaches of regulatory requirements.
- Infringement notices that allow us to impose modest fines for relatively minor or unambiguous breaches (primarily failure to provide required information).
- Enforceable undertakings, which involve a binding agreement to take remedial action and (unlike remediation notices) may include the payment of compensation.
- Civil pecuniary penalties, primarily for breaches of standards.

Reasoning, stakeholder feedback and additional information

9.2.2 Stakeholders were generally comfortable with the need to provide a more graduated and proportional set of enforcement tools. However, there were some concerns about the detail. The two proposals that produced the most stakeholder feedback in C3 were written warnings and infringement notices.

Publication of written warnings

9.2.3 The Reserve Bank already has the ability to issue public written warnings. The key proposal was that the Reserve Bank should also have the power to require insurers to communicate a warning to their policyholders either via their website or through correspondence. A similar power is included in the DTA.⁷⁴

9.2.4 Stakeholders noted the seriousness of requiring publication, given the potential for reputational damage. They were also concerned that the Reserve Bank's ability to shape the wording that was made available to policyholders through insurer communications would confuse policyholders, preventing insurers from communicating issues clearly.

9.2.5 We agree that requiring publication would be a significant power. However, we consider there are situations in which it would be a necessary and appropriate one to exercise. We note that its use would be subject to the Reserve Bank's enforcement framework (discussed in more detail under 'safeguards' below).

9.2.6 We would expect it to be used in cases of suspected contravention of prudential requirements where an insurer had failed to respond adequately to earlier Reserve Bank communications. The purpose of the power would precisely be to enable the Reserve Bank to set out the content that it felt needed to be communicated publicly or to policyholders.

9.2.7 In terms of safeguards, we note that the use of this power would need to be proportional to the risk or harm involved and would be governed by the Reserve Bank's enforcement safeguards and procedures, which we discuss further in the next subsection.

Infringement notices

9.2.8 We discussed the ability to issue infringement notices, so that we could efficiently impose relatively small penalties for administrative issues such as failure to provide data or notices in a timely fashion.

⁷⁴ Subpart 7 of Part 4 of DTA.

- 9.2.9 Stakeholders questioned whether there was a problem here that needed fixing and whether penalties would provide appropriate incentives.
- 9.2.10 Unfortunately, our experience is that there are persistent problems in obtaining appropriate data and reporting from a small number of insurers. These problems can have knock-on effects for the integrity of our data regime as a whole (obtaining a robust set of data across which comparisons can be drawn, for example) and might interfere with our ability to publish further disclosure information (such as in the form of a dashboard)
- 9.2.11 While the incentive effect of penalties is an empirical question that is hard to gauge in advance, we think penalties would assist in sending a clear message that this behaviour is problematic and will be dealt with. Often insurers would be required to inform their board that penalties had been issued and this should provide strong incentives to the relevant departments.
- 9.2.12 We envisage infringement notices being used for minor issues to do with the timeliness of notification to the Reserve Bank but will need to work out the details as part of the legislative drafting process, with input from the Ministry of Justice and the Parliamentary Counsel Office.

Safeguards

- 9.2.13 Stakeholders expressed some concerns around ensuring that any new powers were used reasonably and proportionately. Some of these concerns are best addressed at a later stage, based on the wording of an exposure draft.
- 9.2.14 However, it is worth noting the general safeguards that surround the use of enforcement powers. Any use of statutory powers is subject to general principles of administrative law, which require us to act reasonably and proportionately. Procedural requirements and principles of natural justice apply. Additionally, the Reserve Bank has recently developed and published an enforcement framework which sets out how it will use investigation and enforcement powers.
- 9.2.15 Our enforcement approach is guided by three enforcement principles; it is risk-based, proportionate and transparent. When deciding on particular enforcement action in response to particular non-compliance, we will be guided by four criteria: seriousness of conduct, responsiveness, public trust and confidence and efficacy. Further details can be found on the [enforcement page](#) of the Reserve Bank website.⁷⁵

9.3 Penalty levels

- 9.3.1 As part of C3, we invited stakeholders to comment on appropriate penalty levels for the legislation.

Maximum penalties and the court process

- 9.3.2 Stakeholders were primarily concerned to argue that penalty levels were less important than ensuring that any specific penalty was appropriate to the relevant conduct in the particular case.

⁷⁵ The Enforcement page can be found here: <https://www.rbnz.govt.nz/regulation-and-supervision/cross-sector-oversight/enforcement>.

9.3.3 We remind stakeholders that any penalty would be specified in terms of a *maximum* penalty. It is then up to the courts to decide how these penalties should be applied to particular offences based on the offence and the circumstances. It is unusual for courts to apply the full maximum penalty for an offence.

9.3.4 For criminal offences, there is an extensive body of sentencing law to guide the courts, including the Sentencing Act 2002. The courts will take account of factors such as the gravity of the offending, the culpability of the offender, consistency with other offences of the same type, and the impact of offending, and the circumstances of the offender.

9.3.5 For civil penalties, generally there is less legal precedent and it is more common for legislation to include guidance for the courts in setting penalties. We will consult with the Ministry of Justice on specific provisions for IPSA, but they are likely to be broadly similar to those contained in the DTA.

Proposed penalty levels

9.3.6 In terms of maximum penalty levels, we propose IPSA penalties should be set at levels that sit between those in the FMI Act and those in the DTA. We summarise the rationale for this in Table 9.3.1.

Table 9.3.1: rationale for setting IPSA penalties ‘between’ the regimes for FMIs and deposit takers

	FMI	Deposit taker	Insurer
Potential damage / financial impact	+ Smaller balance sheet, very large volumes of trades, systemic disruption	+++ Very large balance sheet, large volumes, large systemic impact (recession / fire sale)	++ Large balance sheet, smaller transaction volume, less likely systemic disruption
Capital resources (ability to pay)	+ Relatively low	+++ Higher	++ Medium
Potential to gain by offending	+ Very high through fraud but probably dealt with by the Serious Fraud Office (SFO). Lower for prudential breaches	+++ Very high through fraud (but probably SFO). Quite high in the form of attempts to maintain share value etc.	++ Very high through fraud, but probably dealt with by SFO. High through conduct breaches but dealt with by FMA. Moderate for prudential breaches.
Potential gravity in terms of breach of trust	+ General market trust	++ General market trust with some sort of fiduciary relationship to deposit holders	+++ Stronger fiduciary relationship with policyholders, especially for savings products

9.3.7 That calibration informs our proposal for increasing IPSA criminal penalties and introducing civil penalties, as set out in Tables 9.3.2 (criminal) and 9.3.3 (civil).

Table 9.3.2: Proposed IPSA penalties, in comparison to our other legislation

	Existing IPSA	DTA	FMI	IPSA + '40% inflation'	Proposed new IPSA penalties
Maximum fine for business	\$1m (some)	\$5m	\$2m	\$1.4m	\$2.5m
	\$500k (most)	\$2.5m	\$1m	\$700k	\$1.5m
	\$100k (some)	\$500k	\$500k \$200k	\$140k	\$250k
Maximum fines for individuals	\$200,000 (most)	\$500k	\$200k	\$280k	\$300k
	\$50,000 (some)	\$100k	\$100k	\$70k	\$100k
		\$50k	\$50k \$20k		\$30k
Accompanying Maximum prison	3 months (most) none (some)	2 years 1 year (most) none	18 months 1 year 3 months none	N/A	18 months 1 year none

Table 9.3.4: proposed civil penalties, in comparison to our other legislation

	FMI Act	DTA	IPSA proposal
Maximum for an individual	\$75,000 (or for some minor breaches \$15,000)	\$1,000,000	\$500,000
Maximum for a business	\$750,000 (or for some minor breaches \$150,000)	\$5,000,000 or, if greater, 0.1% of assets size related (over \$15 million for the largest deposit takers)	\$2.5m

Proposed structure of penalties

9.3.8 We plan to maintain the general structure of IPSA criminal penalties, which are currently organised into 3 tiers but we will look at whether some of the lower tier criminal penalties should be replaced by either civil pecuniary penalties or infringement offences.

10 Distress Management

10.1 Overview

- 10.1.1 Distress management powers are a key feature of the IPSA regime.⁷⁶ As part of C3, we consulted on a range of issues around distress management for insurers.
- 10.1.2 Stakeholders were comfortable with most of our proposals. In this section, we repeat some of those proposals for completeness (inclusion of a purpose clause for distress management, changes to the trigger conditions for statutory management, and provisions to prevent impediments to resolution from creditor actions).
- 10.1.3 The question of the governance of statutory management / resolution and the distribution of powers between the Reserve Bank and statutory manager / resolution manager need further analytical work and we will reserve this issue for any exposure draft, bearing in mind the stakeholder feedback we received on this issue as part of C3.
- 10.1.4 We provide a fuller discussion of the possibility of resolution planning for insurers, which prompted significant debate in submissions.

10.2 Purpose statement for distress management

Problem definition

- 10.2.1 Distress management provisions provide authorities with considerable discretion to exercise important powers and make significant decisions. A purpose provision can provide useful guidance to the Reserve Bank for the exercise of the relevant powers and can promote clarity and accountability externally.
- 10.2.2 IPSA does not currently have such a provision although one of the principles of IPSA is that the Reserve Bank must have regard to:⁷⁷
- '(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'.
- 10.2.3 In C3, we discussed whether it would be helpful to include a purpose provision for the distress management section of IPSA.

Proposals

- 10.2.4 We **propose** introducing a purpose provision applicable to the distress management regime, generally along the following lines:
1. To enable a licensed insurer in distress to be dealt with in an orderly manner.

⁷⁶ Refer Part 4 of IPSA.

⁷⁷ Section 4 of IPSA.

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.

10.2.5 We **propose** that 'costs' in paragraph five should include:

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

Reasoning

10.2.6 Most stakeholders were supportive of including a purpose provision in this form so we have not altered our proposals from those set out in C3.

10.3 Statutory management

Problem definition

10.3.1 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 Banking (Prudential Supervision) Act 1989 contains a standalone statutory management regime but with broadly similar features to CIMA.

10.3.2 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.

10.3.3 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.

10.3.4 As part of C3, we reviewed 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.

10.3.5 Our proposals here echo those in C3.

10.3.6 However, as part of C3, we also discussed how the governance of statutory management should operate. We discussed the appropriate balance of powers between the Reserve Bank and the statutory manager, noting the need to consider a balance between a public interest orientation and technical expertise in the resolution process. Stakeholder feedback revealed a strong industry preference for placing emphasis on the technical expertise of the statutory manager. We are still working on this issue so present no further proposals here, reserving the issue to an exposure draft.

Proposals

10.3.7 We **propose** that IPSA should contain two sets of provisions to supplement the moratorium that already comes into play in statutory management. Those provisions are:

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.

10.3.8 We **propose** that the trigger conditions for statutory management⁷⁸ should be slightly modified as proposed in C3, to limit some circumstances in which statutory management is not available unless the failure of an insurer would cause significant damage to the financial system or the economy of New Zealand. (We explain this proposal in more detail in the next section 'Reasoning').

10.3.9 We reserve the question of the governance of statutory management to the exposure draft stage, noting stakeholders' preference for placing appropriate reliance on a statutory manager's technical expertise.

Reasoning

The trigger for statutory management

10.3.10 Under section 173 of IPSA, 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.

10.3.11 We are proposing that the words in bold should be removed from the test. That is because 'significant damage to the financial system of the economy of New Zealand' may be too demanding a condition to deal with some possible circumstances. For example, one might imagine a post-earthquake scenario in which an insurer's failure would cause significant

⁷⁸ Section 173 of IPSA.

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.

10.3.12 The grounds for issuing a direction are contained in section 143 of IPSA. For our purposes, the most relevant grounds are failure or likely failure to maintain a solvency margin or comply with other regulatory requirements.

10.3.13 Without the systemic significance requirement in bold, the grounds for issuing directions may 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 mechanisms under the Companies Act 1993. That means that other remedies (such as recovery plans) must have been exhausted and that there are reasons for thinking that administration or liquidation would be problematic. We note that neither CIMA nor the DTA contain a similar requirement for systemic significance.

10.3.14 Stakeholders did not raise any significant objections to this proposal when we consulted on it as part of C3.

Impediments to Resolution from Creditor Actions

10.3.15 Stakeholders felt these provisions were highly technical and did not feel able to comment on them in detail. They also did not raise any objections to the idea of including these clauses.

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

10.3.17 The difficulty of designing these clauses appropriately is in striking the correct balance so that clauses provide the necessary protection in the context of resolution without making it more difficult to enter into contracts (such as derivatives contracts). The proposals here build on careful policy development in the course of preparing the FMI Act and the DTA.⁷⁹ However, before making final policy recommendations, we will carry out some further analytical work to ensure that there are not any insurance-specific issues we need to consider (such as potential interactions with reinsurance contracts). Stakeholder feedback is invited on this issue to assist with this further analysis.

10.4 Resolution planning for insurers

Problem definition

10.4.1 As part of C3, we discussed the possibility of introducing resolution planning requirements for insurers, since we are expecting to do so for at least some banks once the DTA is in full effect.

⁷⁹ See Part 7, sub-part 5 of the DTA and sections 108-126 of the FMI Act.

Proposals

10.4.2 We **propose** that IPSA should empower a standard to deal with resolution preparedness for future-proofing purposes. However, we would not expect to require resolution planning for insurers in the short-term.

Reasoning

10.4.3 Stakeholders raised some concerns about introducing resolution planning for insurers. They noted that international practice for insurance resolution is not as settled as it is for deposit takers and questioned the value added of a requirement for insurers to create resolution plans.

10.4.4 We agree that there is further work to be done in considering resolution strategies for insurers and are also not yet convinced that introducing resolution planning requirements for insurers is appropriate.

10.4.5 However, there is a lot of international research going into insurer resolution and we think that IPSA should empower the Reserve Bank to produce requirements for resolution pre-positioning so that we would be able to do so in the future if appropriate.

10.4.6 In addition to setting out requirements for resolution planning, a standard could also be used to ensure that insurers had appropriate technical preparations in place (for example, appropriate wording in particular kinds of debt instruments or contracts).

11 Other issues

11.1 Small insurer exemptions

11.1.1 The Insurance (Prudential Supervision) Regulations 2010 (**IPS Regulations**) provide certain exemptions from licensing and ongoing requirements for ‘small insurers’ (i.e. ‘specified persons’⁸⁰ with an annual gross premium income below \$1.5 million, as calculated in accordance with the IPS Regulations). Some stakeholders have asked us to consider lifting the gross premium threshold for qualifying as a ‘small insurer’.

11.1.2 The exemption provisions were introduced largely as a temporary measure to give smaller entities assistance in transitioning to the IPSA regime. Only entities carrying on insurance business in New Zealand prior to 8 September 2010 and friendly societies are eligible. As expected, only a small number of insurers remain eligible for the exemption. Generally, the complexity of insurance business and the need for a relatively large pool of policyholders in order to deliver risk diversification means that it is difficult for very small insurers to operate in a sound and sustainable fashion.

11.1.3 We are proposing not to alter existing exemptions for small insurers.

11.2 Holding out and restricted words

11.2.1 IPSA contains prohibitions against falsely holding out a New Zealand connection or using certain insurance-related words (restricted words) in a business name,⁸¹ and falsely holding out to be a licensed insurer.⁸²

⁸⁰ A ‘specified person’ means a person carrying on insurance business in New Zealand immediately prior to 8 September 2010 or a friendly society.

⁸¹ Sections 218 to 220 of IPSA.

⁸² Section 16 of IPSA.

- 11.2.2 In response to C1, stakeholders invited us to consider the scope of these provisions. Some stakeholders argued that the holding out provisions around providing financial advice in the Financial Markets Conduct Act 2013, for example, are drafted more broadly than those in IPSA. They felt that restrictions that were more broadly drafted would provide stronger protection against the risk that entities that were not licensed insurers might be providing insurance or insurance-like products.
- 11.2.3 Section 219 of IPSA prohibits the use of restricted words (relating to insurance) in business names.
- 11.2.4 Section 16 of IPSA says that it is an offence if a person who is not a licensed insurer uses any name, title, trademark, style, designation, or description that represents or implies that the person is a licensed insurer.
- 11.2.5 Stakeholders point out that the restricted words provisions in section 219 relate to business names and do not prevent businesses using these words in sales material or product descriptions. The holding out provisions in section 16 have broader effect but they prohibit holding out as a *licensed* insurer not 'an insurance business' more broadly.
- 11.2.6 The difficulty in expanding the scope of these provisions, though, is that a considerable amount of insurance business is sold through intermediaries such as insurance brokers. Those businesses need to be able to use words like 'insurance, underwriter' and the like. We do not therefore think it makes sense to expand prohibition on the use of the list of restricted words beyond the context of business names. While the holding out provisions appear to be drafted in a relatively limited way ('licensed insurer') we have not seen a practical alternative way of defining holding out that would not interfere with legitimate insurance intermediaries' ability to carry on business.
- 11.2.7 Stakeholders raised some concern that policyholders may not be clear about the distinction between intermediaries and insurance companies and the different roles each play. We think this is probably more a matter for public education or for industry to address than one for regulation, particularly as we do not have a mandate to regulate intermediary conduct.
- 11.2.8 Overall, we are unlikely to recommend changes to holding out and restricted words provisions.

11.3 Coordination with other agencies

Proposals

- 11.3.1 In C4 we consulted on whether IPSA should include statutory provisions requiring the Reserve Bank to consult the FMA:
1. Before issuing or revoking a licence under IPSA;
 2. When making decisions under the proposed statutory approval process for significant transactions discussed in section 8.3 of this consultation.
- 11.3.2 We are **proposing** that IPSA should include statutory consultation requirements in the first context (licencing) but not in the second (approval of significant transactions).

Reasoning

- 11.3.3 The Financial Markets (Conduct of Institutions) Amendment Act 2021 (**CoFI**) introduces a new conduct licensing regime for insurers. Once the new regime comes into force (expected to be early 2025), insurers will need to operate under a ‘financial institution licence’ issued under the Financial Markets Conduct Act 2013 (**FMCA**), in addition to pre-existing FMA licensing requirements and to being licensed under IPSA.
- 11.3.4 It is important that the two regulators ensure that the conduct and prudential licensing regimes work together properly. In practice, the RBNZ already consults with the FMA as a joint financial regulator and co-member of the Council of Financial Regulators.
- 11.3.5 In the licensing context, the FMCA (including the amendments to it introduced by CoFI) requires the FMA to take Reserve Bank views into account. The FMA is required to consult with the Reserve Bank before making licensing decisions under Part 6 of the FMCA.⁸³ Under these circumstances, we think a statutory requirement for the Reserve Bank to consult with the FMA before issuing or revoking a licence is appropriate.
- 11.3.6 In the context of the approvals process for significant transactions, the FMA do not have a direct power to scrutinise and approve transactions through a conduct lens. However, licensed firms are required to notify the FMA of transactions. The FMA may consider varying licence conditions or other action if a transaction creates a ‘material change of circumstances’ that affects the licensee’s capacity to provide services or means licensing criteria are no longer satisfied. The Reserve Bank and FMA would seek to consider transactions in a coordinated way. However, we think there is a risk that a formal statutory requirement to consult might slow down approval processes in some circumstances.

12 Have your say

12.1 How to submit or request further engagement

Please send submissions to ipsareview@rbnz.govt.nz by 5pm on 12 December 2023 and include ‘IPSA Review: Omnibus consultation’ in the subject line.

As explained in section 1.2, for most of this consultation, we set out proposals that draw on previous consultation and feedback. For these proposals, we are inviting stakeholders to submit any further comments they may have on the proposals. We are interested to hear if you agree or disagree with our proposals, and why.

For some issues, where the material is new or where we offer more detail than in previous consultations, we have asked specific questions of stakeholders.

To assist with making submissions, section 12.2 provides a table of all proposals and questions asked in the consultation in the order in which they appear. To assist us in collating responses, it would be helpful for submissions to refer to the paragraph and question numbers set out in the table in section 12.2.

Stakeholders should feel free to comment on as much or as little of the consultation as they wish.

⁸³ Regulation 190 of the Financial Market Conduct Regulations 2014.

If you would like to meet with us to discuss any aspect of the consultation, please contact us by emailing ipsareview@rbnz.govt.nz.

12.2 Summary of proposals and questions

Paragraph	Proposed change
Statutory purposes and principles	
2.2.9	<p>We are interested in stakeholder views on:</p> <ul style="list-style-type: none"> • whether IPSA's purposes should explicitly reference the Reserve Bank's broader purpose and financial stability objective under the RBNZ Act? • whether it should remain a purpose of IPSA to promote the maintenance of a sound and efficient sector – i.e., does the promotion of 'efficiency' remain an important and desirable legislative purpose? • whether a reference to access to insurance is needed? • whether the purposes of IPSA should refer to promoting the soundness of the insurance sector or the soundness of each insurer? • what role policyholder interests should play in IPSA's purposes and principles?
Definition of a contract of insurance	
2.3.5	We propose that the current definition of contract of insurance should not be changed significantly.
2.3.6	We propose introducing a 'declaration power' that would allow us to declare that certain kinds of contract <i>are</i> contracts of insurance (as currently defined). Note that IPSA already provides that that certain types of contracts may be declared <i>not</i> to be insurance contracts through regulation
Definition of 'carrying on insurance business in New Zealand'	
2.4.8	We propose modifying the 'carrying on insurance business in New Zealand' definition in section 8 of IPSA, to remove the requirement that a person must be liable under a contract of insurance to a New Zealand policyholder. This means that all New Zealand-incorporated insurers will need to be licensed, whether or not they issue contracts to New Zealand policyholders.
2.4.9	We propose explicitly excluding overseas-incorporated captive insurers and overseas companies that only act as reinsurers in New Zealand from the definition.
Group supervision – licensing non-operating holding companies	
2.5.9	We propose amending IPSA so that we will have the ability to require licensing for a non-operating holding company, for corporate insurance groups

Paragraph	Proposed change
-----------	-----------------

headquartered in New Zealand (whether operating only domestically or across borders).

Broadly speaking, the licensing regime is proposed to operate as follows:

- A separate licensing regime for NOHCs, similar to as the existing licensing regime for insurers but omitting those obligations which are not relevant to NOHCs. We will set out the details if and when we publish an exposure draft.
- Particular provisions for groups within standards for risk management and corporate governance. The standards would include requirements for the head of group to provide appropriate group-wide governance and risk management.
- Standards to impose requirements for the management of outsourcing and of related-party exposures (section 6.2 below) would also promote the management of intra-group risk.⁸⁴

2.5.10	We will continue to follow the international convention of relying on overseas regulators for group supervision of corporate groups headquartered overseas. For example, we rely on the Australian Prudential Regulation Authority (APRA) to supervise Australian-based insurance groups that have subsidiaries in New Zealand).
--------	--

'Overseas' insurers – branches and subsidiaries

Subsidiaries

3.2.4	We propose introducing an outsourcing standard to ensure that insurers have identified and considered the prudential and business continuity risks presented by outsourcing arrangements.
-------	---

3.2.5	We propose introducing a standard to regulate connected exposures and concentrated exposures.
-------	---

3.2.6	We are considering proposing dividend restrictions as part of the ladder of intervention approach to solvency.
-------	--

Branches

3.3.12	We propose imposing a duty on the the chief executive officer of a New Zealand branch to ensure that the insurer complies with its prudential obligations.
--------	--

3.3.13	We are considering a proposal that branches hold assets in New Zealand equivalent to the New Zealand solvency standard prudential capital requirement for their risk exposures, and that life insurance branches should hold New Zealand statutory funds, with a <i>de minimis</i> exemption for small branches. We are still considering the costs and benefits of this proposal and would particularly value stakeholder feedback (see supplementary questions below).
--------	--

⁸⁴ We note that IPSA already enables us to impose rules on related-party exposures using licence conditions. However, since our broader proposal here is to move to setting more prudential requirements through Standards, we think it would be advantageous for IPSA to empower a Standard for this purpose. (which would provide greater parliamentary oversight and closer alignment with the Reserve Bank's other legislation such as the DTA and Financial Markets Infrastructures Act 2021).

Paragraph	Proposed change
-----------	-----------------

Supplementary questions for proposal 3.3.13 :

- 1) *To what extent do you think it would be valuable to require branches of overseas general insurers to hold assets in New Zealand?*
- 2) *To what extent do you think it would be valuable to require branches of overseas life insurers to hold statutory funds in New Zealand?*
- 3) *If we were to introduce assets in New Zealand requirements, would it be appropriate to follow the Australian approach to defining what is meant by assets being "held" in New Zealand? If not, what approaches might be preferable?*
- 4) *How costly would it be for branches to hold assets in New Zealand? What are the nature of these costs?*
- 5) *Are there any legal problems that you can envisage arising from the assets holding proposals set out here?*
- 6) *If we were to introduce assets in New Zealand requirements, would it be appropriate to include an exemption for small branches? Do you think that a threshold of \$3million of gross premium would be an appropriate threshold for this exemption?*
- 7) *Do you have views on the relative merits of an assets in New Zealand requirement versus a targeted requirement to incorporate in New Zealand, or other options to address identified risks?*

3.3.14	We propose that overseas reinsurers should no longer be required to be licensed under IPSA in order to do business with NZ policy holders (and so won't be required to hold assets in New Zealand).
--------	---

3.3.15	We are not making a decision on whether or not branches over a particular size should be required to incorporate at this time. Existing powers under IPSA could be used to require incorporation for large insurers so we do not need to consider this issue as part of the IPSA review. Whether or not we think incorporation is desirable will depend in part on our completed assessment of the costs and benefits of assets in New Zealand requirements.
--------	--

Setting solvency requirements and supervisory adjustments

4.2.6	We propose that the prescribed capital requirement should apply automatically to non-exempt insurers, without the need for a specific licence condition.
-------	--

4.2.7	We propose that the Reserve Bank should have the power to impose supervisory adjustments to the way the solvency calculation is carried out.
-------	--

Solvency-related reporting

4.3.4	We propose no change to the requirement to produce section 78 reports.
-------	--

4.3.5	We will consider the best place to set out requirements for financial condition reports when producing an exposure draft.
-------	---

Paragraph Proposed change

Ladder of intervention, solvency and statutory powers

4.4.9 We propose anchoring the capital triggers for various powers closely to the MCR and PCR. We propose some powers or requirements should be unlocked when insurers breach the MCR/PCR and some should be unlocked when insurers are ‘likely to breach’ the MCR/PCR. That creates a framework with four trigger points.

4.4.10 We recommend that powers should be unlocked as set out in table 4.4. Note that we are only discussing the capital aspects of conditions for use of powers here. Some of these powers can also be triggered for other reasons. In some cases (notably statutory management), a capital-related trigger is a necessary but not sufficient condition for authorising the use of powers.

4.4.11 **Table 4.4: Solvency triggers and Reserve Bank powers**

Solvency capital trigger⁸⁵	Power enabled
Likely to breach prescribed capital requirement	Appointed actuary and auditor duty to inform Reserve Bank
Breach prescribed capital requirement	Direction powers Investigation powers Power to require a recovery plan
Likely to breach minimum capital requirement	Reserve Bank can apply to Court for voluntary administration order Reserve Bank can seek statutory management
Breach minimum capital requirement	Reserve Bank can apply to the Court for liquidation

Statutory funds and ‘pure risk’ life policies

5.3.6 We propose there should no longer be a requirement to hold statutory funds in relation to YRT policies

5.3.8 We do not propose to extend statutory funds to any general insurance lines. We also do not propose extending statutory fund requirements to health insurance.

Enhanced policyholder security

5.4.5 We are considering introducing the following new policyholder protections:

⁸⁵ Note that some of these powers can also be triggered for other reasons, we are only discussing capital-related triggers here. We propose leaving other triggers unchanged.

Paragraph	Proposed change
	<ul style="list-style-type: none"> • protection of the ‘underwriting asset’ involved in YRT and health policies; • policyholder preference in insolvency; • tighter restrictions on investments in related parties for all insurers; • an ability for the court to order that some of a civil pecuniary penalty imposed on key officers should be paid to policyholders; • a requirement for policyholders’ contractual rights to be document where they are changed as a result of a section 53 transfer.

New standards for governance, risk management and related issues

6.2.2	<p>We propose empowering standards that allow us to introduce rules covering:</p> <ul style="list-style-type: none"> • Corporate governance; • Risk management; • ICAAP/ORSA (to the extent those rules are necessary on top of what is already in the solvency standard); • Outsourcing policy; • Connected / related party exposures.
6.2.3	<p>The above headings indicate the scope and coverage of the standards. The detailed content would be assessed and consulted on at a later stage, if progressed. Overall, we are intending to propose that the legislation gives us sufficient discretion to be able to implement appropriate governance and risk management rules in response to emergent risks (for example in the face of rising climate or cyber risk).</p>

Fit and proper regime

6.3.4	<p>We propose extending the definition of ‘relevant officers’ to include the chief risk officer but not any other senior managers. We consider ‘chief risk officer’ could be defined as the person occupying the position of chief risk officer by whatever name called.⁸⁶ This is on the basis that the position of chief risk officer is well-understood; otherwise the definition could refer to the person with overall responsibility for oversight of risk management for the entity.</p>
6.3.5	<p>We propose introducing a requirement for insurers to seek approval of the appointment of relevant officers from the Reserve Bank <i>before</i> appointments are made. The Reserve Bank would be obliged to decide whether to approve within 20 days of receiving all required information.</p>
6.3.6	<p>We propose introducing a requirement for insurers to notify the Reserve Bank if they obtain information that could reasonably lead them to form the opinion that a relevant officer is not a fit and proper person to hold their position.</p>

⁸⁶ Similar to how ‘chief executive officer’ and ‘chief financial officer’ are defined under IPISA.

Paragraph	Proposed change
Directors' duties	
6.4.4	We propose introducing a new duty for directors of New Zealand-incorporated licensed insurers, to exercise due diligence to ensure that the insurer complies with its prudential obligations under IPSA and its regulations, standards, conditions of licence and directions. A breach of the duty may be sanctioned with a civil pecuniary penalty.
6.4.5	We propose imposing the same duty on the chief executive officer of an overseas licensed insurer (i.e., New Zealand branches).
6.4.6	We don't propose introducing any additional specific requirements for directors to consider policyholder interests.
Actuarial advice and the appointed actuary	
6.5.4	We propose that IPSA should empower an actuarial advice standard which would: <ol style="list-style-type: none"> 1. require insurers to develop and document their own actuarial advice framework, setting out when actuarial advice was required for internal decisions; 2. set out clearly the appointed actuary's duties under IPSA in a single document (potentially cross-referring to detail contained in other standards).
6.5.5	We propose that IPSA should impose a duty on appointed actuaries to exercise due diligence in the performance of the duties set required of them under the actuarial advice standard.
Ratings and solvency disclosure	
7.2.5	We propose expanding the requirements on disclosing overseas policyholder preference so that disclosure requirements are not confined to preference in insolvency but also cover any other situation in which overseas policyholders may be given preference (for example in allocating bonuses to relevant life policies).
7.2.6	We do not propose other changes to these arrangements as part of IPSA Review but will consider future options for improving public and market-facing disclosure facilitated by the new data and disclosure standard discussed in section 7.3 of this paper.
A data and disclosure standard	
7.3.3	We propose that IPSA should empower a data and disclosure standard that would be used to require insurers to provide information to the Reserve Bank or to the public, in pursuit of our regulatory objectives under IPSA. This standard would be used to set out our regular data gathering and disclosure requirements.
7.3.4	There would be no change to the Reserve Bank's existing suite of information gathering powers (set out in statutory notices or conditions of licence, so that we

Paragraph	Proposed change
-----------	-----------------

	can continue gather idiosyncratic data (for example, of the type we temporarily gathered during the COVID pandemic)).
--	---

Supervisory powers

8.2.3	<p>We propose to introduce all the powers discussed in consultation three:</p> <ul style="list-style-type: none"> • extending investigation powers (currently set out in sections 130 to 134 of IPSA) to cover entities that are not licensed insurers but which might be failing to comply with a requirement to obtain a licence or falsely holding themselves out as licensed insurers; • wider information gathering powers – the ability to require information from any person (not just licensed insurers and other specified persons) in pursuit of our prudential purposes under IPSA; • an on-site inspection power; • the ability to require an insurer’s staff to answer questions ‘on notice’ as part of an investigation (as defined in IPSA section 30); • a breach reporting regime; • a power to direct insurers not to renew existing insurance contracts, in addition to the existing power to direct insurers not to write new business.
-------	--

Supervisory approval processes

8.3.3	We propose leaving the current arrangements for Reserve Bank approval of the restructure of a statutory fund unchanged.
8.3.4	<p>We propose combining the statutory tests for other significant transactions (including obtaining significant influence, change of corporate form, transfers and amalgamations) into a single approvals process.</p> <ul style="list-style-type: none"> • The Reserve Bank will be able to decide whether or not to approve a transaction before the transaction takes effect and will be able to attach conditions to approval. • When making that decision the Reserve Bank may have regard to: <ul style="list-style-type: none"> ◦ whether or not the insurers involved in the transaction will continue to meet licensing requirements once the transaction is completed; ◦ policyholder interests; and ◦ any other factors the Reserve Bank considers relevant. • The Reserve Bank will be required to make its decision within a reasonable time after receiving all necessary information. • The restructuring approval process should apply to situations where a licensed insurer acquires business from a non-licensed insurer. • The threshold for ‘obtaining significant influence’ should be set at 25% of voting rights or the ability to appoint 50% of directors.

Paragraph	Proposed change
-----------	-----------------

Enforcement tools	
-------------------	--

- | | |
|-------|--|
| 9.2.1 | <p>We are proposing to introduce all the tools discussed in C3:</p> <ul style="list-style-type: none"> • An explicit power to require insurers to publish a written warning issued by the Reserve Bank. • Remediation notices, which enable the Reserve Bank to specify actions an insurer must take to remedy breaches of regulatory requirements. • Infringement notices that allow us to impose modest fines for relatively minor or unambiguous breaches (primarily failure to provide required information). • Enforceable undertakings, which involve a binding agreement to take remedial action and (unlike remediation notices) may include the payment of compensation. • Civil pecuniary penalties, primarily for breaches of standards. |
|-------|--|

Penalty levels	
----------------	--

- | | |
|-------|---|
| 9.3.7 | We propose the following penalty levels for IPSA: |
|-------|---|

IPSA criminal penalties	
-------------------------	--

Maximum fine for business	\$2.5m \$1.5m \$250k
---------------------------	----------------------------

Maximum fines for individuals	\$300k \$100k \$30k
-------------------------------	---------------------------

Accompanying maximum prison sentence	18 months 12 months none
--------------------------------------	--------------------------------

IPSA civil pecuniary penalties	
--------------------------------	--

Maximum for an individual	\$500,000
---------------------------	-----------

Maximum for a business	\$2.5m
------------------------	--------

Paragraph	Proposed change
9.3.8	We plan to maintain the general structure of IPSA criminal penalties, which are currently organised into 3 tiers but we will look at whether some of the lower tier criminal penalties should be replaced by either civil pecuniary penalties or infringement offences.
Purpose statement for distress management	
10.2.4	<p>We propose introducing a purpose clause containing the following broad purposes:</p> <ol style="list-style-type: none"> 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. <ol style="list-style-type: none"> 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.
10.2.5	<p>We propose that 'costs' in paragraph five should include:</p> <ol style="list-style-type: none"> i. Preserving value in the insurer; ii. Preserving creditor interests; and iii. Limiting financial risk to the Crown.
Statutory management	
10.3.7	<p>We propose that IPSA should contain two sets of provisions to supplement the moratorium that already comes into play in statutory management. Those provisions are:</p> <ol style="list-style-type: none"> 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.
10.3.8	We propose that the trigger conditions for statutory management ⁸⁷ should be slightly modified as proposed in C3, to limit some circumstances in which

⁸⁷ Section 173 of IPSA.

Paragraph	Proposed change
	statutory management is not available unless the failure of an insurer would cause significant damage to the financial system or the economy of New Zealand.
10.3.9	We reserve the question of the governance of statutory management to the exposure draft stage, noting stakeholders' preference for placing appropriate reliance on a statutory manager's technical expertise.
Resolution planning for insurers	
10.4.2	We propose that IPSA should empower a standard to deal with resolution preparedness for future-proofing purposes. However, we would not expect to require resolution planning for insurers in the short-term.
Other Issues	
11.1.3	We propose not to alter existing exemptions for small insurers.
11.2.8	We propose not to alter holding out and restricted words provisions
Coordination with other agencies	
11.3.1	In C4 we consulted on whether IPSA should include statutory provisions requiring the Reserve Bank to consult the FMA: <ol style="list-style-type: none"> 1. Before issuing or revoking a licence under IPSA; 2. When making decisions under the proposed statutory approval process for significant transactions discussed in section 8.3 of this consultation.
11.3.2	We propose that IPSA should include statutory consultation requirements in the first context (licencing) but not in the second (approval of significant transactions).

Appendix One – Statutory purposes and principles, IPSA and DTA

IPSA

Section 3 Purposes

- (1) The purposes of this Act are to—
- a. promote the maintenance of a sound and efficient insurance sector; and
 - b. promote public confidence in the insurance sector.
- (2) Those purposes are achieved by—
- a. establishing a system for licensing insurers; and
 - b. imposing prudential requirements on insurers; and
 - c. providing for the supervision by the Reserve Bank of New Zealand (the *Bank*) of compliance with those requirements; and
 - d. conferring certain powers on the Bank to act in respect of insurers in financial distress or other difficulties.

Section 4 Principles to be taken into account under this Act

In achieving the purposes of this Act, the Bank must take into account the following principles that are relevant to the performance of functions or duties imposed, or the exercise of powers conferred, on the Bank by this Act:

- a. the importance of insurance to members of the public in terms of their personal or business risk management;
- b. the importance of maintaining the sustainability of the New Zealand insurance market;
- c. the importance of dealing with an insurer in financial distress or other difficulties in a manner that aims to—
 - i. adequately protect the interests of its policyholders and the public interest; and
 - ii. ensure that any failure, or possible failure, of the insurer does not have the potential to significantly damage the financial system or the economy of New Zealand
- d. the importance of recognising—
 - i. that it is not a purpose of this Act to eliminate all risk of insurer failure; and
 - ii. that members of the public are responsible for their own decisions relating to insurance;
- e. the desirability of providing to the public adequate information to enable members of the public to make those decisions;
- f. the desirability of consistency in the treatment of similar institutions (while recognising that the New Zealand insurance market comprises a diversity of institutions);
- g. the need to maintain competition within the insurance sector;
- h. the need to avoid unnecessary compliance costs
- i. the desirability of sound governance of insurers;
- j. the desirability of effective risk management by insurers.

DTA

14.3.5 Section 3 Purposes

(1) The main purpose of this Act is to promote the prosperity and well-being of New Zealanders and contribute to a sustainable and productive economy by protecting and promoting the stability of the financial system.

(2) To that end, this Act has the following additional purposes:

- a. to promote the safety and soundness of each deposit taker:
- b. to promote public confidence in the financial system:
- c. to the extent not inconsistent with subsection (1) and paragraphs (a), (b), and (d), to support New Zealanders having reasonable access to financial products and services provided by the deposit-taking sector:
- d. to avoid or mitigate the adverse effects of the following risks:
 - i. risks to the stability of the financial system:
 - ii. risks from the financial system that may damage the broader economy.

Section 4 Principles to be taken into account under this Act

In achieving the purposes of this Act, the Bank must take into account the following principles that are relevant to the performance or exercise of the functions, powers, and duties conferred or imposed on the Bank:

- a. the desirability of—
 - i. taking a proportionate approach to regulation and supervision; and
 - ii. consistency in the treatment of similar institutions; and
 - iii. the deposit-taking sector comprising a diversity of institutions to provide access to financial products and services to a diverse range of New Zealanders:
- b. the need to maintain competition within the deposit-taking sector:
- c. the need to avoid unnecessary compliance costs:
- d. the desirability of maintaining awareness of, and responding to,—
 - i. the practices of overseas supervisors that perform functions in relation to any licensed deposit taker or any holding company of any licensed deposit taker; and
 - ii. guidance or standards of international organisations:
- e. the desirability of ensuring that the risks referred to in [section 3\(2\)\(d\)](#) are managed (including long-term risks to the stability of the financial system)
- f. the desirability of sound governance of deposit takers:
- g. the desirability of deposit takers effectively managing their capital, liquidity, and risk:
- h. the desirability of depositors having access to timely, accurate, and understandable information to assist them to make decisions relating to debt securities issued by deposit takers.