

Review of the Insurance (Prudential Supervision) Act 2010

Feedback statement for consultation on policyholder
security

24 May 2022

Introduction

In August 2021, the Reserve Bank of New Zealand - Te Pūtea Matua issued a consultation paper on Policyholder Security as part of its review of the Insurance (Prudential Supervision) Act 2010 (IPSA). The consultation closed on 15 November 2021.

The consultation discussed:

- financial strength disclosures
- solvency requirements
- termination values
- statutory funds
- risk appetite and overall policyholder protection

In total, we received 19 long-form submissions (mostly from insurers and industry bodies) and 19 short-form submissions through an online web survey (mostly from individuals). We also conducted some focus groups to investigate public understanding of the risk of insurer failure and public attitudes to the trade-off between financial security and the cost of insurance.

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

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

Financial strength disclosure

There was broad agreement amongst stakeholders that financial strength disclosures were only likely to drive a small part of policyholders' decision-making when choosing a policy or insurance provider. Other sources of information are likely to include broader brand reputation, price, advice from brokers and past claims experience. Our focus group work confirmed this view.

Industry stakeholders pointed out that disclosure is only helpful if it is comprehensible to consumers. Expanding disclosure should be avoided if it was unlikely to help market discipline (or impose costs without improving market discipline). It is also important that additional information doesn't create confusion for consumers.

A significant number of submissions suggested that disclosure should move from written disclosure in insurer's documents to a web-based format (which other documents could refer to). If the web-based format was maintained by the Reserve Bank, it could allow comparison between insurers and perhaps include a public education component. Disclosure in this form would require rigorous consumer testing to ensure that it was functioning as intended.

Despite caution about the impact of disclosure on consumers, most submitters felt that ratings were worth maintaining. They may be useful to some consumers (our focus groups showed a minority of consumers do consider ratings). Additionally the process of obtaining a rating meant insurers were subject to an additional independent source of scrutiny (a 'second pair of eyes' as one submission put it). Ratings and solvency information also facilitate market discipline through other channels (investors, brokers, advisers and media).

Views on the value of solvency disclosure were more mixed, with some scepticism about the usefulness of solvency ratios in particular on the basis that these are poorly understood by consumers and difficult to compare across insurers in a meaningful way.

One submission suggested that, given the importance of reinsurance, some indicator of reinsurance strength might also be useful.

Several submitters raised the issue of insurers' responsibility for intermediaries' disclosure.

Submitters were generally comfortable with the small insurer exemption from ratings and some felt it merited some expansion. However, some also noted that small insurers may also pose additional risk. Most did not favour an exemption for new entrants, arguing that new entrants were likely to require particular scrutiny.

Most stakeholders were against requiring a rotation of rating agencies. They noted the cost this would imply, difficulties where ratings referred to corporate groups, and the possibilities that new rating agencies would be less proficient at judging financial strength, given limited familiarity. It was also suggested that rotating agencies would confuse consumers.

There was some openness to the Reserve Bank standardising disclosure in some way (often linked to comments on a comparison website noted above) but potential difficulties were also noted (comparability across rating agencies).

Our response:

- We note that market discipline operates through a variety of channels and not simply through direct provision of information to consumers
- Ratings continue to serve an important purpose and will continue to form part of the IPSA regime
- There is a role for 'better packaged' publicly-oriented disclosure and the Reserve Bank will continue to work on creating an insurance dashboard, bearing in mind the feedback from this consultation and our focus group work and the need to consider a range of potential data users.
- We will further consider how the existence of an online dashboard might best interact with policyholder-facing disclosure requirements for insurers
- We note industry views that any change to solvency disclosure should not make provision of data more complex or onerous, given limited consumer understanding of solvency

Solvency requirements

Most submitters felt that there was little to be gained from changes to the language or measures used to discuss solvency (given limited public understanding as discussed in the previous section) and that there were some risks of confusion amongst those that were familiar with the way solvency is currently discussed in New Zealand.

There was some concern that discussions of a 'solvency margin' might imply a breach was equivalent to 'insolvency'. One submitter suggested 'excess capital' as a preferable alternative to 'solvency margin'.

There were mixed opinions as to whether the content of 'financial condition reports' (FCR) should be set out in a separate standard. Some argued that the New Zealand Society of Actuaries professional guidance (PS21) provided adequate information. Others felt it might

be more convenient to be able to change FCR requirements independently of the Solvency Standard.

There were also mixed opinions on the usefulness of s.78 reports. The two main industry associations both felt they added little as the auditor is ultimately responsible for checking actuarial assumptions. However, the association of insurance brokers, the New Zealand Society of Actuaries and several individual insurers felt s.78 reports remained useful in providing some reassurance that actuarial work was also receiving more detailed scrutiny from the appointed actuary.

There was widespread support for the Reserve Bank moving to a more graduated system for assessing solvency, based on two control levels. Most submitters felt that the Reserve Bank's powers should be unlocked gradually between the two control levels. Several submissions noted that it was important for the Reserve Bank to be transparent about how it intended to use its powers in the context of a ladder of intervention framework. Most submitters were against any mandatory triggers for Reserve Bank action, emphasising the ongoing importance of flexibility and discretion.

Most submissions were in favour of including a default solvency margin of zero in statute, rather than requiring the solvency margin to be contained in license conditions.

There was much less of a consensus around using supervisory adjustments to the solvency calculation. Some stakeholders were concerned that doing so would make it more difficult to compare between insurers. Others felt the Reserve Bank should not be interfering with actuaries' duties and that it would be more transparent to continue to confine adjustments to license conditions requiring more capital. Most felt it was desirable to provide for challenge to any proposed adjustments via an appropriately efficient format, perhaps an independent expert review panel.

Our response:

- There seems to be widespread consensus that moving to two solvency control levels is sensible. We will continue to work out the details of how an 'escalating supervisory response' between the two control levels will work, including as part of future IPSA consultations
- Stakeholder feedback on financial condition reports and s.78 reports is helpful. We will consider this issue further when we have completed other work on the role of key officers under the IPSA legislation (particularly the appointed actuary and auditor roles).
- We are likely to recommend amending IPSA so that a default solvency margin of zero is automatically applied.
- We will continue to consider appropriate mechanisms for making supervisory adjustments to solvency requirements.

Termination values

Stakeholders were unanimously opposed to the introduction of mandated termination values. Most argued that this was a conduct issue not a prudential issue. Some claimed that the issue was always dealt with in contracts. Some also suggested that having fixed termination values would restrict insurers' flexibility if they found themselves in distress.

Our response:

- We will consult with other agencies and consider whether this is an appropriate issue to deal with through IPSA.

Statutory funds

Most stakeholders felt that statutory funds were only appropriate for investment-related business (particularly participating business). They should not be required for yearly renewable term business and therefore also not for health business. One submitter thought there might be some merit for disability insurance.

There was no industry support for an extension to any class of general insurance.

Some submissions suggested that it was preferable to ensure that broader provisions of IPSA provided adequate general policyholder protection, rather than to strengthen statutory fund protections.

There was quite widespread support for a policyholder preference in insolvency. Most but not all stakeholders felt that unmet claims (rather than unearned premium) should be the priority. Some submitters warned that a preference in insolvency risked increasing insurers' costs of borrowing and services in ways that might prove costly for policyholders.

Most stakeholders felt there was no need to mandate a trust arrangement for overseas life insurers that were not exempt from statutory fund requirements since the numbers, in practice, were low and existing provisions were working.

Our response:

- We will continue to weigh up the protection statutory funds provide against some types of risk against the administrative burden they create. We will need to do that in the context of other decisions made as part of the IPSA review, including some detail of the distress management regime.

Overall risk appetite and a policyholder guarantee scheme

Submissions from industry and industry bodies were universally against a policyholder guarantee scheme. They felt a scheme should be unnecessary if other regulatory settings were correct; would risk moral hazard; would increase costs for policyholders (in a market that already showed signs of underinsurance); and would be an inefficient way of providing protection.

Most industry stakeholders felt that current policyholder protection was good, though one stakeholder suggested more attention could be paid to regulating risk management and resolution planning.

Our focus group research suggested that most policyholders had not considered the risk of insurance failure (hence, in part, limited engagement with insurer financial disclosures). There was some assumption that 'someone' should regulate or was regulating insurers but very limited awareness that the Reserve Bank was prudential regulator. Opinions were mixed on whether the Reserve Bank's risk appetite was appropriate.

Once informed about the possibility of insurer failure and the Reserve Bank's risk appetite, most (but not all) policyholders in our focus groups expressed some willingness to pay a little

more in order to procure 'fully guaranteed insurance', so long as any increased costs would not increase insurer profits.

Our response:

- We are still considering whether or not to proceed with further work on a policyholder guarantee scheme.
- We note that our focus group participants were more enthusiastic about the introduction of a scheme than the industry but that participants also had some reservations.
- If we did proceed further with the concept, it would require considerable additional analytical work and further consultation.

Next Steps

This is the second of five planned consultations for phase two of the IPSA review.

The third consultation (on *Enforcement and Distress Management*) has recently closed and the consultation paper can be found [here](#).

Once the phase two consultations are all completed, we will produce an omnibus consultation setting out our in-principle decisions on all the issues raised in the phase 2 consultations, before proceeding to the legislative process.