



**Feedback: Review of the Insurance (Prudential Supervision) Act 2010,
Options Paper 2: Policyholder Security**

12th November 2021

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About Accuro

Accuro is a specialist health insurer covering approximately 35,000 lives, with premium income of approximately \$34m per annum, and net assets of approximately \$10m.

Accuro Health Insurance was set up in 1971 as the Hospital Services Welfare Society which was owned, operated and funded as an entity of the Hospital Boards Association but with its own board appointed by the Department of Health, the Hospital Boards Association and the Combined Hospital Unions. In 1991 the board established HSWS as an independent society under the ownership of its members. Today it operates as a private health insurer trading under the name Accuro Health Insurance.

Our purpose is to help our Members get well and stay well. We are a member based, co-operative model whose history is rooted in a philosophy of care. A commitment to delivering great outcomes for our Members is core to our DNA. That's why we're here.

Accuro is a member of the Financial Services Council (FSC), the industry body representing New Zealand's health insurance sector.

We prepare our accounts on the basis of Appendix D of NZ IFRS 4, and we report our solvency position to the RBNZ under the RBNZ Solvency Standard for Non-Life Insurance Business 2014.

Feedback

Accuro Health Insurance welcomes the opportunity to provide feedback on the Review of the IPSA options paper 2: Policyholder Security.

1. Financial strength disclosures

We support the need for objective and understandable disclosures of an insurers financial strength so that consumers can make informed choices. The challenge is how to do this in a way that is simple clear and provides appropriate context.

1.3 Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholders information on the solvency of insurers?

We are not convinced that either the FSR or Solvency disclosures currently required achieve this goal as both imply a level of understanding that most consumers do not have (nor would we expect them to).

The FSR in particular is not well understood and the subtleties between ratings (with the various pluses and minuses) is quite confusing. Given the cost and time involved in obtaining these ratings from the agency, we are not convinced that they add to consumer understanding for the majority of policyholders.

Furthermore, each of the approved rating agencies use different scales which makes it hard for consumers to accurately compare ratings.

Our view is that public confidence in insurers is achieved through being licensed and regulated by the RBNZ (and indeed the FMA) and the application/management of RBNZ solvency standards. The addition of published financial strength ratings do not add to this.

1.4 Options presented in 3.4

Option 3: We see little merit, and additional costs and inconvenience to insurers, if they are required to regularly switch rating agencies. Rating agency fees are likely to increase, and there is a significant level of compliance costs and resources involved in establishing a relationship with a new rating agency. There is in fact benefit and efficiency in continuity. Rotating agencies also leads to the potential of further customer confusion given different scales used.

Option 4: We support the principle of standardising information to make it easier for consumers to understand and compare. The challenge is how to do this in a way that does not overload the consumer with too much information.

We do not support introducing a common traffic light indicator as this has the potential to add to the confusion or, in attempting to simplify, lead to the risk of incorrect interpretation.

Option 5: In our view the current level of disclosure of solvency ratios is sufficient. RBNZ could consider simplified language and descriptions that could be commonly used to help consumers and policyholders to understand what the solvency ratio means for them in real terms.

We encourage the RBNZ to undertake consumer research to inform the best way present solvency information in a way customers can understand them.

2. Solvency requirements

2.1 Would it be helpful to replace the language of solvency margin and solvency ratio?

We are not convinced that replacing the language as suggested will assist with what we assume the overall objective is – i.e to improve customer understanding.

2.13 Supervisory adjustments within the solvency calculation:

The RBNZ's role should be limited to specifying solvency standards, making enquiries about a particular insurer's solvency calculations as it sees fit, and (if necessary) invoking the powers of intervention provided for in the Act. It should not have the power to unilaterally alter an insurer's calculations. This is particularly relevant for health insurers, where it has become apparent, through the release of the latest draft Solvency Standard, that the RBNZ has differing views from health insurers (and from regulators in other jurisdictions) regarding the long-term risks of underwriting this class of business. The RBNZ's view appears to originate from a 2008 paper on long-term health insurance risks presented to the New Zealand Society of Actuaries. Our view is that the long-term risks described in that paper are very much mitigated by the ability of health insurers to change premiums, benefits, and excess / co-payment levels, which can be used to avoid a "claim spiral". If the RBNZ did have the power to unilaterally alter an insurer's solvency calculations, then it is within the bounds of possibility in our view that health insurers could end up with the RBNZ unilaterally adding additional insurance risk charges to their solvency calculations, even though the insurers' Appointed Actuaries, and other experts in the New Zealand industry and overseas, disagreed with the RBNZ's approach.

4. Statutory funds

4.2 Should health or disability insurance assets be held in statutory funds

In our view the Act, the solvency standards, and the RBNZ as regulator, provide sufficient protection for policyholders, and we see no additional merit, and significant additional compliance costs, in requiring that health insurance assets be held in Statutory Funds. Ultimately a statutory fund or policyholder guarantee scheme would inevitably be funded by consumers if enacted further driving up the cost of insurance, leading to further under insurance.

Policyholders and other creditors both enjoy enhanced security compared to non-regulated organisations due to the application of the Act, the solvency standards issued in terms of the Act, and the regulatory role of the RBNZ.

4.5 Should policyholders be given priority in insolvency?

We support Policyholder priority as a statutory creditor priority and agree this may be the best way to improve policyholder security. This is also preferable to statutory funds which are costly to administer.

5. Risk and overall Policyholder Protection

5.4 Have we correctly identified the risks that a policyholder guarantee scheme should address?

5.7 To what extent do you think a policyholder guarantee scheme is worth considering?

The risks have been appropriately identified, however in our view the appropriate tool to mitigate these risks is to set solvency and risk and governance requirements that are designed and calibrated within the RBNZ's stated risk appetite.

We do not support the establishment of a policyholder guarantee scheme given how this would need to be funded and the inevitability of costs being passed on to the consumer (for little benefit).



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10 November 2021

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SUBMISSION ON THE REVIEW OF THE INSURANCE (PRUDENTIAL SUPERVISION) ACT 2010

We are pleased to have the opportunity to submit on the Review of the Insurance (Prudential Supervision) Act 2010 ('**IPSA**') Options Paper 2: Policyholder Security ('**Consultation Paper**').

About AIA New Zealand

AIA New Zealand Limited ('**AIA NZ**') is a member of the AIA Group ('**AIA**'), which comprises the largest independent publicly listed pan-Asian life insurance group. It has a presence in 18 markets in Asia-Pacific and is listed on the Main Board of The Stock Exchange of Hong Kong. It is a market leader in the Asia-Pacific region (ex-Japan) based on life insurance premiums and holds leading positions across the majority of its markets.

Established in New Zealand in 1981, AIA acquired Sovereign Assurance Company Limited ('**Sovereign**') in 2018 which, at the time, was New Zealand's largest life insurer having been in business in New Zealand for over 30 years. Sovereign formally amalgamated under the AIA brand in August 2019, and we have been protecting New Zealanders and helping them to lead Healthier, Longer, Better Lives ever since. AIA NZ is also a prominent member of the Financial Services Council ('**FSC**').

About this submission

We support the Reserve Bank of New Zealand ('**RBNZ**') undertaking this review. While we consider that IPSA is operating effectively in most areas, we agree that it is important to reconsider key operating provisions in light of events which followed its implementation including the Christchurch earthquakes, ongoing lessons following the global financial crisis and most recently the COVID-19 pandemic.

We provide our responses to the various questions posed in the Consultation Paper in the Appendix attached to this letter. The key points of our submission are:



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- We strongly support the inclusion of a financial strength rating disclosure regime in IPSA. However, we consider the current disclosure regime should be reviewed to better ensure the regime is consumer centric, in order to achieve its regulatory objectives.
- We do not support the proposal to rotate rating agencies (Option 3). This option would be inefficient and costly when weighed against potential benefits to consumers.
- AIA NZ's view is that the solvency standards are the most effective vehicle for protecting policyholders. Therefore, we recommend that a final decision on the additional policyholder protections, such as the policyholder guarantee scheme, should be deferred until consultation commences on the Final Solvency Standard.
- Decisions to introduce additional policyholder security measures must be carefully weighed against a climate of underinsurance in the New Zealand market and the need for New Zealanders to access affordable insurance products at a time of economic uncertainty and rising inflation.

In addition to our own submission, we contributed to and support the FSC submission on this Consultation Paper.

Conclusion

Thank you for the opportunity to submit on the Consultation Paper. Please let us know if you have any questions or would like to discuss any aspect of our submission.

Yours sincerely

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General Counsel & Company Secretary
AIA New Zealand



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Appendix A: Specific responses to the Consultation Paper (with preferred options in response to each question in bold for ease of reference, where applicable)

1. Disclosure

AIA NZ supports a disclosure regime being included within IPSA. However, we do not consider the current disclosure requirements are sufficiently consumer centric and should be reviewed to ensure that they appropriately support informed decision making.

Any changes to these disclosure requirements should be developed through consumer led design principles and we are supportive of the RBNZ's consumer research initiative in this regard. We recommend that any proposed changes to the disclosure requirements are subject to further consumer testing and consultation with consumer advocacy groups prior to being finalised to ensure their effectiveness before insurers invest in further systems changes to support such requirements.

The consultation document proposes options for structural changes to the disclosure regime. Our comments on each of the options identified in the consultation paper are set out below.

Option 1 – Status Quo

We do not support the status quo. As noted above, the current disclosure regime is not sufficiently consumer centric to support informed decision making. Financial strength disclosures and related disclosures should be in Plain English and supplemented with greater contextual information to aid consumers understanding and use of the disclosure information.

Option 2 – Changes to the exemptions for small insurers

We do not have a view on the proposed changes to the exemptions for small insurers. However, whether the exemptions are changed, or the status quo remains, smaller insurers carry a greater risk and therefore the RBNZ should consider whether the current disclosure requirements for exempt insurers provide enough warning to consumers of the risks posed by unrated insurers.

Option 3 – Rotating rating agencies

We strongly oppose the option to rotate rating agencies. AIA NZ's rating provider is managed by our parent company in order to achieve efficiency and consistency across the AIA Group. A requirement to rotate rating agencies periodically would create intra-group inconsistencies and complexity. While this is not insurmountable, we consider that the complexity and costs involved with periodically rotating rating agencies greatly outweigh the perceived benefits as outlined in the consultation paper.



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Recently, AIA NZ changed rating agencies from A.M Best to Fitch Ratings. This was a lengthy project and process involving significant time and operational effort to manage changes throughout the business including updating systems, websites and collateral, the costs of which were not insignificant. A requirement to repeat this exercise every three years would be costly and inefficient and therefore any such proposals should be supported by strong evidence to verify the perceived benefits of rotating rating agencies.

AIA NZ is unaware of any insurers “shopping around” rating agencies for more favourable ratings. The reputational risk of being overly generous for the three rating agencies currently operating in the New Zealand market is such that it is highly improbable that any would compromise standards in order to retain business. If the RBNZ has evidence of this practice occurring, we suggest that this is best managed by revisiting the rating agency’s approval rather than by requiring all insurers to periodically change rating agencies.

Additionally, we consider that periodically rotating rating agencies (which would result in an insurer having three different ratings in a 10 year period), would likely only serve to increase consumer confusion rather than reduce it, particularly in the context of life insurance where customer relationships are more commonly long-term.

Option 4 – Standardise disclosure

AIA NZ’s preference would be for disclosure to be standardised. However, we consider that this would be better managed at an international level through the International College of Regulators rather than creating a New Zealand specific solution. While we understand that this would not necessarily resolve the issue of rating comparability in a timely manner the ultimate result would benefit all interested parties – consumers, regulators and insurers without introducing a further layer of complexity into the disclosure regime.

In the meantime, an interim solution would be for the RBNZ to produce and issue plain English guidance on financial strength ratings (or the absence of them) and related matters such as policyholder preference on a section of the RBNZ’s own website dedicated to consumer resources and education. The guidance could explain the differences between rating agencies’ ratings and the relationship between financial strength ratings and the solvency standards, without risk of individual insurers placing their own nuance on disclosure. Importantly, any such guidance should be developed in accordance with consumer led design principles.



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If some form of traffic light system of disclosure were to be introduced, this would be best run by the RBNZ to ensure consistency of approach and made available together with the guidance. Insurers could then be required to reference the RBNZ's website as part of the financial strength rating disclosure requirements.

For clarity, AIA NZ does not support individual insurers issuing FSR guides to customers. This would be an inefficient and costly solution that, unless heavily prescribed for, is unlikely to be effective in terms of achieving its overall regulatory objective.

Option 5 – increase solvency disclosure requirements

AIA NZ does not support this option. Solvency is a complex matter and we do not consider that consumers benefit from existing disclosures. We consider that the average consumer is not likely to understand the significance of solvency disclosures. While this has not been provided as an option, AIA NZ's view is that the RBNZ could focus on providing meaningful and helpful financial strength rating disclosures to consumers and cease solvency disclosures altogether, retaining solvency disclosures as a prudential supervision tool for the RBNZ only.

Should solvency disclosures be retained, we do not support the inclusion of projections as a disclosure requirement. Projections are inherently uncertain and would need to be accompanied by the appropriate disclosure of the assumptions underlying the projection. It is likely to be challenging to present projections (and disclosures regarding risks and assumptions) in a concise manner that is easily understood by consumers.

2. Solvency Requirements

AIA NZ does not have a strong view on matters raised in this section of the consultation. We therefore only comment on certain sections as outlined below.

Terminology: AIA NZ suggests that the existing solvency terminology should be changed only to align with consistent and widely applied international terminology. The benefits of aligning with a specific jurisdiction(s) (as opposed to a consistent international standard) are potentially outweighed by requiring NZ market participants who are familiar with the existing terminology to learn a new terminology. As the RBNZ has noted, changing terminology to align with another jurisdiction may imply a closer alignment with that jurisdiction's regulatory framework than in reality. The RBNZ would need to carefully consider and manage this risk during the alignment process.



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Section 78 Report: While we acknowledge that the s78 report may demonstrate that the Appointed Actuary has carried out their professional duties appropriately, AIA NZ agrees with the doubts expressed in the consultation paper¹ about the need for the s78 report over and above what is already provided in the financial condition report and audited financial statements.

Ladder of Intervention: As noted in our submission of 18 February 2021 on “*the Review of the Insurance Solvency Standards: Structure and IFRS17*” consultation, we support the proposed ladder of intervention as our preferred option for change in this area. We note that two control levels were proposed in the Draft ISS and we are supportive of this approach. However, IPSA should clearly articulate the regulatory supervision powers available to the RBNZ at each control level while maintaining sufficient flexibility to ensure that regulatory actions can be tailored appropriately for individual stress events.

Regardless of where the RBNZ lands on the proposed ladder of intervention, our view is that the RBNZ should be transparent about how and when these powers will be used.

Minimum Solvency Margin AIA NZ supports a minimum solvency margin of zero be retained as the default requirement.

Supervisory Adjustments within the Solvency Calculation AIA NZ also supports supervisory adjustments within the solvency calculation over the current minimum solvency margin approach, ensuring they are applied consistently and there is transparency about their use. We strongly support a mechanism for challenging supervisory adjustments given their potential financial impact.

3. Termination Values

We do not support RBNZ setting minimum termination values for policyholders. Such a prescriptive approach to commercial matters should not be incorporated into IPSA. Termination values must be determined with reference to the nature and type of policy held. Calculations are often complex and policy/insurer specific. Therefore, we do not consider a prescriptive method for calculating termination values would be practicable. Our view is that if any issues are identified with how insurers determine termination values, these are best dealt with under conduct legislation which provides a principles-based approach to fairness.

¹ Paragraph 144 (page 23) of the consultation paper



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4. Statutory Funds, Policyholder Guarantee Schemes and Policyholder Preference

As any changes to statutory funds or the introduction of policyholder guarantee schemes or policyholder preference are likely to have material cost implications, ideally these measures should be considered once the Interim Solvency Standard has been finalised and in conjunction with the consultation on the Final Solvency Standard. This will allow the industry to consider policyholder security on a more holistic basis. For example, if insurers are holding significantly more capital as a result of the Final Solvency Standard a policyholder guarantee scheme would seem less necessary.

Subject to the above, AIA NZ's views are as follows:

Policyholder preference: If the need for statutory funds is to be reconsidered, policyholder preference is our preferred mechanism for protecting policyholder security in an insolvency event. This option provides policyholders with a level of security without the complexity and costs that will be incurred with the introduction of a policyholder guarantee scheme.

Statutory Funds: As a life insurer, AIA NZ is already required under IPSA to have a statutory fund. If statutory funds are to be maintained under the new IPSA regime, we are supportive of the concept of them being extended to other categories of insurance, where appropriate, as a means of providing additional policyholder security. However, we do not consider it is strictly necessary for insurers to be required to have both a statutory fund and be subject to a policyholder guarantee scheme.

Policyholder guarantee scheme: AIA NZ does not support a policyholder guarantee scheme being implemented for life insurance business as it may add to the cost of insurance and exacerbate the underinsurance problem in New Zealand. While we understand that the RBNZ is implementing a similar scheme for bank deposits, the insurance (particularly life insurance) industry is a significantly different industry, with a much smaller customer base. Policyholders are already provided protection by virtue of the solvency standards and the requirement for financial strength ratings. For life insurance, for the time being at least, there is the additional protection of a statutory fund.

5. Risk Management

While we support enhancing financial strength disclosures (provided they are consumer centric) we recognise that there is a limit to what disclosures alone can deliver. There is an opportunity to strengthen policyholder security by regulating risk management and governance practices and we therefore support further consultation in this area.



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We do not consider that regulation relating to capital management would be appropriate as the solvency standards already exist as a mechanism for setting capital requirements.

Ultimately, we consider the strongest regulatory tool for protecting policyholder security is the RBNZ itself. The RBNZ's capacity and capability to support the insurance industry through thought leadership, guidance, supervision and the enforcement of the prudential framework will have a greater impact on policyholder security than any of the measures discussed in this consultation paper. We note that the RBNZ has had increased budget to strengthen its enforcement capacity and capability. While enforcement is important and necessary, we recommend that sufficient focus and prioritisation is given to collaboration, guidance and thought leadership that leverages off the international experience, where appropriate.



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15 November 2021

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RESERVE BANK OF NEW ZEALAND REVIEW OF THE INSURANCE (PRUDENTIAL SUPERVISION) ACT 2010 OPTIONS PAPER 2: POLICYHOLDER SECURITY – SUBMISSIONS FROM AMERICAN INCOME LIFE INSURANCE COMPANY

- 1 American Income Life Insurance Company (*AIL*) welcomes the opportunity to make submissions on the *Review of the Insurance (Prudential Supervision) Act 2010: Options Paper 2: Policyholder Security*, 31 August 2021, (*Options Paper*).
- 2 *AIL* has provided responses to the questions asked in the Options Paper that concern its New Zealand operations below.
Overview of *AIL*'s New Zealand operations
- 3 *AIL* is a life insurer selling mainly to communities, including lower income households and migrant workers, that traditionally have not been well-served by other insurers in New Zealand.
- 4 It is one of the few life insurers that specifically services this market segment in New Zealand. *AIL* focuses mostly on selling level premium term life contracts, which remain affordable to members as they get older, avoiding the steep premium increases of yearly renewable plans.
- 5 *AIL* operates a branch in New Zealand, with assets held in a dedicated Custodial Fund that ensures the protection of its New Zealand policyholders. Its home office is registered in the State of Indiana in the USA.

AIL's responses to the Option Paper questions

Financial strength disclosures

1.1 Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

- 6 The small insurer exemption should continue. Financial strength ratings provide consumers with information they can readily understand about an insurer's ability to meet claims, but the costs of obtaining these ratings for smaller insurers may outweigh the benefit, particularly captive insurers or boutique professional group insurers whose customers may not require ratings to assess whether to take out insurance with them.

1.2 Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?

- 7 Overseas policyholder preferences are invoked where the overseas insurer is unable to meet its home country claims, which can be expected to occur only when there is global or home country catastrophe. The risk posed by overseas policyholder preference is outweighed (or at the very least equalised) by overseas insurers having access to global reserves to meet New Zealand claims and by the risk diversification benefits that overseas insurers bring to the New Zealand market.
- 8 On this basis, the disclosure rules are sufficient to draw customers' attention to any overseas policyholder preference. Any further disclosure requirements might be unnecessarily repetitive, mislead consumers as to the preference's significance and unjustifiably favour domestic insurers.
- 9 If greater disclosure requirements are imposed, these should not apply to overseas insurers which are required to maintain a New Zealand statutory fund, on the basis that the fund provides greater assurance that the overseas insurers would be able to meet its New Zealand claims and should mitigate against any overseas policyholder preference being a material issue for the relevant New Zealand policyholders.

1.3 Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?

- 10 The current financial strength rating and solvency disclosure requirements are sufficient to provide consumers and policyholders any needed information on the relevant insurer's solvency. Any reforms in this area need to be realistic about the average consumers' inclination and time to process any further required disclosures, particularly if the required information could be perceived as complex.

1.4 Out of the options presented in Section 3.4, what is your preferred option or combination or options for public solvency disclosure requirements?

- 11 For the reasons stated in the response to 1.1, AIL supports **Option 1 – Maintain the status quo**.
- 12 If reform is to occur, AIL prefers **Option 2 – Change the exemptions for small insurers** and, specifically, **Option 2A** or **Option 2C** as these are the simplest of the identified sub-options and will involve the least unjustified compliance costs.
- 13 The other reform options identified would result in greater compliance costs, without necessarily increasing consumer understanding:
- 13.1 **Option 3 – Rotating rating agencies** could cause confusion amongst current policyholders arising from the different styles of rating given by different rating agencies over successive years.
- 13.2 **Option 4 – Standardised disclosure** is impractical where ratings are sourced from rating agents operating in a non-standardised international market. The agencies are very unlikely to alter their international ratings scales for our domestic use. Any explanations would increase the information load placed on consumers in circumstances, and potentially cause more confusion than standardisation would solve. It would be questionable whether the average consumer has the capacity or time to process additional rating information.
- 13.3 **Option 5 – Increased solvency disclosure requirements** would be likely to create confusion for consumers who are unlikely to understand the complexities and significance of the solvency information and, to the extent that they are aware of the solvency requirements, would reasonably rely on the Reserve Bank's assessment of the insurers' solvency in any event. Brokers have sufficient information about the insurers' solvency already and are better placed to explain this information to their clients should it be pertinent to their choice of insurer, rather than trying to explain complex factors to retail policyholders, many of whom will have limited understanding.

1.5 If we increase the public disclosure of solvency ratios, what solvency measures do you think would be the most informative to the public?

- 14 For the reasons specified in the response of 1.4, increased public disclosure of solvency ratios would not be meaningful for average consumers, who are unlikely to understand the complexities and significance of the solvency information. Accordingly, the increased compliance costs of additional disclosures would not be justified.

1.6 Do you think there is a better public solvency disclosure requirement than the options here? If yes, what disclosure requirement would you like to see?

15 No: the current financial strength rating disclosure requirement is adequate.

1.7 Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure (as set out in table 3)? If not, what other high level costs or benefits should be considered?

16 Yes.

1.8 Are there any other ways in which we might improve financial disclosure to improve policyholders' and other factors ability to assess insurer's financial strength?

17 Improving consumers' understanding of financial strength disclosures would be better achieved through education, such as the Reserve Bank providing an accessible consumer guide and conducting awareness campaigns.

Solvency Requirements

2.1 Would it be helpful to replace the language of 'solvency margin' and 'solvency ratio' with either:

- **a metric based on the relationship between Actual Solvency Capital and Minimum Solvency Capital, or**
- **the relationship between stressed assets and stressed liabilities?**

18 Yes: "minimum solvency margin" breaches are terms readily susceptible to being misinterpreted as meaning that the insurer is at risk of being insolvent.

19 The term "excess capital margin" better describes the margin's purpose of providing a buffer above insolvency, so this term should be used instead of "minimum solvency margin". The excess capital should be expressed as a percentage of the required "excess capital margin", so to better assist consumers to understand this metric.

2.2 Should New Zealand solvency terminology be aligned with international standards? Why or why not?

20 Yes: greater alignment could reduce compliance costs and attract new overseas insurers due to increasing the ease with which they operate in New Zealand.

2.3 Which international terminology would it be best for New Zealand to align with?

21 Alignment with the United States standards is preferred.

- 22 Alignment need only be on a conceptual level. It is unnecessary to adopt the United States (or any other foreign) terminology if the current IPSA terms can be defined or interpreted consistently with that terminology.

2.4 Should IPSA enable a separate standard dealing with Financial Condition Reports? (Why/why not?)

- 23 No: the New Zealand Society of Actuaries *Professional Standard (PS21: Life Insurers Financial Condition Report)* contains adequate standards and sufficient protections, so that a separate standard dealing with Financial Condition Reports is unnecessary.

2.5 How useful are s.78 reports? Should they be continued or replaced?

- 24 Section 78 appointed actuary reports should be maintained as they provide useful information.

2.6 Would it be helpful for IPSA to contemplate more than one solvency control level?

- 25 AIL supports two excess capital thresholds for the reasons identified in the Options Paper.

2.7 How many control levels would be useful?

- 26 Two control levels would permit a more nuanced approach to the Reserve Bank's monitoring and enforcement. AIL agrees with the suggested approach in the Options Paper – the lower level applying where the insurers are likely to be non-viable, and the upper level where the insurer is at high risk. The upper level should be set so that it does not catch the temporary solvency fluctuations that occur in the normal course, which are not necessarily indicative of the insurer being at high risk.

2.8 How should the Reserve Bank's powers relate to the different control levels?

- 27 Where the lower level is breached, it is appropriate for the Reserve Bank to exercise its Part 4 Distress management powers.
- 28 Upper level breaches do not warrant the Reserve Bank using its Part 4 Distress management powers – a less intrusive set of powers should apply to these breaches. This set of powers ideally should not be contained in Part 4, because of the insolvency connotations of the term “Distress management” that are not necessarily appropriate for upper level breaches and create the risk of reputational harm if the market is advised of the breach.
- 29 Where the upper level is breached, the Reserve Bank should not be “required” to take action, rather it should have the discretion to exercise any powers where it considers that this appropriate, for example, it could decide not to exercise the powers when the breach is promptly remediated to the Reserve Bank's satisfaction.

2.9 Should powers be unlocked sequentially?

- 30 Yes: this is consistent with the graduated approach to enforcement and monitoring sought to be achieved through having two control levels.

2.10 Should powers unlock at the top rung, with the Reserve Bank issuing public guidance on how it intends to use its powers?

- 31 An upper level breach should not permit the Reserve Bank to exercise intrusive powers. That would be disproportionate to the level of breach. The Reserve Bank should also not be conferred powers in circumstances when they are not intended to be exercised. That could potentially lead to confusion and too high expectations of the enforcement the Reserve Bank may bring.
- 32 For upper level breaches, the extent to which the Reserve Bank exercises its more-limited powers should also depend on the extent to which the insurer is providing reasonable and timely co-operation and remediation, the information the Reserve Bank holds about the breach and insurer's remediation, and the degree of the risk posed by the breach.
- 33 For lower level breaches, a fuller range of powers should unlock automatically to reflect the nature of the breach, but even here the Reserve Bank should be required to consider all relevant circumstances when deciding how to respond in an appropriately proportionate manner.
- 34 Guidance on how the Reserve Bank intends to use its powers would be useful, but should not be a substitute for the legislation containing adequate controls and protections relating to the Reserve Bank's exercise of its powers. These controls should include the Reserve Bank being required to provide notice of its intention to exercise its powers and provide a statement of reasons for doing so (unless this is not reasonably practicable) and insurers having the right to have any objections considered and to challenge any purported exercise through the High Court.

2.11 Should any actions on the part of the Reserve Bank be mandatory when one of the control levels is breached?

- 35 Apart from providing notice of any breach, as specified in the response to 2.10, there should not be any mandatory actions on the part of the Reserve Bank, but rather it should have discretion when deciding how to respond, so the particular circumstances of the breach are considered and an appropriately proportionate approach taken.

2.12 Should a minimum solvency margin of zero be required by default (without the need to specify it in a license condition)?

- 36 No: it is unnecessary to specify a zero margin (where applicable) as a licence condition, rather there should be default solvency margin of zero.

2.13 Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?

- 37 No: the Reserve Bank should be required to take a consistent approach to solvency calculations. Allowing discretion creates uncertainty and potential confusion. However, the Reserve Bank should be able to publish class or individual exemptions as a means to address anomalies.
- 38 Where adjustments are justified due to an insurer's particular circumstances, additional licence conditions are the appropriate means to achieve this in the interests of providing greater transparency to the market.

2.14 Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?

- 39 Yes: a legislative objection and appeal process should be available to challenge supervisory adjustments or licence conditions, in addition to the existing judicial review grounds.

Termination values

3.1: Should IPSA contain provisions requiring minimum termination values for policies that store value long-term? Why / why not?

- 40 No: IPSA should not require minimum termination values for any policies. Termination values are not a matter for prudential regulation to protect solvency, they are more a matter of Conduct and Culture, and competitive positioning in the market. Prescribing minimum termination values would have undesirable consequences: it would increase investment risk for an insurer, as clients would be able to cancel contracts at a time when investment values had declined. Minimum termination values would be likely to lead to increased premium rates for customers, and allow opportunities for one class of policyholders to arbitrage opportunities at the expense of others..

3.2: What would be an appropriate basis for setting minimum termination values?

- 41 Consistent with its response to question 3.1, AIL does not support the introduction of prescribed minimum termination values.

Statutory funds

4.1 Is it still appropriate to provide statutory fund treatment for YRT business? Or should statutory funds only apply to business where policyholders build up a store of value over time to fund their later claims (for example, participating business, unit-linked business, investment accounts and annuities)

42 AIL has no comments on this question.

4.2 Should health or disability insurance assets be held in statutory funds?

43 No: the solvency standards and reserving for claims provide sufficient protection, so holding health or disability insurance assets in statutory funds should not be required, but should be optional.

4.3 Should general insurance contracts also have assets held in statutory funds?

44 No: the solvency standards and reserving for claims provide sufficient protection, so holding general insurance assets in statutory funds should not be required.

4.4 If so should that include:

- **all general insurance business;**
- **assets backing business with a contract boundary over one year;**
- **assets backing accepted claims over a particular size, for claims likely to take more than a year to settle;**
- **some other subset of general insurance business?**

45 As stated in the response to 4.3, holding general insurance assets in statutory funds should not be required. However, if such a requirement is to be imposed, it should be limited to assets backing accepted claims that are likely to take more than one year to settle (Option 2).

4.5 Should all policyholders' be given priority in insolvency over other general creditors?

46 No: such a prescriptive approach might prevent insurers from making payments required to preserve the insurer's assets (for example, paying premiums to ensure that reinsurance arrangements continue). Making such payments may ultimately provide greater benefit to the policyholders.

47 Imposing a policyholder preference could, in fact, undermine the viability of distressed or high risk insurers by increasing the risks for other creditors, who may respond by seeking greater contractual protections (for example, additional rights to require early payment) or reducing or ending the services they provide.

4.6 Should priority be confined to policy benefits or also include claims for unearned premiums?

48 No: such a priority should be imposed, but if a priority is to be imposed, it should cover unearned premiums as well, as the protections should cover all policyholder rights and entitlements.

4.7 Should IPSA be amended so as to make it more explicit that assets (other than transactional bank accounts) should not be shared across different statutory funds?

49 AIL has no comments on this question.

4.8 Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?

50 AIL has assets held in a dedicated Custodial Fund that ensures the protection of its New Zealand policyholders. It does not consider that this requirement would be unduly onerous.

4.9: If requirements to establish a trust were included, are there any issues about the trust's constitution that should be specified in IPSA?

51 AIL has no comment on this question.

4.10 Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?

52 No: counterparties with a life insurer should be aware that the life insurer is required to establish and maintain a statutory fund, and so should be aware of the likelihood that the insurer's assets are subject to the statutory fund obligations. A register would duplicate any reasonable expectations, and so would not provide sufficient benefit to justify its costs.

4.11: Should life insurers with participating life insurance business be required to prepare accounts for capital and retained profits in their statutory funds? Should these be disclosed:

- As a note to the insurers financial accounts? Or,
- In data returns for participating businesses provided by the Reserve Bank?

53 AIL considers that there would be little benefit if either is required to be disclosed.

Risk appetite and overall policyholder protection

5.1 Do stakeholders think that regulation in respect of each of the channels listed in para 217 is broadly appropriate?

No

5.2: If not, which areas are over-regulated or particularly in need of enhancement?

- 54 Overseas insurers are subject to their home jurisdiction risk management requirements and, accordingly, additional New Zealand risk management requirements could give rise to operational inconsistencies, as well as discouraging overseas insurers from operating in New Zealand due to increased compliance costs.

5.3 Are there any additional measures for policyholder security that the Reserve Bank should consider?

- 55 No. Before recommending additional policyholder security measures, the Reserve Bank should adequately assess the potential impacts of these measures on insurers' commercial arrangements and, specifically, whether they may, in practice, be counterproductive.

5.4 Have we correctly identified the risks that a policyholder guarantee scheme should address?

- 56 A guarantee scheme is undesirable.
- 57 As the Options Paper notes, insurers would pass on most of the scheme's cost to their policyholders. If the costs passed on are significant, the increased protection conferred by the guarantee scheme may be negated by a decrease in insurance taken out by the policyholders.
- 58 A guarantee scheme might risk incentivizing (through cross subsidization) some insurers to cover imprudent risks with the result that (in the event of their failure) these insurers (and their policyholders) would be effectively subsidised by more prudent insurers (and their policyholders). This risk could be mitigated by adjusting any scheme levy to reflect an insurer's risks, but this would be expected to be too complicated.
- 59 Insurers which have adequate reinsurance arrangements should not be required to join any guarantee scheme.

5.5 Are there other risks we have not considered that a scheme could also address?

- 60 AIL does not support a guarantee scheme for any policyholder risks.

5.6 Are there particular kinds of policy for which a scheme is particularly important?

- 61 AIL does not support a policyholder guarantee scheme for any kind of policy.

5.7 Overall, to what extent do you think a policyholder guarantee scheme is worth considering for New Zealand?

62 AIL considers that a policyholder guarantee scheme is not worth considering for New Zealand.

5.8 Are there particular kinds of policies that should be covered by a guarantee scheme?

63 AIL does not support a policyholder guarantee scheme for any kind of policy.

Summary

64 Thank you again for the opportunity to comment on the Options Paper. Please let me know if you have any questions or would like AIL to expand on any matters discussed in its submissions.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Joel Scarborough', written over a horizontal line.

Joel Scarborough
Senior Vice President, General Counsel and Secretary

RBNZ IPSA Review

AM Best's Responses to RBNZ consultation: Options Paper 2: Policyholder Security

1.1 Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

We wish to emphasise the value of international financial strength ratings (FSR) for both small and large insurers, as well as ultimately for policyholders. Maintaining an FSR provides an ongoing and independent opinion on claims paying ability on a globally comparable basis. Insurers in both mature and emerging markets around the world often rely on published FSRs to evidence their claims paying ability to policyholders and in some instances to enable access to certain lines of business. In particular, for small/niche insurers an FSR can often be important to evidence their financial strength despite being a smaller operator within their market.

1.3 Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?

Overall, we view the status quo provides a solid balance of information disclosure for policyholders to evaluate the financial strength of an insurer prior to taking out coverage and during their policy term.

Whilst for non-commercial buyers of insurance in NZ, the current solvency disclosures may not be well-understood, it is felt that this segment of policyholders are able to discern and interpret the financial strength ratings provided by the international rating agencies (using the letter scale and accompanying descriptors).

The solvency disclosures, whilst more likely to be of value to experienced/commercial insurance buyers, are still considered to be a useful public disclosure which can be tracked over time and gauged against peers/alternative insurance providers.

1.4 Out of the options presented in Section 3.4, what is your preferred option or combination of options for public solvency disclosure requirements?

Our preference is Option 1 for the reasons mentioned in section 1.3. However, we would also like to provide some specific comments on options 2C, 2D, 3 and 4, as detailed below.

Option 2C - Allowing new insurers to not require a financial strength rating for a few years post licensing to encourage new entrants into the market.

The early years following an insurer's establishment can often be a critical phase to have an FSR in order to understand the company's long-term ability to meet policyholder obligations. It is also important to note that a FSR is not a point-in-time view – for a start-up insurer rated by AM Best, the analysis would incorporate an evaluation of a business plan over a number of years (e.g. a 5-year business plan).

AM Best also has a 'rating new company formations' criteria to capture analytical elements that specifically arise from a company with no historical track record of operation and in a start-up phase. Applying an upfront exemption on FSR requirements that then phases to standard requirements after a few years, may result in sudden exits from the market when these requirements come into force.

Option 2D – Allow small insurers to opt out of getting a financial strength rating in exchange for having a higher solvency requirement. This would be based on our credit rating exemption for small Non-Bank Deposit Takers.

This may be a viable option to ensure policyholder security, but may present onerous risk-based capital requirements for an insurer, which also drivers cost of capital challenges.

Option 3 – rotating rating agencies

This would likely drive challenges for both insurers and rating agencies. Operationally, it would likely present continuity challenges for both parties to be rotating on a routine basis every few years. From both sides of the rating engagement, continuity of understanding/awareness of the rating process and financial strength considerations often builds over time.

Rating agency rotation requirements would also present challenges during periods of M&A, for example, when a rating is under-review. Rotating a rating agency during a pending transaction could result in additional complexities for both incoming and exiting rating agencies.

In reality, the extent to which insurers in NZ are believed to 'rating shop' is viewed to be very low. The significant workload involved with entering the process with a new rating agency to understand whether a different rating level could be achieved is likely a major off-putting factor for an insurer and in many cases there may be no rating differential at all between agencies.

With regard to the view that frequent rating agency rotation helps to ensure material facts are not missed by the appointed rating agency, we would firmly challenge this assertion. In fact, we would view too frequent rotation of rating agencies as potentially hampering the accumulation of information over time. It is also noteworthy that approved rating agencies operate to rigorous policies, procedures and methodologies, which continually evolve to ensure that necessary analytical considerations are appropriately factored into their rating assessments. The rating committee composition of credit rating agencies may also incorporate a mix of analytical staff from various international offices in order to ensure that a globally consistent rating approach is applied.

Furthermore, rating agency rotation requirements for NZ-based subsidiaries/branches of international insurance groups (domiciled outside of NZ) may create an issue in that the rotation would not apply to the parent/group.

Option 4 – Standardise disclosure

Whilst limited detail has been provided around how a traffic light system could overlay rating agency scales, we would question the need/value for this. It would likely be complex for the RBNZ to determine which rating levels/categories fall into the red, amber, green zones.

The option to create a "Guide to Financial Strength" detailing different rating scales & outlooks, as well as solvency levels, would likely be useful for policyholders as a single point

of reference for understanding these metrics. It is also noteworthy that in several jurisdictions around the world (including the US and Europe), regulators disclose a mapping table which highlights the comparability of rating scales across the international rating agencies. This is viewed to aid policyholders understanding of the different rating scales used by the agencies.

1.7 Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure (as set out in table 3)? If not, what other high level costs or benefits should be considered?

Please refer to our responses in 1.4 above.

Monday 15 November 2021

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
Wellington 6140

**Reserve Bank of New Zealand Review of the Insurance (Prudential Supervision) Act 2010 Options
Paper 2: Policyholder Security**

Email: ipsareview@rbnz.govt.nz

I am writing to you to provide the submission of Cigna Life Insurance New Zealand Limited (“Cigna”) regarding the Review of the Insurance (Prudential Supervision) Act 2010 Options Paper 2: Policyholder Security.

Cigna protects more than 450,000 New Zealanders with insurance policies. Our products and services include life, trauma, income protection, funeral and travel insurance.

As a licensed insurer, we support the principles of IPSA – a cost-efficient regulatory regime, robust insurance sector and strong policyholder protection and security. Our key priorities include the delivery of good consumer outcomes and our commitment to remaining responsive in our constantly evolving regulatory environment.

Our submission concentrates on a number of key issues that will directly impact Cigna. As a member of the Financial Services Council, we have also contributed to, and broadly support their submission.

1. Financial Strength Disclosures

Cigna agrees with the modernisation of the Financial Strength Rating disclosures by removing the requirement to disclose ratings on printed material, and instead leaving a reference to each insurer’s webpage, rather than the Reserve Bank’s.

In relation to public solvency disclosure requirements, we support the status quo but recommend minor amendments to streamline and simplify disclosures. We also do not believe that rotating rating agencies would be beneficial for insurers or customers. If financial strength ratings change periodically, as a result of the rating agency, customers may mistakenly perceive this as their insurer not being able to meet their financial obligations, and therefore eroding trust. Our view is that rotating rating agencies would not benefit consumers or insurers, but instead increase compliance costs and add to confusion, rather than provide clarity. What is important is that there is comparability of ratings across different agencies and that there is visibility of any differences.

While we support standardising the disclosure information received by consumers and policyholders in principle, we would welcome further discussion around what metrics might be used for comparison to avoid unintended consequences and further confusion. For example, using solvency ratios as a measure is arguably misleading as these as currently defined are distorted by the negative policy liability.

We do not believe that the disclosure of solvency ratios to consumers would inform their decision making – solvency considerations are highly complicated and public disclosure could result in further

confusion rather than add value. Instead we would recommend using more comparable metrics such as the solvency margin with explanations given in plain English.

2. Solvency Requirements

In relation to amending the terminology of 'solvency margin' and 'solvency ratio', we have concerns around the connotations that the proposed wording of 'stressed assets' and 'stressed liabilities' may imply. These words may result in unintended consequences, increasing customer confusion rather than adding clarity around solvency considerations. We recommend other language is used to clarify solvency margins e.g. "assets in a stressed or difficult scenario" vs 'liabilities in a difficult or adverse scenario' and carefully outline the difference between the two. As mentioned above, we believe that the term 'solvency ratio' as it is currently defined is a poor comparative measure.

We caution against New Zealand solvency terminology being aligned with international standards if the basic terms have a different meaning. This could increase confusion if the same terminology was used for something domestically, with a different meaning overseas.

We do not have a strong view on whether the FCR requirements are published within the solvency standard or another separate standard. In relation to s78 reports, we believe that these may provide some additional comfort to the users of Financial Statements but suggest they focus more on the core actuarial elements, rather than accounting elements (given they are signed off by the Appointed Actuary). We are also supportive of a zero solvency margin being the default.

In relation to supervisory adjustments, we believe these should be the exception rather than as common practice. We are wary of such an additional power being used inappropriately, and see value in bringing in an independent expert, to support integrity of process.

3. Termination Values

We consider that termination values would be inappropriate for the vast majority of New Zealand's insurance business, which is YRT (Yearly Renewable Term). We are aligned with the FSC's view that these termination values are not part of prudential regulation, and note that tax consequences of offering such a termination value should also be considered.

4. Statutory Funds

We do not consider that YRT lump sum business requires its own separate statutory fund. There is an argument however, that longer term disability business could fall under a statutory fund. In favour of a streamlined approach, we consider that there should be at least one option for all insurance to be in one fund, as a life insurer may have other insurance business such as redundancy covers, medical or travel. This means that all policyholders will be subject to the same protections. Our view is that such a fund should also be permitted to receive income or assets from non-insurance activity such as third party commissions or fees, provided it doesn't have liabilities in respect of such business.

Participating products may only be a small part of a statutory fund, so shouldn't be confused with the general principles of a statutory fund. We consider it a reasonable expectation that the allocation between shareholder and policyholder profits for par business would be covered in the FCR.

5. Risk Appetite and Overall Policyholder Protection

We consider that a policyholder guarantee scheme is worth considering for New Zealand, as it could assist in the event of systemic market failure – however note that this would likely be accompanied by high costs.

Conclusion

As a licensed insurer, Cigna believes that strong regulatory oversight reinforces New Zealand's financial markets and consumer confidence overall.

Thank you for the opportunity to submit on the Options Paper. We look forward to our continued involvement in the RBNZ's review of IPSA.

Yours faithfully,



Gail Costa
Chief Executive Officer
Cigna Life Insurance New Zealand

15 November 2021

By email: ipsareview@rbnz.govt.nz

Financial System Policy and Analysis - Financial Policy

Reserve Bank of New Zealand
PO Box 2498
Wellington 6140
NEW ZEALAND

IPSA Review Policyholder Security Consultation

We appreciate the opportunity to provide feedback on the RBNZ's IPSA Review Policyholder Security consultation, issued on 31 August 2021.

This letter comprises AMP Life New Zealand's (AMPLNZ) and Resolution Life New Zealand Limited's (RLNZ) submission.

Background to AMPLNZ and RLNZ

The Resolution Life Group in Australia and New Zealand encompasses both AMPLNZ and RLNZ.

AMPLNZ is a New Zealand-based life insurance business and a branch of the Australian life insurance company AMP Life Limited. AMPLNZ has been operating in New Zealand since AMP Life's incorporation in 1935. Over the following 85 years, AMPLNZ has grown to become one of New Zealand's largest manufacturers of life insurance and operates now as a leading in-force specialist life insurer. AMPLNZ is a significant player and of systemic importance in the New Zealand Life Insurance Market paying out \$NZ201m in claims in 2020.

RLNZ was incorporated following engagement with the Reserve Bank and the Australian Prudential Regulation Authority as part of AMP Life's acquisition by Resolution Life in June 2020. The incorporation of RLNZ was designed to help ensure that the benefits that New Zealand policyholders enjoy under their AMP Life policies are maintained and protected. RLNZ is a locally incorporated insurer governed by a board of majority independent directors and supervised by the RBNZ. RLNZ is the trustee of the AMP Life NZ Trust Fund, which holds a pool of investment assets that support the policies issued by AMP Life to New Zealand policyholders.

Submission

AMPLNZ and RLNZ broadly endorse the industry submission from the Financial Services Council of New Zealand Incorporated (FSC). We have not sought to re-iterate all of the items raised by the FSC. Instead we highlight in the Appendix to this letter items where the Resolution Life Group has additional comment.

We would be happy to discuss any of our feedback directly. Please contact Therese Singleton
[REDACTED] in the first instance.

Your sincerely

A handwritten signature in black ink that reads "Therese Singleton". The signature is written in a cursive style with a large initial 'T'.

Therese Singleton
NZ Chief Executive Officer
AMP Life Limited

Chief Executive Officer
Resolution Life New Zealand Limited

Appendix

1. Financial Strength Disclosures

We broadly support the FSC's submission on the questions relating to Financial Strength Disclosures and make the further comments below:

1.1 *Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?*

We consider that the current exemptions for small insurers should be maintained, given the high relative cost for small insurers of maintaining a rating. Adequate disclosure of any exemption should be provided to policyholders to ensure they are appropriately informed.

1.3 *Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?*

We agree with the FSC that the current financial strength rating and solvency disclosure regime needs reform. However, we expect consumers will still benefit from some level of solvency disclosure alongside the disclosure of financial strength ratings. We endorse the FSC's suggestion of consumer research by the RBNZ to identify the types of solvency information most valuable to consumers.

2. Solvency Requirements

We broadly support the FSC's submission on the questions relating to Solvency Requirements and make the further comments below:

2.3 *Which international terminology would it be best for New Zealand to align with?*

With numerous businesses in the New Zealand insurance market already aligned in some way with entities in Australia, we consider it is most sensible for New Zealand's solvency terminology to be aligned with Australia.

3. Termination Values

We support the FSC's submission on the questions relating to Termination Values.

4. Statutory Funds

We support the FSC's submission on the questions relating to Statutory Funds and make the following further comments:

4.8 *Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?*

We consider the continued use of the RBNZ's existing powers to impose conditions on overseas insurers, is preferable to creating any blanket new trust requirement.

The RBNZ has a range of powers available to impose conditions on overseas insurers, including in connection with the RBNZ's approval for sales, granting of licences and granting of exemptions. We consider the flexibility and application of those powers on a case-by-case basis (as deemed necessary and appropriate), is a better approach than creating a blanket new trust requirement that would only be relevant to a limited number of entities. This submission also recognises the potentially wide variance in the nature and circumstances of any overseas entities involved. The AMPLNZ Trust established in New Zealand houses over \$5bn of assets for New Zealand policyholders, but these are mostly

backing investments for the participating policyholders at AMPLNZ. These types of products are in decline with no other life insurer in New Zealand having the same magnitude of participating business. New entrants are unlikely to re-enter this market.

The material additional complexity, compliance and governance costs associated with the establishment and ongoing operation of a trust, could also have the unintended impact for consumers of discouraging overseas insurers from entering the New Zealand market.

4.10 *Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?*

The RBNZ already has the existing ability to request information of this kind under section 121 if it has any concerns about the assets of a specific insurer's statutory fund. We do not consider imposing any blanket new requirement of this kind would increase policyholder security.

4.11 *Should life insurers with participating life insurance business be required to prepare accounts for capital and retained profits in their statutory funds? Should these be disclosed:*

- *As a note to the insurers financial accounts? Or,*
- *In data returns for participating business provided by the Reserve Bank?*

The extension of the current Insurer Return to incorporate some level of information regarding retained profits, to give comfort to the RBNZ regarding the appropriate management of this business in line with the regulations, would be relatively straight forward. However, we do not believe that inclusion within insurer's financial accounts is useful and particularly once entities have adopted NZ IFRS17, could become confusing.

5. Risk Appetite and Overall Policyholder Protection

We support the FSC's submission on the questions relating to Overall Policyholder Protection.

15 November 2021

Reserve Bank of New Zealand - Te Pūtea Matua
Financial System Policy and Analysis – Financial Policy



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FMG submission on Review of the Insurance (Prudential Supervision) Act - Policyholder Security

FMG welcomes the opportunity to provide feedback on the Reserve Bank of New Zealand's Review of the Insurance (Prudential Supervision) Act 2010 (IPSA) Options Paper 2 - Policyholder Security.

FMG supports in principle the ICNZ submission, which we have been party to preparing. However, we raise some additional concerns below from the perspective of FMG, a New Zealand owned mutual insurer, which are not specifically addressed in the ICNZ submission. As the largest New Zealand owned insurer FMG's views consider what is in the best interest for all New Zealand policyholders and what would provide an even playing field for all participants.

Overarching comments

We agree that policyholder security is fundamental to a healthy, well-functioning insurance market. Below, we outline certain changes to the existing regime that we think would lead to a more balanced and effective regulatory environment.

However, overall we do consider the current prudential regime and its settings to be fundamentally sound, and we do not think wholesale change is required to achieve effective policyholder security. It seems clear that if a number of options considered in this paper were implemented, the industry would be very much over-regulated.

Responses to specific questions raised in the Options paper

Question 1.2 – Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?

Q4.8: Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?

In order to properly consider whether New Zealand has sufficient policyholder protection in place then the regulatory environment for all New Zealand insurers must be considered, including branches of overseas entities. We provide a number of general suggestions below regarding changes we think would enhance the existing prudential framework.

New Zealand Policyholder Preference

When compared to other regulators we see a major gap in that New Zealand Policyholder Protection is not included as one of IPSA's overarching "Regulatory Purposes". Including this as one of the purposes we believe would help to inform and improve certain provisions within the regulations.

We also believe this would provide consistency with other international regulators, which is important as these regulators specifically protect their home jurisdiction policyholders and therefore by default exclude New Zealand policyholders.

Enhanced Disclosure and Solvency Requirements for Branches

FMG has previously raised concerns with the Reserve Bank regarding the application of IPSA to overseas insurers operating as branches in New Zealand. We believe the current legislation gives rise to a lower level of policyholder protection for individuals insured by these entities.

There should be a more consistent approach to solvency requirements for insurers incorporated in New Zealand and those operating as branches, to avoid regulatory arbitrage and ensure competitive neutrality:

Level playing field - FMG does not oppose the use of branch structures in general. However, we believe they should be subject to the same solvency requirements as New Zealand domiciled insurers. This would ensure there is a level playing field for all market participants, noting that New Zealand regulation will in some cases be higher than overseas jurisdictions.

Arbitrage - A key concern is that insurers can arbitrage regulators by choosing to incorporate in a country with lower capital requirements and operate via a branch network. For example, there is no requirement under IPSA for a branch to disclose its solvency position as determined by the Solvency Standard applicable in New Zealand. In particular the Catastrophe Capital Charge in the Non-Life Solvency Standard charge is designed specifically for New Zealand conditions and has a much higher threshold of application (1:1000 years) than the standards applied by overseas regulators. It is unclear to us that the level of protection offered to policyholders by the overseas solvency standard is “*at least as satisfactory as the law and regulatory requirements of New Zealand*” in this regard.

As previously noted to the Reserve Bank, there are a number of ways in which policyholders of overseas branches are potentially disadvantaged by the current prudential regime:

Overseas policyholder preference - Some regimes (including Australia) have an explicit policyholder preference for local insureds, which will disbenefit New Zealand policyholders in a failure situation. Where there is no explicit preference then there is still potential risk to New Zealand policyholders, due to the propensity for ‘ad hoc’ judicial/political/ regulatory activism. In an insurance failure situation, there is a potential for the home supervisor to ring-fence assets in the home jurisdiction for the benefit of policyholders or other creditors in that jurisdiction. In the absence of a countervailing requirement for assets to be held in New Zealand sufficient to at least cover policy liabilities in New Zealand, policyholders could be seriously disadvantaged as a result of a branch structure.

Difficult/costly insolvency proceedings - Policyholders will have legal rights if the insurer faces difficulties, but those rights will need to be exercised via an overseas jurisdiction’s insolvency regime, which may prove difficult and costly.

Reinsurance proceeds - Reinsurance proceeds will not necessarily be paid to the New Zealand branch in respect of claims made on the branch, given reinsurance contracts will generally sit with the parent entity and not make distinctions as to the geographic location of the claim. This could further weaken the position of New Zealand based policyholders in a failure situation.

Notification requirements insufficient – Notification requirements do exist, but these mean little to policyholders in practice. The Reserve Bank’s Options Paper talks specifically about instances of low compliance with disclosure requirements by overseas insurers (paragraphs 83-85). It is also important to note that, for branches of larger groups, rating agencies are very unlikely to focus on the strength of the New Zealand business.

Supervisory scrutiny by home-state regulator – Even given broadly equivalent supervisory adequacy, an overseas branch based in New Zealand may not present a significant level of

risk to the home jurisdiction and therefore not attract the same level of supervisory scrutiny as an equivalent business licensed in New Zealand. Overseas supervisors may also not have the same awareness of the changing risk environment in response to events in New Zealand. These reduced incentives for scrutiny may also apply to management and Boards of insurers themselves, particularly where New Zealand policyholders only represent a small part of the entities' overall business. Reserve Bank supervisors have felt that some branches of overseas insurers have not always been well-managed, perhaps partly because of this distance from home jurisdictions.

Local functionality – The Reserve Bank has also previously talked about general concerns with governance (i.e. lack of local presence/independence) and risk management/IT functionality (i.e. reliance on overseas parent entities) for all overseas insurers.

New Zealand policyholders would expect there to be a level playing field between all New Zealand insurers. We do not agree that further education and/or disclosure will effectively address the potential shortcomings mentioned above. We believe branches should be subject to the same solvency and disclosure requirements as New Zealand domiciled insurers.

1.1 Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

Increasing exemptions for small insurers

As referenced above, we believe there should be a level playing field between all insurers, in order to avoid regulatory arbitrage and ensure effective competition.

Small insurers are given exemptions due to size, but it is this lack of size that means they often struggle to have the right resource to effectively manage business and capital risk. It is true that failure of these insurers is unlikely to materially impact the financial soundness of the sector, but public confidence could be impacted. Were several small insurers to suffer financial distress after a significant event it could cause a significant decline in public confidence.

As such, FMG would not support further exemptions for small insurers.

1.8 Are there any other ways in which we might improve financial disclosure to improve policyholders' and other interested parties' ability to assess insurer's financial strength?

Insurers responsible for disclosing to clients

The ICNZ's submission notes that, where a policy is sold via an intermediary (e.g. a broker), the requirement to disclose and liability for non-disclosure should rest with the intermediary, with the insurer's obligation being limited to disclosing their financial strength rating to that intermediary.

In our view, this would not encourage enhanced policyholder security. Either the insurer should be responsible for directly engaging with the client, or otherwise it should have effective systems and processes in place to ensure that appropriate disclosure has been made.

Q4.5: Should all policyholders be given priority in insolvency over other general creditors?

Policyholder preference in insolvency situation

The ICNZ's submission also notes general support for introduction of a policyholder preference in insolvency. However, FMG is concerned that prioritising policyholders over other creditors may create a number of unintended consequences.

Introducing this preference would be unique within the New Zealand context (in that no other industry puts their customers ahead of suppliers). It is expected that this would also have the following adverse impacts on general insurers' operations:

- Commercial arrangements with partners, suppliers and other parties may need to be renegotiated due to the change in risk profile;

- This change puts these parties in a less advantageous position that exposes them to more risk (i.e. that in the event of solvency, they will not be repaid); and
- We expect this would be reflected in a reduced willingness to work with insurers, price uplifts and/or more restrictive/less favourable terms. In particular, it is expected this change could increase costs for insurers.

In turn, we expect the consequences of this change would flow through to and adversely impact policyholders in terms of what they pay for insurance and the availability of cover. There may also be unintended consequences as result of this change, especially in so far as arrangements with other industries are concerned (e.g. technology or platform providers, or even contractors involved in a reinstatement such as a house rebuild).

We also acknowledge and agree with comments in paragraph 204 of the Options paper that introducing a policyholder preference in insolvency is likely to provide fewer benefits than it would for bank depositors, where large (and simple) amounts of unsecured debt are involved and need to compete with depositors for assets in insolvency. In contrast, the nature and variety of insurance products and policyholders' interests in them mean that they may be less exposed, and that the preference mechanism would need to be very complex and costly to comply with.

Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Regulatory Affairs Manager at [REDACTED]

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'C Black', with a long horizontal flourish extending to the right.

Chris Black
Chief Executive
FMG

Monday 15 November 2021

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
Wellington 6140

By email: ipsareview@rbnz.govt.nz

Reserve Bank of New Zealand Review of the Insurance (Prudential Supervision) Act 2010 Options Paper 2: Policyholder Security

This submission on the Reserve Bank of New Zealand (RB) Review of the Insurance (Prudential Supervision) Act 2010 (IPSA) Options Paper 2: Policyholder Security, 31 August 2021 (the Review), is from the Financial Services Council of New Zealand Incorporated (FSC).

As the voice of the sector, the FSC is a non-profit member organisation with a vision to grow the financial confidence and wellbeing of New Zealanders. FSC members commit to delivering strong consumer outcomes from a professional and sustainable financial services sector. Our 98 members manage funds of more than \$95bn and pay out claims of \$2.8bn per year (life and health insurance). Members include the major insurers in life, health, disability and income insurance, fund managers, KiwiSaver and workplace savings schemes (including restricted schemes), professional service providers, and technology providers to the financial services sector.

Our submission has been developed through consultation with FSC members and represents the views of our members and our industry. We acknowledge the time and input of our members in contributing to this submission.

The FSC's guiding vision is to grow the financial confidence and wellbeing of New Zealanders and we strongly support initiatives that align with our strategic intent and deliver:

- strong and sustainable customer outcomes
- sustainability of the financial services sector
- increasing professionalism and trust of the industry.

We welcome the opportunity to provide feedback on the Review and support the continued aims from 2017 of policyholder protection, a cost effective regulatory regime, and a sound insurance sector. The key points of this submission are as follows:

- We strongly encourage the RB to undertake comprehensive research and user experience testing with consumers on how they form their view of financial strength, what disclosures would be valuable to them, and how they can be presented in way that customers can understand.
- We encourage the RB to consider a website maintained and updated by the RB to assist the insurance industry and policyholders to have accurate information on financial strength ratings (FSR) that is clearly explained and can be compared to make informed decisions.
- We do not consider that disclosing solvency information is beneficial for consumers. The focus of the Review on disclosures should be on FSRs and the removal of the requirement to

disclose solvency information due to the lack of comparability between insurers and the distortion of solvency information.

- We consider policyholder protection to be sufficiently addressed by solvency requirements coupled with strong governance oversight, good risk management policies and practices rather than costly statutory funds or a policyholder guarantee scheme that would inevitably impact the cost of insurance in New Zealand.

It is concerning that this Review addresses how solvency should be structured, and the various control levels, after the consultation on the Exposure Draft of the Interim Solvency Standard, 21 July 2021 (the Draft ISS). We strongly encourage consideration of the remaining options papers in the Review and coordination with solvency standard consultation or engagement prior to reaching the final interim solvency standard.

We welcome continued discussions.

██
██

Yours sincerely

Richard Klipin
Chief Executive Officer
Financial Services Council of New Zealand Incorporated

1. FINANCIAL STRENGTH DISCLOSURES

We consider that the FSR disclosures¹ framework should be reviewed to better achieve its regulatory objectives. Our suggestions for how the disclosures regime could be improved are detailed in response to Question 1.4 below.

1.1 Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

Some of our members agree that the current exemptions for small insurers should be maintained, however other members have concerns that this exemption creates an unequal playing field and all insurers should be subject to equal supervision and as such do not consider the current exemptions should be extended. The risk of a smaller and potentially less capitalised entity failing is arguably higher than those which are larger and more established. Whichever approach is taken, the disclosure requirements should be reviewed to ensure that consumers understand what a FSR is, and the potential risks to consumers from unrated or exempt insurers.

1.2 Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?

We do not consider that the disclosure requirements provide sufficient contextual information to consumers to support informed decision making. The disclosure requirements should be reviewed to ensure that consumers are provided with a plain English explanation of what an overseas policyholder preference is and the risk that it poses to domestic policyholders.

1.3 Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?

We do not support solvency disclosures as noted under option 5 in Question 1.4 below and we consider that the current FSR disclosure regime should be reviewed to ensure efficiency and effectiveness of disclosure. Consistent with the principles of the IPSA, we believe that this can be achieved in a way that both improves customer outcomes but also reduces compliance costs and operational complexity for insurers.

We suggest consideration of a RB webpage that advisers, intermediaries and existing or potential policyholders can access, which records all insurers FSRs, when they last changed and the result of that change so comparisons can be easily made. This would simply be an extension of the insurer FSR information that is already on the RB website. Additional explanatory information regarding FSRs, small insurer exemptions, and policyholder preference could be made available through this webpage. We consider this approach would be more beneficial to customers, ensuring greater accuracy and consistency in how information is disclosed, reduce compliance costs and operational burden (insurers could simply refer customers to the RB webpage in their collateral). Insurers would still be required to notify of policyholders of a downgrade, however this could be done in far less

¹ Sections 64 and 65 of the IPSA.

risky manner on a RB managed website whereby notifications could be readily and instantaneously changed by the RB upon receipt of notification of the change from the insurer at no material cost.

Many customers do not appear to understand what a FSR is, what they mean and how to compare between the different agencies. Given that the RB already displays ratings, they should be the single repository. Information should be included on what the ratings mean, including an explanation of the difference between the different rating agencies so people can compare in an informed manner. We also recommend an education programme to further assist consumers.

A further benefit of displaying the FSRs on the RB website is that the RB would obtain data on the numbers accessing this information which would help guide future disclosure and policy around the benefit of future rating disclosures. Furthermore, the RB website display could be expanded to enable consumers to make comments or provide feedback.

1.4 Out of the options presented in Section 3.4, what is your preferred option or combination of options for public solvency disclosure requirements?

Option 1

As noted under Question 1.3 above, we support option 1 of maintaining the status quo for FSRs but with modifications to improve efficiency and effectiveness of disclosure. However, as noted under Option 5 we do not support the disclosure of solvency information.

Option 2

We refer to our response at Question 1.1.

Option 3

We do not support rotating rating agencies. Many of our members use the rating agency selected by their parent company and to require rotations would create significant complexity for these members. This is important as part of the insurer's rating may be linked to implicit or explicit parental support which the rating agency can assess more accurately if it is also rating the parent. Requiring a subsidiary to have a different agency will lead to duplication and be costly, inefficient, and inconsistent.

Often customers are with the same insurer for many years. If the insurer were to rotate rating agencies every few years this could be confusing for customers, particularly given the different rating scales. There is a risk that a customer may perceive that there is a change in the insurer's financial strength when in fact the only change is the agency providing the rating.

Changes in ratings, credit watches or rating agencies come at significant cost. Collateral and forms would need to be reprinted and replaced. Communication would be required through all distribution and intermediary channels resulting in additional costs for those channels also. We do not consider that the perceived benefits from rotating rating agencies as noted in the Review sufficient to justify the cost. In addition, as there are only three approved rating agencies it is questionable what value would be added if all insurers were rotating between the same three agencies.

Insurers' management teams spend a significant amount of time educating their rating agency's analyst team as to the strategy and operating fundamentals of their business. Therefore, rotating on a regular basis would require re-education. The continuity of agency ensures the agency has

sufficient historical knowledge of the business to accurately assess the financial strength of the insurer.

We disagree with the proposition that insurers can shop around for more favourable ratings. This would be an expensive process to seek an indicative rating from multiple agencies and switch to the most favourable one. Ratings agencies have similar methodologies in assessing financial strength, so it is unlikely the rating given by one agency will differ materially from another. If the RB is concerned about the relative merit of different rating agencies, we suggest the more effective way to manage such an issue would be to revoke the RB's approval of the applicable rating agency or agencies.

Option 4

We support standardising the information consumers and policyholders receive as suggested at paragraph 101. This information could be standardised into a RB webpage as a central point for the reasons discussed Question 1.3 above, for an impartial guide to financial strength, for understanding usage, and how it can be improved.

Insurers could then be required to disclose the RB's webpage details in a similar manner to the existing requirements under IPSA. This would not only provide consumers with access to a useful source of information (which importantly would include comparative and historical information) but also simplify the process for insurers managing future changes and reduce costs.

We note the suggestion of a guide at paragraph 102 and do not support this primarily due to the fact it is unlikely to achieve the RB's regulatory objectives as well creating additional compliance costs and operational complexity (for example, a change in rating for any one insurer would mean that all insurers would need to update the guide and distribute the updated guide through all channels). We also do not support overlaying rating agencies' existing scales with another scale or traffic light system as we consider would add yet another layer of complexity into the disclosure process and will likely cause more customer confusion.

Option 5

We do not consider that disclosing solvency information is beneficial for consumers and as previously submitted by the FSC and acknowledged by the RB, solvency information is distorted and not comparable between insurers. We suggest that the RB focuses on FSR disclosures and remove the requirement to disclose solvency information.

1.5 If we increase the public disclosure of solvency ratios, what solvency measures do you think would be the most informative to the public?

As noted under Option 5 in Question 1.4 above, we do not support the disclosure of solvency information. Solvency is a complex matter and we do not consider that consumers benefit from such disclosures. Solvency ratios represent a point in time and are only meaningful if consumers undertake regular or long term reviews of solvency ratios. We do not consider that this is a reasonable burden to place on consumers.

In addition, projected solvency ratios are also considered unhelpful to customers. Projections are inherently uncertain and would require extensive explanations, assumptions, and disclaimers so the information will be lengthy and technical to the point that it may become meaningless to consumers.

If research with consumers shows there is indeed consumer demand and they are considered of value, then it should be standardised and simplified in order to enable comparisons. The use of plain English to enable customers to understand what it means and revealing the real solvency position is important. The RB would also need to play a role in educating customers but not so far as to give customers the perception that they can place reliance on such tools simply as they have been approved by a regulator.

1.6 Do you think there is a better public solvency disclosure requirement than the options here? If yes, what disclosure requirement would you like to see?

We do not consider there to be a better public solvency disclosure requirement. Rather, we consider that the RB should focus on creating an efficient and effective FSR disclosure regime. We refer to our responses to Questions 1.3 and 1.4 for a RB webpage and a simplified disclosure regime.

1.7 Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure (as set out in table 3, page 19)? If not, what other high level costs or benefits should be considered?

We do not consider the provision of percentages to be transparent or helpful as they do not reflect the true position. We also disagree with the assessment provided in Table 3 of the Review as noted in Appendix 1 of this submission.

1.8 Are there any other ways in which we might improve financial disclosure to improve policyholders' and other factors ability to assess insurer's financial strength?

As an overall comment, we have concerns that providing customers with lengthy and potentially complex information will be confusing and detract from other pertinent information in respect of their insurance cover, for example, policy terms and exclusions. As such, disclosure must be meaningful and useful to customers and strike a balance between ensuring they are informed but not being so overwhelming that it acts as a deterrent to obtaining insurance cover.

We strongly encourage the RB to undertake comprehensive research and user experience testing with consumers on how they form their view of financial strength, what disclosures would be valuable to them and how they can be presented in way that customers can understand them.²

2. SOLVENCY REQUIREMENTS

We note the overlap and connection of how solvency should be structured and the various control levels in this section with the Draft ISS. We reiterate, where applicable, our earlier submitted points as part of the Draft ISS consultation.

² A useful reference in this context is the report Disclosure: Why it shouldn't be the default, a joint report from the Australian Securities and Investments Commission (ASIC) and the Dutch Authority for the Financial Markets (AFM) (<https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-632-disclosure-why-it-shouldn-t-be-the-default/>).

2.1 Would it be helpful to replace the language of ‘solvency margin’ and ‘solvency ratio’ with either:

- **A metric based on the relationship between Actual Solvency Capital and Minimum Solvency Capital, or**
- **The relationship between stressed assets and stressed liabilities?**

We question whether it is appropriate to consider this now or preferable to review once the amended solvency standard is finalised and there is better understanding of the underlying ratios and their comparability across insurers.

We also seek clarity on whether the objective behind making such replacements is to enhance consumer understanding, and if so, how changing from a solvency margin and solvency ratio to a metric assist in that objective. We encourage consideration of what has been applied for banks whereby videos on what ‘solvency’ means are provided in easy to understand language and further public education initiatives.

2.2 Should New Zealand solvency terminology be aligned with international standards? Why or why not?

We support alignment for international consistency.

2.3 Which international terminology would it be best for New Zealand to align with?

We consider it preferable to align with jurisdictions with similarities in products, namely the yearly renewable term (YRT) market.

2.4 Should IPSA enable a separate standard dealing with Financial Condition Reports? (Why/why not?)

Further clarity is sought on the RB concerns as it is not clear what additional benefits this would provide. We consider that the RB should have the ability under the IPSA to publish the standards that are necessary to appropriately regulate the insurance sector. If a separate standard is deemed necessary for Financial Condition Reports, then the IPSA should allow this, subject to a consultative development process.

We also consider that removing these additional sections from the Final Interim Solvency Standard would aid clarity.

2.5 How useful are s.78 reports? Should they be continued or replaced?

We consider that section 78 reports should be removed. The external audit and audit reports already include a review of insurance (actuarial) liabilities and solvency positions. The section 78 report adds very little, if anything, to the financial statements which are already externally audited.

2.6 Would it be helpful for IPSA to contemplate more than one solvency control level?

We are comfortable with a graduated ladder of intervention and an internal capital adequacy assessment process. The IPSA should contemplate if this facilitates a graduated response from the RB.

2.7 How many control levels would be useful?

We consider two control levels to be useful, a business as usual stress level and the other for a risk or distress state.

2.8 How should the Reserve Bank's powers relate to the different control levels?

We consider that RB should articulate what powers can be used at the different control levels but, at the same time, retain the flexibility to respond appropriately to individual stress events.

We consider a key component currently missing from the RB's approach is an insurer's own recovery or resolution plan to help facilitate an orderly recovery or exit in the event of financial distress. As noted by APRA, "a recovery plan comprises a menu of recovery options designed by a financial institution to enable it to survive a financial shock and restore itself to a sound financial condition without the need to seek public sector support".³ We suggest that the RB's toolbox to manage insurers in distress includes insurer recovery and resolution plans.

2.9 Should powers be unlocked sequentially?

We support a graduated response.

2.10 Should powers unlock at the top rung, with the Reserve Bank issuing public guidance on how it intends to use its powers?

We support the issuance of guidance depending on the final decision reached.

2.11 Should any actions on the part of the Reserve Bank be mandatory when one of the control levels is breached?

We support a discretionary approach.

2.12 Should a minimum solvency margin of zero be required by default (without the need to specify it in a license condition)?

We consider it more appropriate to be specified in license conditions.

³ <https://www.apra.gov.au/news-and-publications/apra-releases-key-observations-from-thematic-review-of-insurers-recovery> 18 September 2019

2.13 Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?

We support this approach only in specific circumstances as per the FSC's previous submission on the on the RB Review of Insurance Solvency Standards: Structure and IFRS 17 Consultation Document, November 2020. Supervisory adjustments should be the exception rather than an integral part of capital requirements and should only be introduced if there is a robust and transparent process, with open dialogue between the RB and market participants.

2.14 Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?

We support the right of recourse and the ability to engage and proceed to mediation where applicable with an appropriately appointed independent expert or arbitration.

3. TERMINATION VALUES

3.1 Should IPSA contain provisions requiring minimum termination values for policies that store value long-term? Why / why not?

We do not consider that the IPSA should contain such provisions as they are already allowed for within the contracts of the products that have stored value.

Policy termination values are not a matter of prudential regulation. Rather they are an issue related to policyholder value and therefore conduct. From a purely prudential regulation perspective, the RB should discourage minimum termination values as these impose an additional constraint on insurers that may restrict an insurer's ability to respond to financial distress.

3.2 What would be an appropriate basis for setting minimum termination values?

Refer to our response to Question 3.1.

4. STATUTORY FUNDS

General overview

We query the continued relevance and purpose of statutory funds. As noted in paragraph 182 of the Review, traditionally life contracts included an investment element. However, these types of products have not been actively sold for a number of years in New Zealand. Therefore, in a mainly YRT risk life and health market, we query whether statutory funds are still relevant given the additional complexity and director duties imposed by their administration. We note there is currently no requirement for general insurers to maintain statutory funds, yet they have current unearned premium and outstanding current claims liability similar to life companies.

If the intent is to give insurance policyholders some form of preference over other creditors this would be better achieved through policyholder preference which is simpler to implement and more cost effective.

We consider the most effective means of protecting policyholders is achieved through the regulation of capital management. Policyholders' security will always be better protected by requiring insurers to meet or surpass the requirements of appropriate solvency standards, coupled with a requirement for insurers to have strong governance oversight and good risk management policies and practices.

4.1 Is it still appropriate to provide statutory fund treatment for YRT business? Or should statutory funds only apply to business where policyholders build up a store of value over time to fund their later claims (for example, participating business, unit-linked business, investment accounts and annuities).

We do not consider it is appropriate to apply statutory fund treatment for YRT life and health business. However, some members consider statutory funds to be only applicable for investment style or longer term liabilities and some members are of the view statutory funds should not apply at all.

4.2 Should health or disability insurance assets be held in statutory funds?

As noted in the general overview above, we see no benefit for health or disability insurance assets to be held in statutory funds and we support the introduction of policyholder preference.

4.3 Should general insurance contracts also have assets held in statutory funds?

We have not responded to this question as FSC does not have general insurance members.

4.4 If so, should that include:

- All general insurance business;
- Assets backing business with a contract boundary over one year;
- Assets backing accepted claims over a particular size, for claims that are likely to take more than one year to settle;
- Some other subset of general insurance business?

We consider there should be the same requirements as for life insurers and one fund for simplicity.

4.5 Should all policyholders' be given priority in insolvency over other general creditors?

We support policyholder priority as a statutory creditor priority may be the best way to improve policyholder security. This is also preferable to statutory funds which are costly to administer.

4.6 Should priority be confined to policy benefits or also include claims for unearned premium?

We consider priority be limited to claims only.

4.7 Should IPSA be amended so as to make it more explicit that assets (other than transactional bank accounts) should not be shared across different statutory funds?

We do not agree with amending the IPSA in this regard as individual insurers operate differently, have different processes and splitting assets or bond holdings across different accounts may be operationally difficult. Depending on liquidity requirements term deposits may also be difficult to break or split.

4.8 Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?

We note the inconsistent requirements at present. For many New Zealand policyholders being part of an overseas statutory fund will provide an enhanced level of security relative to requiring a specific New Zealand fund or trust for the branch. The overseas fund will typically be larger, more diversified across risks and often have the benefit of economies of scale that may not be available to a smaller dedicated New Zealand fund. For knowledgeable policyholders these may be the very reasons that they purchased the policies they have. We therefore question whether it is appropriate to remove this from these policyholders.

4.9 If requirements to establish a trust were included, are there any issues about the trust's constitution that should be specified in IPSA?

We have no comment on this question.

4.10 Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?

We have no comment on this question.

4.11 Should life insurers with participating life insurance business be required to prepare accounts for capital and retained profits in their statutory funds? Should these be disclosed:

- As a note to the insurers financial accounts? Or,
- In data returns for participating business provided by the Reserve Bank.

We have no comment on this question.

5. RISK APPETITE AND OVERALL POLICYHOLDER PROTECTION

5.1 Do stakeholders think that regulation in respect of each of the channels listed in **para 218 is broadly appropriate?**

We consider these to be broadly appropriate.

5.2 If not, which areas are over-regulated or particularly in need of enhancement?

We have no comment on this question.

5.3 Are there any additional measures for policyholder security that the Reserve Bank should consider?

We have no comment on this question.

5.4 Have we correctly identified the risks that a policyholder guarantee scheme should address?

If it is determined that a policyholder guarantee scheme is a credible and supported option, a separate consultation on a policyholder guarantee scheme should be considered, particularly due to funding details and the costs that will inevitably be passed on to customers due to increased premiums. The RB will also need to ascertain public appetite for this when it has been recognised in recent research that New Zealanders are underinsured for life and health products and increased premiums will potentially be a deterrent for getting more people to take out policies.

5.5 Are there other risks we have not considered that a scheme could also address?

As noted in response to Question 5.7, we do not support the introduction of a policyholder guarantee scheme.

5.6 Are there particular kinds of policy for which a scheme is particularly important?

As noted in response to Question 5.7, we do not support the introduction of a policyholder guarantee scheme.

5.7 Overall, to what extent do you think a policyholder guarantee scheme is worth considering for New Zealand?

We do not support the introduction of a policyholder guarantee scheme given how this would be funded and the unintended consequence that it may in fact result in being passed onto consumers. We consider policyholder protection to be sufficiently addressed by solvency requirements coupled with strong governance oversight and good risk management policies and practices and policyholder preference.

A policyholder guarantee scheme also needs to be viewed in the wider context of policyholder protection rather than just as a standalone consideration. The review of the matters raised in this Review as well as the concurrent review of the solvency standards are all measures that will ultimately mitigate the risks that would warrant a policyholder guarantee scheme.

As noted in paragraph 225 of the Review, the areas covered by these schemes internationally (compulsory motor insurance and private pensions), are not products provided by licenced New Zealand insurers. The closest products to these may be annuity or income protection policies where policyholders are dependent on the insurer for payments over a prolonged period and are relatively small product classes which does not warrant a scheme for the entire industry.

5.8 Are there particular kinds of policies that should be covered by a guarantee scheme?

As noted in response to Question 5.7, we do not support the introduction of a policyholder guarantee scheme.

Appendix 1: Amendments required to Table 3 of the Review

	2	3	4	5
info			Down red	
discipline		Should be dash		
Insurer complexity		two red arrows	More complexity	More complexity
Market participation				

Table 3: overview of the costs and benefits of alternative options compared to option 1 - the status quo.				
Provide information to a consumer or policyholder.	↓	–	↓	–
Improve market discipline.	↓	–	–	↑
Complexity and cost for insurer.	↑	↓ ↓	↑	↑
Impact on market participation.	↑	–	–	↓



FINANCIAL SERVICES FEDERATION

15 November 2021

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
Wellington 6140

By email to: ipsareview@rbnz.govt.nz

Dear Sir/Madam

FSF submission on IPSA Review Policyholder Security Consultation

The Financial Services Federation (“FSF”) thanks you for the opportunity to submit on the IPSA Review Policyholder Security Consultation.

By way of background, the FSF is the industry body representing the responsible and ethical finance, leasing, and credit-related insurance providers of New Zealand. We have over eighty members and affiliates providing these products to more than 1.7 million New Zealand consumers and businesses. Our affiliate members include internationally recognised legal and consulting partners. A list of our members is attached as Appendix A, and data relating to the extent to which FSF members (excluding affiliate members) contribute to New Zealand consumers, society, and business is attached as Appendix B.

As the FSF membership captures credit-related insurance providers, categorised as non-life and general insurers, this warrants our submission on some of the matters contained in this second IPSA Options Paper.

The FSF’s submission is written mainly with the purpose of full support to the Insurance Council of New Zealand’s (“ICNZ”) submission on this same Options paper. We will make some further specific comments in representation of smaller general insurers but nonetheless our submission remains in full alignment with ICNZ’s.

Our submission will consist of general comments on the Options paper followed by more specific comments on the options and schemes contained in the Paper.

General comments

In support of ICNZ’s submission, the FSF echoes concerns regarding what problems have actually been identified which warrant the proposals contained in the Options paper, and whether this Options paper in itself is the most appropriate method of achieving some of

the policy objectives when considering the upcoming introduction of proposals to review the existing Insurance Contract Law regime (“ICL”) and other suites of relevant legislation.

The FSF is also extremely mindful of the burdens and costs associated with the proposed regulation being disproportionate to the actual risks and harm identified, particularly on general and smaller insurance providers. There is a tremendous amount of regulatory change being imposed on the insurance and finance sector currently and even more is forecast. The FSF urges caution considering the introduction of further regulation. With the current trajectory of compliance requirements Aotearoa’s open market is being more difficult to inhabit for smaller insurers and is certainly a barrier to new entrants and innovation.

The FSF believes a comprehensive analysis should be undertaken prior to any further regulatory introductions, confirming that there is an actual and realised need for this reform and properly informing market participants on such issues. The FSF queries whether such a method was applied in the introduction of this Options paper.

Financial strength disclosures

In relation to this proposed matter, the FSF aligns completely with the ICNZ’s submission. The FSF strongly maintains that the current exemption for small insurers from financial strength rating disclosures should be maintained. Alongside ICNZ, we support a small increase to the exemption to \$2m to maintain an open market to small insurers in light of an increased market cost.

The FSF is comfortable with the current solvency terminology and does not support this being changed. Policyholders do not need any further information on reinsurance and so forth. The FSF supports ICNZ’s suggestion that financial disclosures should rather be designed to reflect modern practices for the dissemination of information, such as being website based, rather than being further prescribed into jargon heavy and intimidating language likely to disincentive policyholder engagement and achieve the reverse of this proposal’s objective.

Solvency standards

The FSF also supports the more banded approach to the assessment of solvency with two control levels, therefore being more useful if IPSA contemplate more than one solvency control level.

Again, the FSF’s opinions align with ICNZ’s answers to questions 2.1 – 2.14 in their submission. We particularly agree with the ICNZ’s rationale behind this two-banded approach, as it will indeed enable supervisors to take a more graduated approach, increasing their oversight before insurers are in distress.

Termination values

The FSF does not agree that there should be any minimum termination values. We also concur with ICNZ’s suggestion that this should not be in the realm of the IPSA review, but rather considered for ICL.

Statutory funds

The FSF does not consider that a statutory fund is appropriate and is uncertain as to the defined problem which the proposal is designed to resolve.

Although other jurisdictions have used statutory funds for life insurance, FSF insurance members who are general insurance providers, do not see any need for statutory funds to be imposed on them. The reasoning for this has been echoed many times in the FSF's submission on the Draft Interim Solvency Standards exposure draft consultation.

In summary this submission states that there have not been any risks identified specific to the small and general insurance sector which places them in the category of associated risks which the life and non-general insurance sector possess. Punishment and further compliance costs on such entities who have not provided any justification for the need for this further regulation is detrimental to the operation and market participation of smaller entities. General and non-general are categorised differently as a result of the nature of the products and the vast differences in their risks associated. Therefore, the FSF does not support the proposal of statutory funds and their application on general and non-life insurance.

Policyholder preference

In the unlikely case that insolvency has occurred, the FSF has no contention with the introduction of a policyholder preference on insolvency. Its application in Australia would suggest that this is a logical form of policyholder protection and the FSF supports its application in New Zealand.

However current regulatory regimes in combination with the Reserve Bank of New Zealand's toolkit and prudential and enforcement regimes, mitigate the risks of insolvency greatly, and this is therefore not of great concern to FSF and its members.

Policyholder guarantee scheme

The FSF reiterates the ICNZ's points against a policyholder guarantee scheme:

- It is unclear what problem is to be solved with the introduction of a policyholder guarantee scheme.
- The current solvency standard and policyholder protection framework are sufficient to meet the matters that the policyholder guarantee scheme is seeking to address.
- The scheme does not align with IPISA's principles and purposes, and the introduction of the scheme would impose significant unnecessary costs and complexity.

These points suggest such a scheme is unnecessary and therefore requires no introduction. Current solvency standards, alongside the Reserve Bank of New Zealand's toolkit, are quite sufficient to deal with solvency and consumer protection.

Conclusion

The FSF is arguing mainly for a continuation of the status quo, with slight enhancements where there have been issues identified. The main concern is that this thrust of changes is adding unnecessary costs and causing a disproportionate negative impact on general and smaller insurance providers. The FSF also asks that any further proposed changes have

clearly articulated issues and objectives. Proposals which have not identified a realised issue are not persuasive in their necessity.

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact the FSF's Legal and Policy Manager by emailing [REDACTED]

Yours sincerely,

A handwritten signature in black ink, consisting of several overlapping loops and a vertical stroke, positioned to the left of the typed name.

Diana Yeritsyan
LEGAL AND POLICY MANAGER
Financial Services Federation

Appendix A



FINANCIAL SERVICES FEDERATION

FSF Membership List as at November 2021

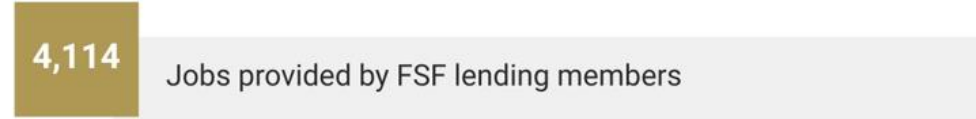
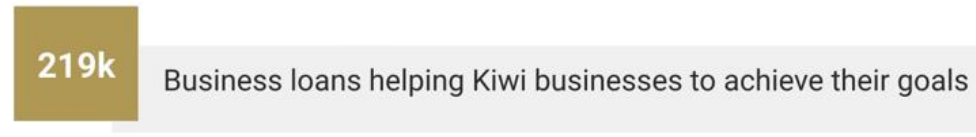
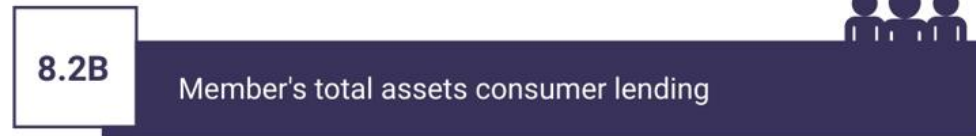
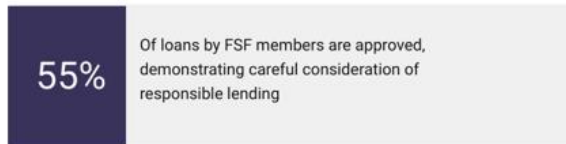
Non-Bank Deposit Takers, Insurance Premium Funders,	Vehicle Lenders	Finance Companies/ Diversified Lenders	Finance Companies/ Diversified Lenders, Leasing Providers	Credit Reporting, Debt Collection Agencies, Insurance Providers	Affiliate Members
<p>XCEDA (B)</p> <p>Finance Direct Limited ➤ Lending Crowd</p> <p>Gold Band Finance ➤ Loan Co</p> <p>Mutual Credit Finance</p> <p><u>Credit Unions/Building Societies</u></p> <p>First Credit Union</p> <p>Nelson Building Society</p> <p>Police and Families Credit Union</p> <p><u>Westforce Credit Union</u></p> <p><u>Insurance Premium Funders</u></p> <p>Elantis Premium Funding NZ Ltd</p> <p>Financial Synergy Limited</p> <p>Hunter Premium Funding</p> <p><u>IQumulate Premium Funding</u></p> <p>Rothbury Instalment Services</p>	<p>AA Finance Limited</p> <p>Auto Finance Direct Limited</p> <p>BMW Financial Services ➤ Mini ➤ <u>Alpha</u> Financial Services</p> <p>Community Financial Services</p> <p>European Financial Services</p> <p>Go Car Finance Ltd</p> <p>Honda Financial Services</p> <p>Kubota New Zealand Ltd</p> <p>Mercedes-Benz Financial</p> <p>Motor Trade Finance</p> <p>Nissan Financial Services NZ Ltd ➤ Mitsubishi Motors Financial Services ➤ Skyline Car Finance</p> <p>Onyx Finance Limited</p> <p>Toyota Finance NZ</p> <p>Yamaha Motor Finance</p>	<p>Avanti Finance ➤ Branded Financial</p> <p>Basalt Group</p> <p><u>Basecorp Finance Ltd</u></p> <p>Blackbird Finance</p> <p>Caterpillar Financial Services NZ Ltd</p> <p>Centracorp Finance 2000</p> <p>Finance Now ➤ The Warehouse Financial Services ➤ Southsure Assurance</p> <p>Humm Group</p> <p>Future Finance</p> <p>Geneva Finance</p> <p>Harmony</p> <p>Instant Finance ➤ Fair City ➤ My Finance</p> <p>John Deere Financial</p> <p>Latitude Financial</p> <p>Lifestyle Loans NZ Ltd</p> <p>Metro Finance</p> <p>NZ Finance Ltd</p>	<p>Pepper NZ Limited</p> <p>Personal Loan Corporation</p> <p>Pioneer Finance</p> <p>Prosopa NZ Ltd</p> <p>Smith's City Finance Ltd</p> <p>Speirs Finance Group ➤ Speirs Finance ➤ Speirs Corporate & Leasing ➤ <u>Yogo</u> Fleet</p> <p>Thorn Group Financial Services Ltd</p> <p>Turners Automotive Group ➤ Autosure ➤ East Coast Credit ➤ Oxford Finance</p> <p>UDC Finance Limited</p> <p><u>Leasing Providers</u></p> <p>Custom Fleet</p> <p>Fleet Partners NZ Ltd</p> <p>ORIX New Zealand</p> <p>SG Fleet</p>	<p>Baycorp (NZ) ➤ Credit Corp</p> <p>Centrix</p> <p>Collection House</p> <p><u>Debtworks (NZ) Limited</u></p> <p>Equifax (<u>prey</u> Veda)</p> <p>Illion (<u>prey</u> Dun & Bradstreet (NZ) Limited</p> <p>Intercoll</p> <p>Quadrant Group (NZ) Limited</p> <p><u>Credit-related Insurance Providers</u></p> <p>Protecta Insurance</p> <p>Provident Insurance Corporation Ltd</p>	<p>Buddle Findlay</p> <p>Chapman Tripp</p> <p><u>Credisense Ltd</u></p> <p>Credit Sense Pty Ltd</p> <p>Experian</p> <p>EY</p> <p>FinTech NZ</p> <p>Finzsoft</p> <p>Green Mount Advisory</p> <p>Happy Prime Consultancy Limited</p> <p>HPD Software Ltd</p> <p>KPMG</p> <p>LexisNexis</p> <p>PWC</p> <p>Simpson Western</p> <p>Verifier Australia</p> <p>Total 83 members</p>

Appendix B



FINANCIAL SERVICES FEDERATION

The Financial Services Federation (FSF) is the non-profit industry association for responsible and ethical finance, leasing and credit-related insurance providers operating in Aotearoa New Zealand.



Data collected and aggregated by KPMG in FSF's annual member data survey as at February 2021. Values in NZ\$.

IAG New Zealand submission

to the

Reserve Bank of New Zealand – Te Pūtea Matua

on the

IPSA Review: Options Paper 2 Policyholder Protection

15 November 2021



1. Introduction

- 1.1 This submission is a response by IAG New Zealand Ltd (IAG, we) to the Reserve Bank of New Zealand – Te Pūtea Matua (RBNZ) on the Review of the Insurance (Prudential Supervision) Act 2021 ('IPSA'), Options Paper 2: Policyholder Security ('Options Paper').
- 1.2 We welcome the opportunity to submit on this consultation and the RBNZ's ongoing engagement during this review. We note that a number of the topics and options covered in this Options Paper are discussed at a high level and that if these are to be progressed, then further engagement with insurers will be required. This will be important to both fully understand the costs, benefits and risks of any specific proposals, as well as to ensure such approaches are effective and efficient in practice.
- 1.3 We also note that as discussed in our response to Q5.1 below, the risk appetite in relation to policyholder protection is not currently articulated explicitly. We have therefore approached this consultation on the basis that current policy settings (e.g. section 4(d)(ii) of IPSA) and the last decade of experience represent the current appetite for policyholders to suffer a loss from an insurer failure. Greater clarity on the intended risk appetite in this respect would make it much clearer what objective is trying to be achieved through the regime, the sorts of measures that may be appropriate and how they should be designed and calibrated. Explicit consultation on this point would enable feedback on this aspect to be sought from stakeholders.
- 1.4 IAG is New Zealand's leading general insurer. We insure more than 1.8 million New Zealanders and protect over \$650 billion of commercial and domestic assets across New Zealand. We receive more than 450,000 claims a year and in the last financial year paid \$1.576 billion in settling them.
- 1.5 IAG's contacts for matters relating to this submission are:

Bryce Davies, Executive Manager Corporate Relations



Andrew Saunders, Government Relations Manager



2. Responses to questions in the Options Paper

Question in Options Paper	IAG Feedback
Financial strength disclosures	
<p>Q1.1: Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?</p>	<p>If the current exemptions in regard to financial strength ratings are maintained, we consider any increases in the thresholds should be limited to maintaining equivalency to when they were last set.</p>
<p>Q1.2: Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?</p>	<p>We consider improvements are required to address potential gaps in the current rules and to assist policyholders to properly understand the implications and risks associated with an overseas policyholder preference. We refer to the specific recommendations contained in ICNZ’s submission on this topic including:</p> <ul style="list-style-type: none"> • introducing a specific requirement on intermediaries to provide disclosure of overseas policyholder preferences; • regular and robust RBNZ monitoring of overseas arrangements to ensure notification requirements are being adhered to; and • developing educational materials based on research and testing that help New Zealand policyholders to better understand the risks involved when an overseas policyholder preference is disclosed. <p>We also note that if a policyholder preference in insolvency was to be introduced (refer to our responses to Q4.5 & Q4.6 below) it would be necessary to take steps to avoid confusion amongst policyholders as to the completely different implications of domestic and overseas policyholder preferences on different types of insurers.</p>
<p>Q1.3: Do you consider the current financial strength rating and solvency disclosure sufficient to provide consumers and policyholder’s information on the solvency of insurers? If no, what information would most help consumers and policyholders?</p>	<p>While the current financial strength rating and solvency disclosures have their limitations, we consider they are broadly appropriate and provide an outline of an insurer’s financial soundness that is useful for policyholders and other observers. The nature of insurers reinsurance programmes is also important to understanding their financial strength, and we note some of this information is already disclosed publicly by some insurers.</p> <p>We are concerned that making changes to aspects of the disclosure requirements may not increase understanding by policyholders and in turn risks creating confusion, while also introducing additional complexity and costs. It is nonetheless important to at least modernise the requirements to provide for the increasing move away from</p>

Question in Options Paper	IAG Feedback
	paper-based transactions and to reduce unnecessary compliance costs for insurers.
Q1.4: Out of these options, what is your preferred option or combination or options for public solvency disclosure requirements?	<p>Option 1 – Maintain the status quo</p> <p>As outlined above in response to Q1.3 above and further below, we consider the status quo (financial strength rating and solvency ratio disclosure) remains generally appropriate and understandable.</p> <p>Option 2 (Change the exemptions for small insurers)</p> <p>Overall, we consider some changes to the rating exemptions for small insurers are appropriate, but these must be limited to addressing specific areas of disproportionality. Material gaps and/or regulatory distortions should not be introduced.</p> <p>A small increase in the premium income threshold for the exemption for small insurers from financial strength rating disclosure requirements (Option 2A) may be appropriate, but it must remain at a low level and proportionate to the level as it was originally set so as not to leave a meaningful gap in the regulatory regime.</p> <p>Allowing insurers that were licensed post-2010 and with a gross written premium below the cap to apply for an exemption (Option 2B) would be logical and consistent with other aspects of the regime.</p> <p>Not requiring a new insurer to have a financial strength rating for a few years post licensing (Option 2C) would not be appropriate because:</p> <ul style="list-style-type: none"> • this would distort the regulatory treatment of similar sized insurers; • for new insurers there is an increased rationale for providing information to policyholders as the insurer does not have a track record; and • unless the insurer is small, in which case the small insurer exemption would apply in any case, the requirement for a rating would not be disproportionate. <p>We note that Option 2D (allowing small insurers to opt out of getting a financial strength rating in exchange for having a higher solvency requirement) may have merit. It would nonetheless introduce additional complexity into the regime, and it is difficult to comment on in the absence of detail of what is proposed for this option.</p> <p>Option 3 (Rotating rating agencies)</p> <p>We do not support the proposal to mandate the rotation of rating agencies because it would introduce additional costs</p>

Question in Options Paper	IAG Feedback
	<p>and complexities for no clearly identifiable benefit and at the risk of potentially confusing policyholders (given the different rating scales employed). It could also create additional complexity and costs for insurers operating in multiple jurisdictions.</p> <p>Option 4 (Standardise disclosure)</p> <p>We would support some refinements with the intent of standardising disclosure as this could help to improve policyholder understanding of the information disclosed. The most efficient way for this to be progressed could be for the RBNZ to include information on its website that explains visually how the different rating scales relate to each other, which would aid policyholders interested in understanding these differences and relativities. Insurers could then direct policyholders to this single independent and authoritative source, while avoiding the issues and costs associated with including detailed explanatory material on their own websites and/or in printed material.</p> <p>We do not see a strong case for introducing further complexity by overlaying a standardised scale or traffic light system over the top of the rating agencies scales. As well as casting confusion on the role of the existing ratings and potentially being too simplistic, a traffic light system could be fraught with issues given the likely reputational and other consequences of its application.</p> <p>Option 5 (Increase solvency disclosure requirements)</p> <p>We do not support further increasing solvency disclosure requirements. This seems more likely to increase confusion among policyholders than to aide understanding as the suggested additions would be more complex than the current disclosures, which as noted in the Options Paper aren't necessarily well understood by many policyholders in any case.</p> <p>In relation to projected solvency ratios, we note this would require significant explanation and standardisation to be useful for policyholders, like all projections are only as good as the information available at that time they are made, and volatility in them over time would introduce a level of noise for policyholders to try and evaluate.</p> <p>Finally, for any proposed changes in relation to disclosure, it is important that the basis of any additional information is certain and auditable.</p>
Q1.5: If we increase the public disclosure of solvency ratios, what	Research on how the existing metrics are used, and whether any other metrics might be better understood, would be

Question in Options Paper	IAG Feedback
<p>solvency measures do you think would be the most informative to the public?</p>	<p>useful and could inform whether there are benefits to any changes that could outweigh the costs and complexity involved.</p> <p>As outlined above in response to Q1.4 above, based on the current state of knowledge we consider the present level of disclosure of solvency ratios is appropriate.</p>
<p>Q1.6: Do you think there is a better public solvency disclosure requirement than the options here? If yes, what disclosure requirement would you like to see?</p>	<p>As outlined above we consider the public solvency disclosure requirements remain broadly appropriate and that changes may not improve policyholders understanding (please refer to our answers to Q1.4 and Q1.5 above).</p> <p>If however RBNZ was to consider a new approach, in order to enable disclosure to comprehensively outline an insurer's financial strength and risk profile it would be necessary to provide information that reflected a comprehensive and comparable view of each insurer (e.g. solvency ratio, re-insurance, risk management, trends etc). Such a framework would likely involve a mix-of quantitative and potentially qualitative measures and a degree of judgement. Should an option of this kind be explored further consultation on the detail of it and its implementation would be required.</p>
<p>Q1.7: Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure? If not, what other high level costs or benefits should be considered?</p>	<p>We broadly agree with the qualitative assessment of costs and benefits outlined in paragraphs 106 – 112 of the Options Paper.</p> <p>As a general observation, while there is undoubted benefit in the 'sunlight' that disclosure brings, this alone is not enough to warrant additional requirements. In considering any new disclosure requirements it is critical that these:</p> <ul style="list-style-type: none"> • Pass a strong 'in practice use test' to maintain the efficiency of the regime. Disclosure that does not have an immediate and ongoing use or that only provides some form of contingency should be avoided. • Be consistent with the principles of market and self-discipline and as such, depending on the nature of the disclosure, be either unambiguous in requirements or be left to insurers to interpret. • Are sufficiently clear and concise to not confuse policyholder/stakeholders. • Recognise the differences between the life and general insurance industries. • Focus on information or documents that insurers already have to hand and or use in the running of their business.

Question in Options Paper	IAG Feedback
	<ul style="list-style-type: none"> • Not be inconsistent with disclosures made by parent companies. • Be co-developed with the industry. • Allow sufficient time for development, implementation and bedding down.
<p>Q1.8 Are there any other ways in which we might improve financial disclosure to improve policyholders' and other interested parties' ability to assess insurer's financial strength?</p>	<p>Section 64 of IPSA should be amended to:</p> <ul style="list-style-type: none"> • Provide that where a policy is sold via an intermediary (e.g. a broker) the requirement to disclose, and the liability for non-disclosure should rest with that intermediary themselves, with the insurer's obligation being limited to disclosing their financial strength rating to that intermediary. <p>and</p> <ul style="list-style-type: none"> • Facilitate and further enable disclosure by electronic means (including from insurers own and RBNZ's websites) in recognition of the increasing use of electronic methods.
Solvency requirements	
<p>Q2.1: Would it be helpful to replace the language of 'solvency margin' and 'solvency ratio' with either:</p> <p>i. a metric based on the relationship between Actual Solvency Capital and Minimum Solvency Capital, or</p> <p>ii. the relationship between stressed assets and stressed liabilities?</p>	<p>The proposed changes would introduce complexity by both including new and additional metrics, and by moving away from the solvency standard itself. This risks creating confusion amongst policyholders, although we recognise the primary audience for information is in reality the insurance industry, regulatory professionals and commentators.</p> <p>As mentioned above, research on how the existing metrics are used, and whether other metrics would be better understood, is necessary to understand whether there are benefits to outweigh the change costs involved.</p>
<p>Q2.2: Should New Zealand solvency terminology be aligned with international standards? Why or why not?</p>	<p>While in principle standardisation with international terminology is welcomed, we note that:</p> <ul style="list-style-type: none"> • alignment of terminology is only valuable where the underlying methodology is equally aligned and otherwise risks confusion; and • international approaches vary and so it would be a question of which jurisdictions to align with, in which case as a Trans-Tasman insurer we would recommend Australia.
<p>Q2.3: Which international terminology would it be best for New Zealand to align with?</p>	
<p>Q2.4: Should IPSA enable a separate standard dealing with</p>	<p>Yes, as this would allow for changes to regulatory capital or the Financial Condition Report to be made independently.</p>

Question in Options Paper	IAG Feedback
Financial Condition Reports? (Why/why not?)	
Q2.5: How useful are s.78 reports? Should they be continued or replaced?	We don't consider section 78 reports to be particularly useful and would support these reports being discontinued given other existing requirements (e.g. auditing).
Q2.6: Would it be helpful for IPSA to contemplate more than one solvency control level?	As outlined in our previous submissions on the IPSA Review and Solvency Standard Review we support having two solvency control levels in place of the current single level, and generally support calibration at around a 1:200 year probability of sufficiency.
Q2.7: How many control levels would be useful?	
Q2.8: How should the Reserve Bank's powers relate to the different control levels?	We agree with the proposal in paragraph 152 of the Options Paper that powers should be unlocked as relevant at the two solvency control levels, and as pertinent to the issues arising (i.e. appointment of an Administrator at the lower level). Further consultation on the details of this would be appropriate and would seem suitable for inclusion in the upcoming consultation module on distress management.
Q2.9: Should powers be unlocked sequentially?	
Q2.10: Should powers unlock at the top rung, with the Reserve Bank issuing public guidance on how it intends to use its powers?	As outlined above in response to earlier questions, we do not consider it necessary or appropriate for all powers to be unlocked at the top control level. If, however this was to be progressed, then as suggested in paragraph 155, to provide a reasonable level of certainty it would be appropriate for policy or guidance to be issued on, in what circumstances, and how the various powers would be used.
Q2.11: Should any actions on the part of the Reserve Bank be mandatory when one of the control levels is breached?	It will always be important to consider the specific situation and so in general we don't consider mandatory use of powers is the appropriate approach. There is a risk otherwise that employing powers unnecessarily or in the wrong manner leads to worse outcomes for policyholders.
Q2.12: Should a minimum solvency margin of zero be required by default (without the need to specify it in a license condition)?	We agree it would be clearer and more efficient for a default solvency margin of zero to be specified, with this varied in licence conditions where necessary.
Q2.13: Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?	There is a place for a supervisory adjustment mechanism in situations where a risk is not adequately covered in the solvency standard. Where considered necessary, whatever method is employed to increase the regulatory capital requirement for individual insurers, it is important that the method/s are applied in ways that provide for a fair comparison across insurers so as to avoid inappropriately distorting policyholders' perspectives.

Question in Options Paper	IAG Feedback
Q2.14: Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?	Yes, any adjustments should be subject to challenge. The challenge should be to an independent committee with appropriate experience and skills.
Termination values	
Q3.1: Should IPSA contain provisions requiring minimum termination values for policies that store value long-term? Why / why not?	No comments on this section, not relevant to general insurers.
Q3.2: What would be an appropriate basis for setting minimum termination values?	
Statutory funds	
Q4.1: Is it still appropriate to provide statutory fund treatment for YRT business*? Or should statutory funds only apply to business where policyholders build up a store of value over time to fund their later claims (for example, participating business, unit-linked business, investment accounts and annuities).	No comments on these questions, not relevant to general insurers.
Q4.2: Should health and disability insurance assets be held in statutory funds?	
Q4.3: Should general insurance contracts also have assets held in statutory funds?	<p>A key purpose of statutory funds in life insurance is to ensure the policyholder savings component of long-term traditional life policies is protected. In contrast general insurance policies are typically annual in nature and do not have a policyholder savings component that can accumulate over decades to significant multiples of the annual premiums paid.</p> <p>We do not consider a statutory fund requirement is necessary or appropriate in relation to general insurance products. In our view the case for this is not strong given the nature of general insurance and given we for example carry insurance claims reserves that have already been stressed in</p>

Question in Options Paper	IAG Feedback
	<p>the solvency calculation. We also consider the costs and complexity involved would outweigh any possible benefits.</p> <p>There are unique aspects to life insurance that underly the statutory funds model that don't apply in relation to general insurance (e.g. inherently long-term nature, guaranteed renewability, and in some cases an investment component), and even where general insurance claims can play out over periods of more than one year the circumstances are different and a statutory funds framework would not be a solution. We also note there would be considerable cost and complexity involved in general insurers establishing, administering, funding and maintaining statutory funds given the larger numbers of products offered by general insurers and the comparatively high level of customer change of what are normally annual policies. Furthermore, if there was any required ring-fencing this could reduce general insurers' flexibility in running their businesses, in business-as-usual situations and following major events, and would have an opportunity cost. All these costs and impacts would contribute to increasing the costs of providing general insurance in New Zealand.</p> <p>Finally, we note a key risk to a general insurer's solvency is inadequate reinsurance in the aftermath of a catastrophic event. This risk of inadequate reinsurance would not be mitigated through a statutory fund framework.</p>
<p>Q4.4: If so should statutory fund requirements apply to:</p> <ol style="list-style-type: none"> a. all general insurance business; b. assets backing business with a contract boundary over one year; c. assets backing accepted claims over a particular size, for claims likely to take more than a year to settle; d. some other subset of general insurance business? 	<p>As discussed above in response to Q4.3, we do not consider statutory fund requirements should apply to any general insurance business.</p>
<p>Q4.5: Should all policyholders be given priority in insolvency over other general creditors?</p>	<p>The implications of giving policyholders priority in insolvency over other general creditors depends on the detail of how this was designed and applied. In exploring this further, as well as the issues identified in the Options Paper, a range of matters would need to be considered including:</p> <ul style="list-style-type: none"> • In the absence of an effective 'assets in New Zealand' requirement for overseas branches, as was consulted

Question in Options Paper	IAG Feedback
	<p>in Options Paper 1 of the IPSA Review, a policyholder preference in New Zealand is unlikely to provide any benefit to domestic policyholders in the event of the failure of an overseas branch’s parent company. If this was not resolved, then the result would be to further accentuate the inconsistency of regulatory treatment between overseas branches and domestically incorporated insurers.</p> <ul style="list-style-type: none"> • In an insolvency situation, challenges with quantification of policy benefits will make pro rata payments to policy holders difficult and timing of payments could lead to unfair/unequal distributions. For example, some extant claims could be paid immediately (e.g. total loss house fire), whereas some would be paid on a cost incurred liability established basis such as D&O claims, professional indemnity claims, material damage claims, business interruption claims. If claims are paid progressively as a policy payment entitlement is triggered, this means that some policy holders would get a full payment, which would reduce the remaining sums available for other claimants. • This measure could complicate financing for insurers, making it more challenging and/or costly to operate in New Zealand. For example, it could impact raising capital through bonds or debenture if they rank behind policy claims given the likely uncertainties around the size of the policyholder first charge. • How a policyholder preference in insolvency related to other statutory priorities. <p>Should this proposal be investigated further, additional consultation on the detail would be required. It may be appropriate to explore the merits of a policyholder preference in insolvency in subsequent consultation modules considering insurer distress.</p>
<p>Q4.6: Should priority be confined to policy benefits or also include claims for unearned premium?</p>	<p>We consider that should a policyholder preference in insolvency be pursued as an option the focus should be on policy benefits, which is where acute issues for policyholders will arise in the event of an insurers insolvency.</p> <p>We recognise there could be a case for putting claims for unearned premium ahead of other creditors. While a policyholder would lose out in this situation, the loss will be of a lesser scale than a policyholder with a large claim and they would have the opportunity to put in place alternative</p>

Question in Options Paper	IAG Feedback
	<p>cover. It also important to recognise that other creditors who would be relatively disadvantaged by this preference could be under equal or greater financial pressure.</p> <p>Limiting the scope of any priority to policy benefits would also reduce moral hazard risk to a degree and recognise the pooling of claims across the policy term.</p>
<p>Q4.7: Should IPSA be amended so as to make it more explicit that assets (other than transactional bank accounts) should not be shared across different statutory funds?</p>	<p>No comments, questions not relevant to general insurers.</p>
<p>Q4.8: Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?</p>	
<p>Q4.9: If requirements to establish a trust were included, are there any issues about the trust's constitution that should be specified in IPSA?</p>	
<p>Q4.10: Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?</p>	
<p>Q4.11: Should life insurers with participating life insurance business be required to prepare accounts for capital and retained profits in their statutory funds?</p>	
<p><i>Risk appetite and overall policyholder protection</i></p>	
<p>Q5.1: Do stakeholders think that regulation in respect of each of the channels listed in para 218 is broadly appropriate?</p>	<p>Before responding to these questions in the section on 'risk appetite and overall policyholder protection', we note that the regulatory risk appetite in relation to policyholders' security are not explicit. As noted in paragraph 217, that the ISPA regime is not a 'zero failure regime' for insurers has been articulated for some time. This does not of itself however articulate what the risk appetite is in relation to potential losses for policyholders should an insurer fail and in in different situations (e.g. a policyholder with an unpaid</p>
<p>Q5.2: If not, which areas are over-regulated or particularly in need of enhancement?</p>	

Question in Options Paper	IAG Feedback
	<p>total loss home claim following a natural disaster, or a policyholder potentially due a premium refund for a few months of cover).</p> <p>Assumptions as to this risk appetite in this respect can be made or an implicit risk appetite inferred by current policy settings and regulatory experience. Nonetheless, clarity on the risk appetite that is trying to be given effect to through the IPSA regime in relation to policyholders would provide clear objectives that are trying to be achieved and the extent to which policyholder security should be enhanced. This is in turn critical to evaluating the appropriateness of policy measures such as a policyholder guarantee scheme.</p> <p>We consider that regulation under the channels outlined below paragraph 218 are the appropriate ones to be considering. While noting our comments immediately above on risk appetite, in light of the objectives of the IPSA regime and current settings, and recognising that other measures are already being progressed, we consider the settings are broadly appropriate.</p> <p>In considering the regime overall it is important to not view the channels in isolation and to consider the totality of the regime, while having regard to the additional measures already being considered/pursued that will help to strengthen insurers and/or the oversight of them and therefore further reduce the likelihood of insurer failure. Pursuing measures across all channels will add material costs for insurers and so it is important to select those measures that address specific issues and have the best cost/benefit. Given this, when a new measure is introduced it is also necessary to look across the regime in total and determine whether a recalibration of other settings is required to achieve/maintain an appropriate level of risk management.</p> <p>In relation to the specific areas listed:</p> <p><i>Enhancing insurers' risk management and governance</i></p> <p>This is an important area, and we note the existing provisions in place, RBNZ's enhanced supervision capacity, and the current joint RBNZ/FMA review of governance arrangements across the financial service sector. We don't see any case for further enhancements beyond this at present.</p>

Question in Options Paper	IAG Feedback
	<p><i>Better information to policyholders about risk and financial soundness</i></p> <p>As outlined above, we agree there are some areas where financial strength disclosure requirements could be refined.</p> <p><i>Increasing the level of capital held against risk</i></p> <p>The appropriate level of capital is a primary focus of the review of solvency standards that is occurring in parallel to the Review of IPSA. We note this already includes a proposal to materially increase capital requirements through the introduction of a new Operational Risk Capital Charge of 3% of GWP.</p> <p><i>Enhancing policyholders' access to assets in insolvency</i></p> <p>We have outlined above in response to Q4.5, issues that should be considered in any further exploration of policyholders being given a preference in the event of an insurer's insolvency.</p>
<p>Q5.3: Are there any additional measures for policyholder security that the Reserve Bank should consider?</p>	<p>No further comments or suggestions.</p>
<p>Q5.4: Have we correctly identified the risks that a policyholder guarantee scheme should address?</p>	<p>We note that given the various ways in which a guarantee scheme of this kind could be developed, there are serious limitations in the ability to assess the benefits, costs and risks of such a scheme in the abstract.</p> <p>RBNZ has correctly identified that the costs of such a scheme could be substantial, although further detail and work would be required to understand this, and the consequent impact on insurance affordability.</p> <p>It would also be important to consider this proposal and the associated costs in the light of the range of regulatory changes to the prudential regime (e.g. increased solvency requirements) and under other regulatory regimes (e.g. EQC cap increase, increased FMA levies, upcoming conduct of financial institutions and insurance contract law implementations), the cumulative effects of which will be substantial in terms of direct costs and disruption for general insurers, and consequently the impacts on insurance affordability.</p> <p>Additional risks that need to be considered include:</p> <ul style="list-style-type: none"> • Increased moral risk and a reduction in market discipline if policyholders were insulated from all

Question in Options Paper	IAG Feedback
	<p>possible losses. When there is a safety net, consumers may also be less inclined to assess the financial situation of the insurer that they contract with and to make a prudent selection. They may seek the cheapest products regardless of the risk associated with the insurer, because of the belief that they will not suffer from the negative consequences of their choice in the event the risk materialises (i.e. the insurer goes bankrupt). A reduction in market discipline could also incentivise insurers to hold less capital and thereby increase the risk of insurer failure.</p> <ul style="list-style-type: none"> • That this would be inconsistent with the principle under section 4(d)(ii) of IPSA (recognising the importance of members of the public being responsible for their own decisions related to insurance). • Whether it would discourage insurers from participating in New Zealand due to the risk of having to pay for the failure of another less well managed and/or capitalised insurer, which would depend to a degree on the design of such a scheme.
Q5.5: Are there other risks we have not considered that a scheme could also address?	We are not aware of any further risks that the scheme could address.
Q5.6: Are there particular types of insurance for which a scheme is especially important?	We don't consider a policyholder guarantee scheme is worth considering for New Zealand at this time. The risk profile is being reduced through ongoing enhancements to the prudential regime, it would be inconsistent with market discipline and a level playing field, and it would be complex and costly to implement.
Q5.7: Overall, to what extent do you think a policyholder guarantee scheme is worth considering for New Zealand?	The case for a policyholder guarantee scheme is materially different than in relation to banking, with general insurance having a materially different risk profile:
Q5.8: Are there particular kinds of policies that should be covered?	<ul style="list-style-type: none"> • General insurance failures can generally be managed over time. Bank failures in contrast occur much faster and have the scope to be more disorderly than insurance failures. • The failure of a general insurer has less contagion impact. <p>IAG believes the strengthening of the IPSA regime, and the enhancement of RBNZ's supervisory capacity, will provide an increasingly rigorous framework for addressing insurance company risks and will make a failure of another insurer unlikely. The supervisory framework provides RBNZ</p>

Question in Options Paper	IAG Feedback
	<p>flexibility to intervene early in response to warning signals in the industry and a wider range of powers for such intervention.</p> <p>We consider insurers should not be responsible for the financial promises of their competitors. Introducing a guarantee scheme to cover the costs of the failure of a general insurer would in effect impose a tax on viable insurance businesses to cover the failures of their competitors. This is inconsistent with a market competing for the delivery of a product to consumers.</p> <p>Suggestions that the insurance industry should be responsible for funding the failure of another industry participant should also be cognisant of the extra costs already borne by companies that have a relatively lower risk profile (through greater capital/reinsurance), and the security this affords customers, employees, suppliers and shareholders. If through a guarantee scheme the Government forces all other companies to subsidise the loss of a high-risk company, then the stakeholders of other companies are effectively penalised for being risk averse. This creates a perverse result, as it is in the interests of the community and market discipline to reward prudence.</p> <p>The OECD (Insurance Regulation, Liberalisation and Financial Convergence, No.3, 2001, Policyholder Protection Funds: Rationale and Structure) noted that in this situation</p> <p style="padding-left: 40px;">“prudently managed companies, which avoid effectively being in financial distress, need not only to contend with reckless competitors that offer aggressive pricing to attract customers, but also to compensate for the eventual failures of such competitors. This situation could seriously undermine sound and fair competition in the industry”.</p>

12 November 2021

By email: ipsareview@rbnz.govt.nz

Reserve Bank of New Zealand - Te Pūtea Matua
Financial System Policy and Analysis – Financial Policy

Dear Sir/Madam,

ICNZ submission on Review of the Insurance (Prudential Supervision) Act: Policyholder security

Thank you for the opportunity to submit on the Reserve Bank of New Zealand's (RBNZ's) Review of the Insurance (Prudential Supervision) Act 2010 (IPSA) Options Paper 2: Policyholder security (Options paper).

By way of background, the Insurance Council of New Zealand - Te Kāhui Inihua o Aotearoa (ICNZ's) members are general insurers and reinsurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand assets and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

Please contact Nick Whalley (nickw@icnz.org.nz) if you have any questions on our submission or require further information.

This submission has two parts:

- overarching comments, and
- answers to questions in the Options paper.

1. Overarching comments

While we agree that ensuring there is sufficient policyholder security under the IPSA regime is important, and that refinements and enhancements in some areas of this regime (e.g. financial strength disclosures, technical solvency requirements and the introduction of a policyholder preference in insolvency) are appropriate, as expanded upon below, overall we consider that this regime and its settings are fundamentally sound and would not support substantial changes being made to it. This reflects that, from our perspective, there are no major gaps between the current regime and the appropriate level of policyholder protection.

In general terms, we note that if all the options proposed in this paper were to be implemented, the industry would be grossly over regulated. Once consultation has been completed, we envisage that only some would be taken forward, after considering the complete IPSA framework in its entirety and the outcomes from the separate Solvency Standard workstream. Additionally, while it is

appropriate to access the public pulse to address these issues, judgement must be exercised to balance potentially a preference for risk-free protection on the one hand with the costs that brings.

In the remainder of this section we expand upon the reasons why no substantive change is required, either generally or as it relates to the specific proposals put forward.

It is unclear what the problem to be solved is and there are considerable potential adverse impacts for policyholders

From our perspective, there is a question in the Options paper that remains unanswered about the specific problems that would be solved by making substantial changes to the financial strength disclosure requirements, extending statutory fund requirements to general insurance or a policyholder guarantee scheme. If it exists, this has not been clearly articulated or evidenced in the Options paper in our view.

It is also important that one does not look at additional/alternative policyholder security measures in isolation, acknowledging that there are limits to what greater 'policyholder security' measures may be able to achieve, with trade-offs off also needing to be made. Regard specifically needs to be had to the potential negative impacts in terms of additional regulatory burden, complexity and cost on insurers. These ultimately flows through and negatively impact on the availability and affordability of insurance, to policyholders' detriment. Specifically:

- More onerous regulatory requirements and implementing significant change itself adds cost and complexity which will be ultimately passed upon onto policyholders in terms of the cost of premiums. These high prices could also lead to a lower uptake of insurance, increasing the protection gap and exposing the New Zealand economy to greater risk. There is also an opportunity cost associated with siphoning funds out of the insurance industry.
- Additional/alternative regulatory requirements also raise barriers of entry for potential new market entrants and may disincentivise existing market participants from continuing to participate, particularly where the cost and complexity involved is not proportional, reducing choice in the market and competition (including benefits from a competitive product offering, service standard and pricing perspective).

We note that in his 9 March Letter of Expectation to the RBNZ, the Minister of Finance specifically highlighted insurance affordability and availability as a specific area of focus.¹

It is important to evaluate the proposals against IPSA's broader principles and purposes

Comments above about cost, complexity, regulatory burden and flow-on impacts to policyholders connect with IPSA's principles and purpose which form the wider context against which policyholder security proposals need to be evaluated. As noted in the Options paper, IPSA is designed to promote the soundness and efficiency of the insurance sector and to promote public confidence without introducing a 'zero failure regime'.²

In addition to ensuring policyholders' interests are adequately protected in the event an insurer is in financial distress, and the desirability of providing the public with adequate information to enable them to make decisions,³ regard needs to be had to:

¹ <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Letters%20of%20expectation/Letter-of-Expectations-2021.pdf?revision=4e0412b3-ed17-42f7-ac85-2b55d311c652>.

² See s 4(d)(i) of IPSA.

³ Sections 4(c)(i) and 4(e) of IPSA.

- the importance of recognising that members of the public should be ultimately responsible for their own decisions regarding insurance,⁴
- the importance of maintaining the sustainability of the New Zealand insurance market,⁵ and
- the need to maintain competition within the insurance sector and avoid unnecessary compliance costs.⁶

Related to these last matters and the promotion of a sound and efficient insurance sector,⁷ is the risk of new or additional moral hazards brought about by these changes (e.g. because the consequences of adopting a riskier position are avoided). Working through all these matters involves having regard to competing considerations and striking the right balance. It would not be appropriate to look at policyholder security as the sole outcome in isolation.

When viewed in this context, and in absence of a clearly articulated or evidenced problems currently, proposals to extend statutory fund requirements to general insurance or a policyholder guarantee scheme would suggest IPSA is shifting towards a more conservative risk setting and a 'no failure' regime. In our view, this change in risk setting would be inappropriate.⁸

Public research

Reflecting on the trade-offs and balancing exercise referred to above, it is heartening to learn that the RBNZ intends to conduct public research including holding forums and undertaking surveys. It is important that this occurs to get a better understanding of the merits of proposals from an end-user/policyholder perspective. We encourage the RBNZ to undertake comprehensive research and user experience testing to determine how the public view current financial strength disclosures (including how valuable they currently find them, the extent to which they use them and any suggestions they have on how these might be improved).⁹

The remaining comments in this section summarise our views on the key proposals in the Options paper.

Financial strength disclosures

While we continue to support financial strength disclosure requirements,¹⁰ and note that ideally, policyholders should be evaluating and comparing the financial soundness of insurers before purchasing cover, with these disclosures potentially serving an appropriate data point to make more

⁴ Section 4(d)(ii) of IPSA.

⁵ Section 4(b) of IPSA.

⁶ Sections 4(h) and 4(g) of IPSA.

⁷ Section 3(1)(a) of IPSA.

⁸ We also acknowledge the confirmation during the RBNZ webinar on 15 September 2021 for this consultation that IPSA's current purposes and principles do not form part of this review.

⁹ Please note, while such work should inform what specific options and refinements are most appropriate, it is unlikely that a complete solution would be identified through this and we see there being an ongoing role for broader education on what disclosures mean in this context.

¹⁰ As indicated in our submission back in 2017 on the IPSA review Issues paper, <https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf>, paragraph 38. We acknowledge ratings are intended as consumer protection mechanisms and so there is value in the presence of a rating irrespective of efficacy, merely because a policyholder can recognise the insurer has a rating. We also acknowledge the degree of scrutiny rating agencies place on insurers, and consider this provides an important support to insurer self and market discipline. Additionally, having requirements to report creates financial disciplines within insurers, regardless of what is reported or how well they are understood by policyholders. Credit ratings are also reasonably well understood and this measure of solvency is the one that the majority of insurers operating in New Zealand are obliged to disclose – with exemptions only provided for small insurers. Overseas insurers are required to disclose financial strength and overseas policyholder preference even when they are not required to report against the Solvency Standard.

informed decisions, our understanding is that this is not common practice and it should not be assumed that policyholders base their overall view of an insurer, or their particular financial strength, solely or largely based on these disclosures. Matters such as brand reputation, ease of claims process and payment of claims are also important attributes that help inform a policyholder's preference. Additionally, consistent with our previous remarks,¹¹ our view is that the New Zealand insurance market is too small to warrant additional or alternative financial strength disclosure requirements, which would add cost and complexity without delivering any material benefits to policyholders, and may in fact cause confusion and negatively impact upon the availability and affordability of insurance.

Focussing upon current financial strength disclosure requirements, we consider there is an opportunity to make refinements so that they are more effective and efficient for insurers to comply with and easier for policyholders to engage with. Specifically, to reflect modern practices for the dissemination of information, these requirements should be amended so that, rather setting out the full details within the disclosure itself, the disclosure should simply refer the policyholder to the relevant insurer's and the RBNZ's websites, which they can access to easily obtain accurate up-to-date information at any time.

We acknowledge that inconsistencies in rating agency scales may currently cause confusion and we would support current insurer rating disclosure requirements being amended to refer to a new rating agency comparison table on the RBNZ's website to address this. However, we would not support the introduction of additional disclosure requirements designed to improve standardisation as these would only add irrelevant 'noise' or confusion policyholders in our view.

We support a small increase to the threshold and a timing adjustment for small insurers' exemptions from financial strength rating disclosure requirements. The disclosure requirements set out in s 64 of IPSA should be amended to ensure insurers and intermediaries (e.g. brokers) have the equivalent obligations and to support the modernisation of disclosure as proposed above.

We are comfortable with the current solvency terminology and do not support this being changed. One needs to be mindful of the main audience of solvency standard reporting is not policyholders but insurance industry and regulator professionals who are familiar with the use of this well-established terminology. Changes in this regard are unnecessary and would add cost and potentially introduce uncertainty and complexity.

Solvency standards

As indicated in our earlier submission as part of the Solvency Standard review workstream,¹² we support the move to a banded approach to the assessment of solvency with two control levels. This change addresses the continuum that exists between insurers becoming riskier and non-viable and enables supervisors to take a more graduated approach, increasing their oversight of weaker insurers relatively early before they are in serious distress and then escalate levels of oversight and intervention as risks increase.

We consider that it is unnecessary to have a separate standard for dealing with Financial Condition Reports and that the contents of s 78 IPSA reports are not materially useful. We support the RBNZ being able to make supervisory adjustments within the solvency calculation, providing these are

¹¹ Footnote 10 above, paragraph 40.

¹² https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_Solvency_Standards_Structure_and_IFRS_17.pdf.

transparent and comparable, and a mechanism for challenging them is provided for. We agree that a minimum solvency margin of zero should be provided for by default.

Termination values

We do not consider that IPSA is the appropriate place to prescribe any minimum termination values for policies that store value long-term. To the extent that this proposal is progressed, we consider that this matter would be best considered as part of the Insurance Contract Law review as this issue primarily relates to customer outcomes under an insurance contract rather than prudential supervision.

Statutory funds

We consider that a statutory fund requirement is neither necessary nor appropriate for general insurance. The protections this requirement affords reflect and protect policyholders from the unique characteristics and risks life insurance products pose, including:

- Their guaranteed renewability and the associated difficulty life policyholders may face in obtaining replacement policies on similar terms (e.g. due to deterioration in health).
- Their general long-term and high-value nature, with key cover/benefits responding to events at potentially a much later date in the future (e.g. death or terminal illness potentially decades away) with sums insured which are typically between \$100,000 to \$1million or more.
- Their potential investment component.

When general insurance products contain long term elements, these are not equivalent to life insurance products from a storing policyholder value and time horizon perspective, as unlike the life insurance, policyholders are able to easily switch between providers. The risks involved are also different as the concern in the general insurance context is an insurer's ability to pay claims with long-tails, where the issue is whether reserving is adequate. This matter is best dealt with through risk margins and solvency requirements (not statutory funds).

In broader term, it is unclear what problem the introduction of a statutory fund requirement for general insurance would address. In our view, the cost, regulatory burden and complexity involved would also clearly outweigh any benefits relative to the status quo. The ring-fencing required to comply with a statutory fund requirement would also reduce general insurers' flexibility in running their businesses. The introduction of this requirement would also have a flow-on negative impact on the availability and affordability of insurance.

While we acknowledge statutory fund requirements are reasonably common across Commonwealth jurisdictions, we note these tend to be limited to life insurance business only.¹³

We support the introduction of a policyholder preference in insolvency for general insurance. While the design of this would need to be worked through and the subject of further analysis and consultation, we expect that this should at least extend to outstanding claim amounts owed to consumer policyholders, this being the area of most potential harm in our view.

Policyholder guarantee scheme

We do not support the introduction of a policyholder guarantee scheme for general insurance because:

¹³ See paragraph 175 of the Options paper.

- It is unclear what the problem to be solved in this context is and note that no clear or compelling argument or evidence has been presented in this respect.
- We believe that the matters that such a scheme seeks to address are already being appropriately addressed via the current solvency and policyholder protection framework, noting that general insurers are already subject to a solvency requirement which is significantly above any other jurisdiction and these are expected to be further increased as a result of the Solvency Standard review and the outputs from new catastrophe modelling.
- Such a scheme does not align with IPSA’s principles and purpose, including the non ‘zero failure’ setting. Introducing a scheme would also result in significantly increased costs, complexity and regulatory burden for insurers, which in turn would negatively impact upon the affordability and affordability of insurance.

We are also concerned that the introduction of such a scheme could reduce market discipline and introduce moral risk. We also note that a centralised scheme of this nature would be fundamentally less efficient than insurers holding capital in their own right.

There are limitations to what can be drawn upon from other jurisdictions in this context given the absence of international consistency or best practice because schemes abroad generally focus on compulsory insurance that is not relevant in the New Zealand context (e.g. compulsory workers compensation or third party motor vehicle insurance).¹⁴ There are also a number of practical issues that would need to be overcome if this matter was to be considered further.

2. Answers to questions

Question / discussion point	Feedback
<i>1. Financial strength disclosures</i>	
<p>1. Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?</p>	<p>The current exemption for small insurers from financial strength rating disclosure requirements should be maintained. We support a small increase to the current exemption \$1.5m annual premium income threshold (i.e. to \$2m) to reflect increases in the market and equivalency since this was last set. This approach reduces barriers of entry for small new or specialised insurers, addressing the disproportionate nature of the compliance costs involved (which may otherwise discourage a small insurer to continue to operate in the market).</p> <p>While this means that the relevant policyholders do not get the benefit of these disclosures, we consider that this is the appropriate trade-off given that it likely there would be less competition and options in the market if this exemption was removed, which would be to policyholders’ detriment.</p> <p>We do not support a significant increase in the exemption threshold so that it applies to larger insurers because the issues outlined above are not applicable. Doing so would also affect a much wider population of policyholders and there is a risk this would create a substantially uneven playing field, particularly in so far as insurers close to, and above or below, the threshold were concerned.</p>

¹⁴ See paragraph 225 of the Options paper.

Question / discussion point	Feedback
<p>2. Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?</p>	<p>We refer to comments in our submission on the earlier IPSA Scope and Overseas Insurer consultation.¹⁵ In summary, we consider that the overseas policyholder preference (OPP) disclosure rules should be updated to be more relevant and workable. This includes:</p> <ul style="list-style-type: none"> • Introducing a specific requirement on intermediaries to provide disclosure of OPPs, as is the case for FENZ levies. • Regular and robust RBNZ monitoring of overseas arrangements to determine whether new OPPs develop and that notification requirements are being adhered to. • Developing educational materials for New Zealand policyholders to better inform them about the risks involved when an OPP is disclosed. As a precursor to this, it would be useful for the RBNZ to conduct research and testing to understand public understanding in this area.
<p>3. Do you consider the current financial strength rating and solvency disclosure sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?</p>	<p>While we understand that some policyholders may not consider or understand financial strength rating and solvency disclosures, we consider that these are nonetheless appropriate in that they are well established, fundamentally sound and logical - providing disclosure that is relatively simple and a good proxy of risk levels and an insurer's overall financial soundness.¹⁶</p> <p>We would not support the introduction of additional or alternative disclosure requirements (e.g. as described in paragraph 72 of the Options Paper) given:</p> <ul style="list-style-type: none"> • We consider that it is highly unlikely that this would improve policyholder understanding or better inform their decision-making. Instead, such additional information runs the risk of either being 'noise' that at is at best considered by them to be irrelevant or at worst, confuses matters. • With regard to the matters specifically referred to in paragraph 72, an insurer's risk appetite and reinsurance arrangements are complex matters. We do not consider that these could be presented in a way that is sufficiently simple, objective and standardised to appropriately inform policyholders. These matters also involve commercially sensitive information that would not be appropriate to disclose publicly. • Having to implement and then operate to such requirements would lead to additional complexity and cost for insurers which would ultimately impact the affordability and availability of insurance to policyholders' detriment. Specifically, raising premiums for insurance and barriers of entry for any potential new market entrant. This may also discourage existing insurers from continuing to participate in the market. • A compelling case has not been otherwise presented for their introduction, which in light of the comments made above, would not be rational from a cost and benefits perspective. <p>Notwithstanding the above, we consider that there is an opportunity to enhance the current disclosure requirements so that they are more effective and efficient for insurers to comply with and easier for policyholders to engage with. Specifically, to reflect modern practices regarding the dissemination of information, these</p>

¹⁵ https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_IPSA_Scope_and_Overseas_Insurers_190321.pdf. See page 15, heading 'Additional work on overseas policyholder preferences (OPP)'.

¹⁶ Also see other comments made under footnote 10 above in this regard.

Question / discussion point	Feedback
	<p>requirements should be amended so that, rather than setting out the full details within the disclosure itself, they simply refer to the insurer's and the RBNZ's websites where the policyholder can easily (and at any time) obtain accurate up-to-date information. The relevant references to websites could be set out as standardised text in documentation for policyholders before they enter into, or renew, their insurance. In the event details change, insurers and the RBNZ would be able to easily update this information, as one centralised 'source of truth'. This contrasts with the considerable cost insurers currently face in re-printing, replacing and distributing hardcopy documentation throughout their various distribution channels (including any intermediary channels) and avoids the risk that a policyholder is relying upon outdated information. We understand significant operational and systems costs are currently incurred when a rating change occurs. This issue is particularly challenging to navigate when a rating change occurs while an application for a new policy or a renewal is in progress.</p> <p>Additionally, as indicated above, we consider that financial strength disclosures is an area where it would be useful for the RBNZ to conduct research and user testing with policyholders to determine what disclosures are valuable to them, focussing on what is already being disclosed and deficiencies from their perspective. That said, we note the following in this respect:</p> <ul style="list-style-type: none"> • The terms of coverage, premium amount, brand reputation, ease of claims process and payment of claims and the advice given by the insurance adviser would seem to be more determinative of a policyholder's decision about which insurer they select. • While such work should inform what specific refinements make most sense, it is unlikely that a complete solution would be identified through this and we see there being an ongoing role for broader education on what these disclosures mean. • We would expect that, unless the relevant financial strength rating is extremely poor, it is unlikely for policyholders to make decisions based upon it.¹⁷
<p>4. Out of these options, what is your preferred option or combination or options for public solvency disclosure requirements?</p>	<p>We agree that the options presented should not be treated as being mutually exclusive and specifically see merit in some enhancements to the status quo (option 1), changes to ensure consistent treatment of exemptions for small insurers (option 2), and to further standardise disclosure (option 4). However, we are not in favour of rotating rating agencies (option 3) or increasing solvency disclosure requirements (option 5) because, amongst other things, these options would not positively impact the key issue identified – namely policyholder understanding.</p> <p>Detailed feedback on each option proposed is set out below.</p> <p><i>Option 1 (status quo)</i></p> <p>We support the status quo with the enhancements, as outlined in response to question 3 above.</p> <p><i>Option 2 (Change the exemptions for small insurers)</i></p>

¹⁷ However, it could be that the value of the financial strength rating is preventative in nature from an insurer perspective (i.e. ensuring insurers at least maintain a suitably strong rating). We also acknowledge the other benefits outlined in paragraph 89 of the Options paper e.g. in terms of incentivising prudent insurer conduct more generally and with reference to other users of this information.

Question / discussion point	Feedback
	<p>In terms of Option 2A, as outlined in response to question 1 above, we would support a small increase to the premium income threshold for the exemption for small insurers from financial strength rating disclosure requirements.</p> <p>We support Option 2B as this would allow for fairer and more consistent treatment of small insurers regardless of when they are licensed (i.e. pre or post 2010).</p> <p>We do not support Option 2C because:</p> <ul style="list-style-type: none"> • this does not have regard to the size of the insurer (which is relevant to the assessment of disproportionate costs/burden and the size of the affected policyholder population) • in our view, this would provide an unfair advantage to a potentially large new market entrant (i.e. a new insurer that grows and/or acquires existing business such that they quickly become large in scale), and • policyholders ideally need to know more about an insurer that does not have an established track record. <p>While we do not have any particular views either way on Option 2D, we envisage that this is something that could be dealt with via licensing conditions. The lack of detail about this option, how it would be implemented and the complexity involved makes it difficult for us to provide more meaningful comment.</p> <p><i>Option 3 (Rotating rating agencies)</i></p> <p>We do not support the proposal to rotate rating agencies because:</p> <ul style="list-style-type: none"> • Rotating agencies would not improve policyholder understanding, instead we expect this may actually confuse matters from their perspective. Often customers are with the same insurer for many years and if the insurer were to rotate rating agencies every few years, this could confuse them, particularly given the different rating scales. There is also a risk that they may perceive this as a change in the insurer's financial strength when in fact the only change is the agency providing the rating, the rating provided being equivalent. • As there are only three approved rating agencies, it is questionable what value would be added by all insurers rotating between them. • If the current mode of disclosure requirements remain unchanged, significant additional costs would be incurred in rotating rating agencies, with customer documentation needing to be re-printed, replaced and distributed through channels each time a rotation occurred. We expect this option would also see rating fees increase due to agencies needing to frequently build up their knowledge about insurers they are not familiar with. Again, this added cost and regulatory burden could negatively impact the availability and affordability of insurance which would be to the policyholders' detriment. <p>We also note that for insurers that are part of global organisations there may be practical challenges rotating agencies as these decisions currently tend to be regionally or globally driven. Where an insurer is a subsidiary of an overseas group, requiring a different rating agency to be used for the New Zealand business would introduce additional cost and complexity. It is also unclear how such a requirement could apply to overseas insurers operating in New Zealand via branches.</p>

Question / discussion point	Feedback
	<p>It also appears doubtful that rotating ratings agencies would lead to new rating agencies entering the market, as they operate in a global market in respect of which the New Zealand component is only a very small part.</p> <p><i>Option 4 (Standardise disclosure – different rating agency ratings)</i></p> <p>While we acknowledge that inconsistencies in rating agency scales may cause confusion for policyholders reviewing them,¹⁸ as noted above we understand that some policyholders may not review ratings to start with. While this is another area where it would be useful for public research to be undertaken, we also suspect that those policyholders who are already reviewing these ratings may be sufficiently sophisticated to compare them. Putting those matters to one side, to assist policyholders compare between rating agency scales nevertheless, we see merit in the RBNZ including a table on their website setting out how different rating agency ratings compare. This table would need to be a fair and accurate representation, drawing upon an appropriately qualified and authoritative source. We are aware of equivalent tables that exist abroad in other contexts.¹⁹ This table would be a logical extension to the central repository of insurer rating information already recorded on the RBNZ’s website. Consistent with earlier remarks, rating disclosure requirements could be adjusted to simply refer policyholders to information on the RBNZ’s website to this end.</p> <p>In general terms, we would not be supportive of the introduction of any additional disclosure requirements designed to improve standardisation, as we are concerned that this additional information produced would be interpreted by policyholders as irrelevant ‘noise’ or worse, may confuse matters further from their perspective. Consistent with our earlier remarks, one also needs to be mindful of the costs additional standardisation requirements may involve.</p> <p>Specifically, we would not support:</p> <ul style="list-style-type: none"> • The introduction of an overlay of another financial strength rating scale or traffic light system on top of the existing rating scale because, in addition to the general issues noted directly above, we are concerned that a traffic light system would be an unduly simplistic and retrograde step (given only three colours are available) and imply that everyone has the same risk tolerance which is not the case.²⁰ • A requirement for insurers to attach a ‘Guide to Financial Strength’ that provides a comparison for all insurers with each new policy or renewal. The number of licensed insurers in New Zealand means that this would need to be a long document and we would be concerned again that this may be construed as irrelevant ‘noise’ or may overwhelm and confuse policyholders. This guide would also be expensive and time-consuming to maintain. A change in rating for any one insurer, or an insurer entering or exiting the market, would result in all insurers needing to update, replace and distribute the Guide through their distribution channels. These costs and complexities would be compounded if hardcopies were required. As the financial strength ratings for all licensed insurers are already

¹⁸ For example, the way the scales work, and the fact that there are many different bands which can be modified in different ways (e.g. by the addition of + or -), mean the scales are not intuitive, e.g. a rating of A+ looks better than a rating of AA- when this is not the case.

¹⁹ By way of an illustrative example in another context, see <https://www.moneyland.ch/en/rating-agencies>.

²⁰ With some policyholders being prepared to use a riskier insurer if that means they are paying less premium.

Question / discussion point	Feedback
	<p>recorded on the RBNZ's website, as suggested above, disclosures could refer policyholders to that instead, with the addition of the comparison table suggested above.</p> <p><i>Option 5 (Increase solvency disclosure requirements)</i></p> <p>We do not consider that introducing additional solvency disclosure requirements would assist. Again, we expect this would be interpreted as irrelevant 'noise' or cause policyholder confusion. Also, as noted in paragraph 108 of the Options paper, if a policyholder does not understand solvency disclosures, requiring the disclosure of additional solvency ratios would not improve matters. In our view, it would be preferable to focus on educating policyholders on the small number of existing solvency disclosures rather than adding to them.</p> <p>We also do not agree with disclosing projected solvency ratios as we believe this would add unnecessary uncertainty and confusion for policyholders. Such projections would require extensive explanations, assumptions and disclaimers. The information would be lengthy and technical, to the point that it may be interpreted as being meaningless or confusing for policyholders. It is also questionable whether it would be appropriate for customers to rely upon projections given their speculative and volatile nature. In practical terms, it is difficult to envisage how insurers with very different sizes, operating structures and models, strategies, products, pricing and investment decisions could produce standardised and comparable growth metrics. Projections would also be constantly changing and this exercise would be particularly challenging for a business that is fast-growing to complete. We expect that it is also unlikely that any insurer would project insolvency. The timeframe of the projection and the period which policyholders may claim in may also diverge, so it is unlikely to be a useful reference point in that respect.</p> <p>As with the other options that introduce additional complexity and costs, in considering whether to introduce additional solvency disclosure requirements, regard also needs to be had to the adverse flow-on impact on the availability and affordability of insurance which would be to policyholders' detriment.</p> <p>If the real motivation for this proposal is meeting the needs of informed industry analysts, we consider that this would be best addressed through some other mechanism with reference to the existing financial information already available to them. Consistent with our response to question 7 below, we would be concerned with changes to disclosure requirements to meet others' bespoke needs introducing additional complexity that would be to the broader category of policyholders' ultimate detriment.</p> <p>We agree that any proposals here, if progressed, would need to be worked through in conjunction with separate Solvency Standard review workstream.</p>
5. If we increase the public disclosure of solvency ratios, what solvency measures do you think would	As outlined in response to question 4 above, we would not support an increase in the disclosure requirements for solvency ratios. We believe that the current disclosure framework is sufficient.

Question / discussion point	Feedback
be the most informative to the public?	
6. Do you think there is a better public solvency disclosure requirement than the options here? If yes, what disclosure requirement would you like to see?	No. Please see our response to questions 5 and 6 above.
7. Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure? If not, what other high level costs or benefits should be considered?	<p>While in general terms we agree with the assessment of potential costs and benefits of financial strength rating and solvency disclosure requirements, it is useful to elaborate upon and/or clarify several of the comments made in the Options paper.</p> <p><i>Providing increased understanding (rather than information)</i></p> <p>We do not consider it is appropriate to characterise one of the benefit metrics as ‘increasing information available to policyholders’. The focus instead should be on increasing understanding, focussing on what is already being disclosed and how this could be improved, in our view. In assessing the value of disclosures, it will be important to consider the extent to which information truly informs their decision-making. One also needs to ensure disclosures are as simple and clear as possible for policyholders to understand, with undesirable and costly duplication and/or complexity avoided.</p> <p>As above, we are concerned that providing policyholders with different, additional, lengthy and/or potentially complex information would either be interpreted as irrelevant ‘noise’ or confuse. This may also detract from other pertinent information relevant to their decision-making such as policy terms, conditions and exclusions. Each additional or change in disclosure requirements would also present its own unique set of challenges that would need to be overcome, including implementation challenges and re-educating policyholders who may already be familiar with current arrangements. These issues are a particular concern given the issues of under insurance and low financial literacy in New Zealand, noting the comments made in paragraph 96 in this respect. Each disclosure must be meaningful, striking an appropriate balance between ensuring it is appropriately informative, but not being so overwhelming, long and complex that it acts as a deterrent to reading it and informing them.</p> <p>As above, we strongly encourage the RBNZ to undertake comprehensive research and user experience testing with policyholders on how they form their view of financial strength, what disclosures would be valuable to them, focussing on what is already being disclosed and how this could be improved.</p> <p><i>Other costs of alternative and/or additional disclosures</i></p> <p>It is difficult to accurately determine the costs of changes to disclosure requirements given the proposals are only outlined at a high-level. What is certain, however, is that any additional or alternative requirements would add cost without any meaningful benefit .</p>

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	<p>Specifically, alternative or additional disclosure requirements would need to be developed and implemented, leading to additional costs and complexity, which would ultimately have negative impacts from an availability and affordability of insurance perspective. Implementing these changes in requirements would also divert insurers' resources away from undertaking projects to improve the efficiency of their systems and processes or undertake product innovation, which would similarly be to the policyholders' detriment.</p> <p><i>Consideration of other beneficiaries of disclosures</i></p> <p>As the primary focus of the analysis of disclosures in this Option paper is from a policyholder perspective, we are concerned with proposals justifying changes to disclosure introducing additional complexity with reference to others' needs (i.e. for boards and senior management as suggested in paragraph 89 of the Options paper (last bullet point) which would ultimately be to these policyholders' detriment. Focussing unduly upon outcomes from this point of view undermines the purpose and efficacy of these disclosures from a policyholder perspective. As above, there is a need for simplicity and clarity, assuming a low level of understanding.</p> <p>We also note that boards and senior management are deeply connected and involved in the insurance industry, have a wealth of information at their fingertips through other sources (including market and own research/data, information via Appointed Actuary), and access to support from the wider business, such that this does not need to be a key area of focus in assessing changes to disclosure requirements.</p>
<p>8. Are there any other ways in which we might improve financial disclosure to improve policyholders' and other interested parties' ability to assess insurer's financial strength?</p>	<p>As indicated in an earlier submission,²¹ s 64 of IPSA needs to be redrafted. Specifically:</p> <ul style="list-style-type: none"> • The requirement for the insurer to disclose should be amended to reflect that, where a policy is sold via an intermediary (e.g. a broker), they may not have any direct contact with the policyholder - in fact under the terms of the relevant distribution agreement they may be prohibited from doing so. In such circumstances, consistent with the demarcation and interface of responsibilities under the Conduct of Financial Institutions and Financial Advice regimes, the requirement to disclose and liability for non-disclosure should rest with that intermediary themselves, with the insurer's obligation being limited to disclosing their financial strength rating to that intermediary.²² • Additionally, consistent with comments made above, the requirement for disclosure under this section should be amended to encourage disclosure by electronic means including via the insurer disclosing information on their and RBNZ's websites. <p>Please also see our responses to questions 1, 3 and 4 above.</p>
<p>2. Solvency standards</p>	

²¹ <https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf>, paragraph 39.

²² Currently s 64 treats the insurer as complying with the disclosure requirements if the intermediary does, but does not exempt the insurer or hold the insurer liable if the broker fails to do so. We note that a similar issue arose in Fire and Emergency New Zealand levy context where insurers used to be treated inconsistently and were unfairly liable for intermediary errors. This was corrected under the Fire and Emergency New Zealand Act 2017.

Question / discussion point	Feedback
<p>1. Would it be helpful to replace the language of ‘solvency margin’ and ‘solvency ratio’ with either:</p> <ul style="list-style-type: none"> i. a metric based on the relationship between Actual Solvency Capital and Minimum Solvency Capital, or ii. the relationship between stressed assets and stressed liabilities? 	<p>We are comfortable with existing concepts and language associated with the ‘solvency margin’ and ‘solvency ratio’. Noting the comments made in paragraph 108 of the Options paper, we also need to be mindful that the main audience of this current information is not policyholders but insurance industry and regulator professionals who are already well placed to understand and apply this well-established terminology. This change would simply add unnecessary cost and introduce potential uncertainty and complexity.</p> <p>Additionally:</p> <ul style="list-style-type: none"> • We note the additional language proposed in the Draft Interim Solvency Standard in these respects. • From our perspective it is unclear what the advantage would be of referring to these matters in IPSA as opposed to the Solvency Standard itself.
<p>2. Should New Zealand solvency terminology be aligned with international standards? Why or why not?</p>	<p>No, we are comfortable with the current solvency terminology. The lack of common terminology overseas means that aligning this with international terminology would have little benefit (i.e. it would only be relevant to the jurisdiction the terminology was aligned with). Additionally, as noted in paragraph 138 of the Options paper, this may lead to confusion because, while the same terminology is used, it may have a different meaning.²³</p>
<p>3. Which international terminology would it be best for New Zealand to align with?</p>	<p>As above, we are comfortable with the current solvency terminology. If such a proposal was to progress, given the close business relationships and common ownership structures in some cases, alignment with the terminology used in Australia would be most logical. We consider that alignment with other jurisdictions, such as the European Union or United States, would create significant confusion and complexity.</p> <p>If the terminology was changed, we consider that it would be important to use terms that are clearly distinct from existing concepts of capital (e.g. share capital, accounting capital or economic capital). We believe that ‘capital base’ and ‘own funds’ are too generic in these respects. Out of the options presented, our preference would be ‘Qualifying Capital Resources’ or ‘Regulatory Capital’.</p>
<p>4. Should IPSA enable a separate standard dealing with Financial Condition Reports? (Why/why not?)</p>	<p>We consider that it is unnecessary to have a separate standard for dealing with Financial Condition Reports (FCRs), these matters are already adequately covered by Solvency Standards and NZSA Professional Standards.</p> <p>For completeness, we refer to the comments made in our recent submission on the Draft Interim Solvency Standard, expressing concern about the proposed expanded role of FCR.²⁴ We would be concerned about any expansion to the scope of this report, particularly where this would involve broadening the FCR beyond the knowledge and</p>

²³ For example, if Capital Base is used, the way this amount is derived may be different.

²⁴ https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_draft_interim_solvency_standard_011021.pdf, pages 4 (D. The role of the Appointed Actuary and the Financial Condition Report (FCR) and 20.

Question / discussion point	Feedback
	<p>expertise of the Appointed Actuary. If that is the intention, consideration should be given to whether the responsibility for this report best sits with the insurer itself, with the Appointed Actuary's input (rather than with them directly).</p>
<p>5. How useful are s.78 reports? Should they be continued or replaced?</p>	<p>We do not consider that the contents of s 78 IPSA reports are materially useful and accordingly would support these reports being discontinued. The audit process already considers the insurance items within financial statements and this assessment is undertaken by actuaries independent of the organisation. Accordingly, in providing the audit assurance, there is already assurance that the insurance liabilities are suitable for the purpose of financial reporting. The solvency position reported in the annual financial statements are also audited to a similar standard.</p> <p>We support the principle of having the Appointed Actuary sign off on the actuarial numbers in the financial statements and support this requirement continuing. It may also be possible to simplify and/or standardise the format adopted.</p>
<p>6. Would it be helpful for IPSA to contemplate more than one solvency control level?</p>	<p>As per the comments in our submission on the Solvency Standard Structure and IFRS 17, we support the move to a banded approach to solvency with two control levels and refer to the detailed feedback provided in that context.²⁵ We also refer to our most recent feedback to the RBNZ consultation on the Draft Interim Solvency Standard.²⁶ To briefly summarise, we believe this change addresses the continuum that exists between insurers becoming riskier and non-viable, enabling supervisors to take a more graduated approach, increasing their oversight of weaker insurers relatively early before they are in serious distress and then escalate levels of oversight and intervention as risks increase. We acknowledge that IPSA needs to be amended to reflect the move to two solvency control levels.</p> <p>The shift to a banded approach to solvency needs to be considered in conjunction with the new solvency standard which will change individual insurers' solvency ratings.</p>
<p>7. How many control levels would be useful?</p>	<p>As above, we support the move to two control levels. We agree that the top level should be set at the point at which an insurer begins to become high risk, calibrated at around a 1:200 year probability of sufficiency, with the lower level set at the point at which the insurer is likely to be non-viable.</p>
<p>8. How should the Reserve Bank's powers relate to the different control levels?</p>	<p>We support milder powers being unlocked at the top control level (for example those relating to information and investigation), with other more significant and intrusive powers (such as directions and the appointment of an administrator) being unlocked at the lower control level. This approach is preferable to all powers being enabled at the top control level from a certainty perspective and would also diminishes the value of a graduated/banded approach in our view.</p> <p>If all powers were to be unlocked at the top control level, it would necessary for the RBNZ to issue detailed guidance on how and when the various powers would be used.</p>
<p>9. Should powers be unlocked sequentially?</p>	<p>Yes. As noted above, we consider that the available powers should be unlocked in a graduated way, with only milder powers being unlocked at the top level, with additional more significant and intrusive ones being unlocked at the lower level.</p>

²⁵ https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_Solvency_Standards_Structure_and_IFRS_17.pdf.

²⁶ https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_draft_interim_solvency_standard_011021.pdf.

Question / discussion point	Feedback
10. Should powers unlock at the top rung, with the Reserve Bank issuing public guidance on how it intends to use its powers?	<p>As noted above:</p> <ul style="list-style-type: none"> • We do not support all powers being unlocked at the top control level. • If this was to occur, it would be necessary for the RBNZ to issue detailed guidance on how and when the various powers would be used.
11. Should any actions on the part of the Reserve Bank be mandatory when one of the control levels is breached?	<p>Consistent with comments made in our submission on the RBNZ's Solvency Standard Structure and IFRS 17 consultation, we consider the reference to control levels 'unlocking' enforcement powers is appropriate.²⁷ We do not support mandatory use of powers as this would remove the flexibility for the RBNZ to respond as appropriate in the specific circumstances.</p>
12. Should a minimum solvency margin of zero be required by default (without the need to specify it in a license condition)?	<p>Yes. It would be more appropriate and efficient for the minimum solvency margin (or whatever equivalent term is used, if it is changed) to be zero by default, without the need to specify this in a license condition. There should also be an expectation that a capital buffer is held so that this zero default is not breached. Licensing conditions could be applied to vary this to cater for those non-standard positions (as appropriate).</p>
13. Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?	<p>Yes. We support the RBNZ being able to make supervisory adjustments within the solvency calculation and acknowledge and agree with the comments made in paragraphs 164 to 166 of the Options paper in this respect.</p> <p>The calculation of the adjustments should be on a consistent basis that is comparable between insurers. It also needs to be transparent, both to the insurer (so that they can have an open and fact-based discussion around any such adjustments) and other users of the solvency information.</p>
14. Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?	<p>Yes, there should be a mechanism to challenge the supervisory adjustments. We suggest that this would involve an independent committee of suitably skilled and qualified individuals reviewing the matter and then making a decision. Whatever the form the challenge mechanism takes, it will be important for this to involve an efficient process, that enables prompt decision-making – a dispute taking months or years to resolve would be highly undesirable if one needed to comply with the adjustment until the outcome of the challenge was determined. There would also need to be an efficient mechanism for the adjustment to be promptly removed once the issue that gave rise to it has been resolved.</p> <p>Consideration should also be given to where the cost of the challenge should lie, including in circumstances where the adjustment is upheld.</p>
3. Termination values	

²⁷ Footnote 25 above.

Question / discussion point	Feedback
<p>1. Should IPSA contain provisions requiring minimum termination values for policies that store value long-term? Why / why not?</p>	<p>We do not consider that IPSA is the appropriate place to prescribe any minimum termination values for policies that store value long-term. The rationale for this being included IPSA (as explained at the RBNZ webinar for this consultation on 15 September 2021), that this matter is relevant to policyholder security / solvency, as it is connected with capital requirements and ensuring there are enough funds held to pay claims, is not compelling in our view. The Options paper is silent on that positioning and instead appears to frame this matter as an issue of policyholder fairness. While we accept that termination values would be relevant from a prudential and solvency perspective to the extent they already exist, we do not consider it is appropriate to create liability under IPSA where there would otherwise be none.</p> <p>To the extent this proposal is progressed (which we do not express any particular views on given it is not applicable to our members),²⁸ we believe further investigation is required to determine whether this is a demonstrated problem from a policyholder outcome perspective and, if it is, that it is best considered in the context of the Insurance Contract Law review, this issue being best characterised as an issue of customer outcomes under insurance contracts rather a matter for prudential supervision.</p> <p>For completeness, we expect that mandating minimum termination values where they do not presently exist would add cost to insurers which would need to be passed onto policyholders in terms of the premiums they pay for insurance.</p>
<p>2. What would be an appropriate basis for setting minimum termination values?</p>	<p>As noted above:</p> <ul style="list-style-type: none"> • We do not consider IPSA is the appropriate place to prescribe any minimum termination values. • To the extent that this proposal is progressed, an investigation should be undertaken to determine whether this is a demonstrated problem from a policyholder outcome perspective and, if it is, that this would be best considered as part of the Insurance Contract Law review. <p>Without resiling from the above position, if such a requirement was considered necessary:</p> <ul style="list-style-type: none"> • It would be important for this mechanism to be as simple as possible to minimise compliance costs. • Policy values as reflected in financial statements would appear to be the most appropriate basis for assessing minimum termination values as these reflect the most realistic economic value and leverage existing accounting treatment of these policies.
<p>4. <i>Statutory funds</i></p>	
<p>1. Is it still appropriate to provide statutory</p>	<p>It is not considered appropriate to express any view on this matter as it relates to life insurance, which is outside our remit as the industry body for general insurers in New Zealand.</p>

²⁸ The relevant policies being ones that involve a portion of premiums accumulating and storing value for policyholders to fund benefits and claims in future years. That is, as opposed to standard general insurance products, which renew annually with coverage being funded out of yearly premiums. Our members do not currently offer Builder's warranty insurance. We comment on the treatment of general insurance products that have long-term characteristics, which are still annually funded, in the next section on statutory funds.

Question / discussion point	Feedback
<p>fund treatment for YRT business? Or should statutory funds only apply to business where policyholders build up a store of value over time to fund their later claims (for example, participating business, unit-linked business, investment accounts and annuities).</p>	
<p>2. Should health and disability insurance assets be held in statutory funds?</p>	<p>It is not appropriate to express any particular view on this matter as it relates to health and disability insurance which are outside our remit as the industry body for general insurers in New Zealand.</p>
<p>3. Should general insurance contracts also have assets held in statutory funds?</p>	<p>As explained in detail below, a statutory fund requirement is neither necessary nor appropriate for general insurance.</p> <p><i>Statutory fund requirements reflect and address unique features of life insurance</i></p> <p>As indicated in paragraph 181 of the Options paper statutory fund protections have traditionally been provided only to life insurance policyholders in New Zealand because of the particular characteristics of life insurance policies, including their long-term nature.</p> <p>It also useful to reflect upon justification for the introduction of the statutory fund requirement for life insurance in the first place. We note the following:</p> <ul style="list-style-type: none"> • The purpose of the statutory funds regime as articulated in the Cabinet paper which led to the development of IPSA, is to protect policyholders of long-term insurance contracts, such as life insurance, in the event that the insurer becomes insolvent, noting these contrast with the much shorter-term nature of general and health insurance products.²⁹ • One of the other justifications for the statutory fund requirement is to stop products with short term exposure undermining assets required to service long term life insurance liabilities. Specific regard was had to the need, where life and general insurance co-exists within the same entity, for life insurance business to be separated from other insurance business to protect against contagion between these two areas of business, with life insurance policyholders being protected from the risk of their insurer's general insurance business becoming insolvent.³⁰ For completeness, we note that if both life and general insurance assets were ring fenced together under a statutory fund requirement, this protective feature would be redundant.

²⁹ Office of the Minister of Finance Cabinet Economic Development Committee paper - Review of Financial Products and Providers: Prudential Regulation of Insurance, released 22 August 2008, paragraph 26.

³⁰ Office of the Minister of Finance Cabinet Economic Development Committee paper - Review of Financial Products and Providers: Prudential Regulation of Insurance, released 22 August 2008, paragraph 17.

Question / discussion point	Feedback
	<p>Reflecting upon the above, it is clear that statutory fund requirements reflect and protect life policyholders from the unique characteristics and risks life insurance products pose namely:</p> <ul style="list-style-type: none"> • <u>Their guaranteed renewability</u> i.e. the difficulty the policyholder may face obtaining a replacement policy on similar terms (e.g. due to deterioration in health). As above, we note this is also a feature of yearly renewable life insurance policies. This contrasts with general insurance products which, in the vast majority of cases, are annually renewable,³¹ with the policyholder by and large being free to switch between providers without any adverse impacts as they see fit, which is a common occurrence. • <u>Their general long-term and high-value nature</u> i.e. with key cover/benefits responding to events at potentially a much later date in the future (e.g. death or terminal illness potentially decades away), with sums insured that are typically between \$100,000 to \$1million or more. In contrast, the vast majority of claims under general insurance policies operate under annually renewing policies operating on an ‘occurrence’ basis,³² with potential liability being either known during, or shortly after, the applicable period of insurance ends, with far smaller amounts typically being paid under them. Where larger amounts are paid (e.g. total loss building or specialised motor or plant, corporate liability claims or claims for lengthy business interruption), these make up only a small fraction of the total claims that general insurers pay and amounts payable may still be lower than amounts payable under key life insurance cover/benefits. • <u>Their potential investment component.</u> In contrast with traditional life insurance policies, general insurance products contain no investment component. The primary focus of a general insurance product is to indemnify, namely to put the policyholder back in the position they were in immediately before the insured loss/damage occurred. <p>However, we do not consider it is helpful to characterise life insurance as being uniquely complex. Life, health and disability and general insurance each have very different attributes with their own complexities.</p> <p><i>Long-term general insurance issues are different to long-term life insurance ones</i></p> <p>We do not agree with the assessment in paragraph 193 and 197 of the Options paper that general insurance involving long-term exposures are equivalent to life insurance products from a storing policyholder value and time horizon perspective.</p> <p>Addressing each of the examples cited in support of this position in turn:</p> <ul style="list-style-type: none"> • <u>Claims under a Professional Indemnity policy:</u> For a valid claim for civil liability to be made under a Professional Indemnity, or other liability product/cover that operates on ‘claims made and notified’ basis (e.g. Directors’ and Officers’, Employers’ Liability, Statutory Liability), it is necessary for cover to be continuously

³¹ Excluding short-term or run-off cover, e.g. to align with the renewal date of a new provider of offering or reflect the winding up of a business respectively.

³² This means that for the claim to be valid the relevant event giving rising to the loss/damage must occur during the period of insurance of the relevant insurance contract.

Question / discussion point	Feedback
	<p>in place from the date that conduct giving rise to the claim arose until the date the circumstances and claim is notified to the insurer.³³ However, in contrast with the difficulty a life insurance policyholder may face switching provider described above, a general insurance policyholder of such products is generally free to move between providers, and is not restricted to staying with the same insurer over the whole period of cover. This reflects the general market practice which is to honour a claim where a policyholder switches between insurers provided the applicable cover has been taken continuously over this period.³⁴ Additionally, while the period between when this cover was initially taken out and claimed upon would typically be longer than under a typical occurrence based insurance policy, due to the operation of limitation periods (generally six years from the date of the act or omission the claim is based on),³⁵ these timeframes are far shorter than those possible under life insurance policies.</p> <ul style="list-style-type: none"> <p><u>Large claims under general insurance policies that take a long time to settle (e.g. housing rebuilds following the Canterbury Earthquake Sequence (CES))</u>: We note that since the CES, the general insurance industry has shifted towards sum insured house policies, cash settlements of total loss house claims and a single contact point for EQC / private insurance claims management under the new Natural Disaster Response Model, all which makes settlement much more efficient and rapid than was previously the case. The CES was also an extraordinary and rare event and overall large claims of this nature make up a very small portion of the claims general insurers pay overall. Additionally, like the ‘claims made and notified’ liability policies referred to above, unlike life insurance products, there is no inherent restriction in the nature of the product that prevents a general insurance policyholder changing between insurers in these circumstances. While there may be delay in being able to do so in practical terms (e.g. waiting for the rebuild/repair to be completed before another provider is willing to take on the risk going forward),³⁶ again these ‘long’ timeframes would be much shorter than those possible under a life insurance policy. We also note that, if a statutory fund requirement was in place for a subset of an insurer’s assets in such situation, and reinsurance was exhausted, this could lead to a worse outcome from a policyholder perspective.</p> <p>In general terms, where a general insurance product involves a long-term element, the risks involved are different to those derived from the long-term characteristics of life insurance products. The concern in the general insurance context, is an insurer’s ability to pay claims for the long tail, which turns upon whether the reserving is adequate. This is a matter best dealt with through risk margins and solvency requirements, not statutory funds.</p> <p><i>Unclear what problem a statutory requirement would solved and the costs involved</i></p>

³³ This treatment ensures that adequate premium for risk is collected over the life of the relevant liability exposure irrespective of which insurer the policyholder is with, reflecting that, given the nature of these exposures, it may take some time before an issue that gives rise to a claim materializes.

³⁴ In practical terms, to make this assessment the insurer would generally look to ensure that the ‘retrospective date’ of the policy (which is the date when the applicable cover was first taken) fell before the event giving rise to the claim and that cover has been continuously held since then.

³⁵ Limitation Act 2010.

³⁶ In such situations the obligation to remediate a claim sits with the insurer on risk at time of loss/damage, the fact that a policyholder subsequently changes insurers would not remove that earlier provider’s liability.

Question / discussion point	Feedback
	<p>As above, it is unclear what problem the introduction of a statutory fund requirement would address and nothing has been clearly demonstrated or evidenced in the consultation paper in this respect.</p> <p>As indicated in an earlier submission,³⁷ the considerable cost and complexity involved in general insurers establishing, administering, funding and maintaining statutory funds would outweigh any benefits relative to the status quo. It is also expected that the asset ring-fencing required to comply with any statutory fund requirement would be costlier and more complex to administer for general insurers than life insurers given the shorter-term nature of their products and the frequency with which they may change.</p> <p>This required ring-fencing would also reduce general insurers' flexibility in running their businesses. The benefits of this flexibility include, in the event of a major catastrophe event (such as an earthquake), sharing and spreading risk, noting that New Zealand is largely reliant upon a large pool of funds held by the international insurance community. There would also be an opportunity cost associated with siphoning funds out of the general insurance industry to meet any statutory fund requirement.</p> <p>Consistent with earlier remarks about proposals that add regulatory burden and cost, the impacts described directly above would also have a flow-on impact in terms of the availability and affordability of insurance to policyholders' detriment.</p> <p><i>Other comments</i></p> <p>Lastly, while we acknowledge statutory fund requirements are reasonably common across other Commonwealth jurisdictions, these tend to be limited in application to life insurance businesses.³⁸ In New Zealand's closest jurisdictions for comparison purposes, Australia and the United Kingdom, statutory fund requirements consistently also only apply to life insurance business.³⁹ We also understand there is also no statutory fund requirement for general insurers in Canada.</p> <p>Putting the issue of international comparability to one side, regard also needs to be had to the unique features of the New Zealand general insurance market referred to above (i.e. small size and high risk), which make remaining attractive to overseas insurers particularly important, including from a regulatory burden and cost perspective.</p> <p>We also note that general insurers already have a solvency requirement to hold sufficient capital to withstand a 1:1000-year seismic event and 1:200 year for other (including non-insurance) events. This is significantly above any other jurisdictions. Solvency requirements are expected to be further increased as a result of the Solvency Standard review and the outputs from new catastrophe modelling.</p>
4. If so should statutory fund	As noted above, we consider that a statutory fund requirement is neither necessary nor appropriate for general insurance.

³⁷ <https://www.icnz.org.nz/fileadmin/Assets/PDFs/ICNZ-submission-on-the-IPSA-review-issues-paper.pdf>, paragraph 28.

³⁸ See paragraph 175 of the Options paper.

³⁹ We also note that the IPSA regime was based upon the prudential regime in Australia.

Question / discussion point	Feedback
<p>requirements apply to:</p> <p>a. all general insurance business;</p> <p>b. assets backing business with a contract boundary over one year;</p> <p>c. assets backing accepted claims over a particular size, for claims likely to take more than a year to settle;</p> <p>d. some other subset of general insurance business?</p>	
<p>5. Should all policyholders be given priority in insolvency over other general creditors?</p>	<p>We support the introduction of a policyholder preference in insolvency for general insurance. While it is highly unlikely that this preference would need to be utilised given general insurers' high levels of solvency and resilience, if it did, as a matter of principle, we strongly believe that it is appropriate to prioritise policyholders' interests above others. This position is consistent with ICNZ's focus on customer-centricity and the principle in s 4(c)(i) of IPSA of ensuring policyholders' interests are adequately protected when an insurer is in financial stress, while still reflecting that IPSA is not intended to be a 'zero failure' regime and that members of the public should be ultimately responsible for their own decisions regarding insurance to a certain extent.⁴⁰</p> <p>We also note the following in this regard:</p> <ul style="list-style-type: none"> • We consider that it is appropriate to draw a distinction and prioritise policyholders' interests above commercial parties (i.e. other general unsecured creditors), particularly in so far as consumer policyholders are concerned, who are potentially vulnerable and generally less able to assess and monitor financial soundness. • Introducing this preference would bring the prudential regime for general insurance in New Zealand more in line with international expectations, which may provide comfort to international participants in the New Zealand market, acknowledging that, as noted in the discussion document, this matter was raised by the International Monetary Fund (IMF) in their review of New Zealand's insurance regulation against international standards.⁴¹ • While introducing this preference introduces additional regulatory burden and cost, and could potentially negatively impact insurers' other general unsecured creditors (e.g., suppliers, partners and reinsurers), given general insurers' high levels of solvency and resilience, we expect that any potential adverse impacts would be able to be worked through - for example, via commercial arrangements (as necessary), noting that insurers are likely to be general unsecured creditors' least risky trading partners due to their high levels of solvency. Reinsurers will also be familiar with such preference arrangements to a certain extent, given they are reasonably

⁴⁰ Section 4(d)(ii) of IPSA.

⁴¹ See paragraph 185 of the discussion document and <https://www.rbnz.govt.nz/-/media/ReserveBank/Files/regulation-and-supervision/FSAP/Detailed-assessment-of-observance-Insurance-core-principles.pdf?la=en>, pages 5 and 33.

Question / discussion point	Feedback
	<p>common abroad. We also note that these arrangements are already in place in the Life Insurance sector in New Zealand, so that there is already an awareness of such arrangements in the New Zealand context.⁴²</p> <p>While the scope of this preference would need to be worked through, and the subject of detailed analysis and further consultation, we would expect that this should extend to outstanding claim amounts owed to consumer policyholders at a minimum, this being the area of most potential harm in our view.</p> <p>In designing the preference, the following would need to be considered:</p> <ul style="list-style-type: none"> • Whether the preference should extend to non-consumer policyholders. While these policyholders may be more resilient financially, this may not necessarily be the case. This resilience may also not be necessarily sufficient to sustain a large claim not being paid out (such as where there is a total loss of plant, building or stock or a significant liability or business interruption claim). • Whether the preference should be limited to New Zealand based policyholders and/or risks, or extend to those abroad. While this requires further analysis, we note that limiting this preference to New Zealand policyholders and/or risks may be sufficient to ensure New Zealanders' having trust and confidence in the insurance industry but could be detrimental from an international reputation perspective. • That the general insurance sector is much smaller than the banking sector in New Zealand in terms of the direct potential economic impacts of failure and the nature and makeup of their pool of respective unsecured general creditors.⁴³ • How the preference would apply to overseas insurers operating in New Zealand via branches (if at all). As outlined in our submission on the previous IPSA Scope and Overseas Insurer consultation, we consider that there is a range of views and considerations that regard needs to be had to in this respect.⁴⁴
<p>6. Should priority be confined to policy benefits or also include claims for unearned premium?</p>	<p>As noted above, at a minimum, we consider that the policyholder preference in insolvency should extend to outstanding claim amounts (i.e. policy benefits) owed to consumer policyholders, this being the area of most potential harm in our view.</p> <p>We acknowledge the potential benefits of extending this preference to non-consumer policyholder claim amounts from a wider policyholder protection and simplicity perspective but would be concerned if this came at the expense of sufficient protection for consumer policyholder claims. Similarly, we would be concerned about a preference extending to unearned premium potentially eroding the ability to pay claims generally.</p> <p>An additional complication with covering unearned premium in the commercial context is the potential complexity of the calculations required. This may undermine the efficacy of the preference, with potentially large amounts of resourcing required to calculate what is owed. For example, it may be very complicated to calculate unearned amounts for seasonally adjusted covers, motor vehicle fleet or blanket contract works policies, where insured values change during the period of insurance and would</p>

⁴² See s 116 of IPSA.

⁴³ See comments in paragraph 204 of the discussion document.

⁴⁴ https://www.icnz.org.nz/fileadmin/user_upload/ICNZ_submission_on_IPSA_Scope_and_Overseas_Insurers_190321.pdf, pages 11 to 16.

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	<p>ordinarily only be quantified at a later point (e.g. as part of reconciliation or 'washup' process at the next renewal date, looking at the previous 12-month period). The larger the size of the portfolio insured in this manner and the number and frequency of the changes, the more complex these exercises will be. Another complexity in the commercial context would be calculating unearned premium when premium funding arrangements via a third-party funder were involved.</p>
<p>7. Should IPSA be amended so as to make it more explicit that assets (other than transactional bank accounts) should not be shared across different statutory funds?</p>	<p>Given the reference is made to existing statutory fund requirements, we envisage that this proposal does not relate to general insurance, so are not minded to comment on it.</p> <p>If we are wrong and the proposals referred to in this question (and other proposals outlined in paragraphs 205 to 214 of the Options paper) are intended to relate to general insurance, nevertheless we do consider that it would be appropriate to comment because it unclear what a statutory fund requirement would specifically involve in the general insurance context and how this would interface with this proposal. As noted above, we consider that a statutory fund requirement is neither necessary nor appropriate for general insurance.</p>
<p>8. Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?</p>	<p>We do not consider that it is not appropriate to express any view on this matter, as relates to life insurance which is outside our remit as the industry body for general insurers in New Zealand.</p>
<p>9. If requirements to establish a trust were included, are there any issues about the trust's constitution that should be specified in IPSA?</p>	<p>This question follows on from the previous one and we repeat our remarks in that respect.</p>
<p>10. Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?</p>	<p>This question follows on from the previous one and we repeat our response to question 8 in this respect.</p>

Question / discussion point	Feedback
<p>11. Should life insurers with participating life insurance business be required to prepare accounts for capital and retained profits in their statutory funds? Should these be disclosed:</p> <p>a. As a note to the insurers financial accounts? Or,</p> <p>b. In data returns for participating businesses provided by the Reserve Bank?</p>	<p>We do not consider that it is appropriate to express any view on this matter, as it relates to life insurance which is outside our remit as the industry body for general insurers in New Zealand.</p>
<p>5. <i>Risk appetite and overall policyholder protection</i></p>	
<p>1. Do stakeholders think that regulation in respect of each of the channels listed in para 217 is broadly appropriate?</p>	<p><i>General comments</i></p> <p>We envisage that the intention is to refer to paragraph 218 (not paragraph 217) of the Options paper and agree the channels referred to under that paragraph could hypothetically be used to enhance policyholder security.</p> <p>We also agree with comments in paragraph 217 about the intention of IPSA not to be a ‘zero failure regime.’ As indicated in the previous section, one cannot look at improving policyholder security in isolation and it is critical from our perspective that we ensure there is the right balance between competing considerations and IPSA's principles/purposes, noting that increased policyholder security measures are likely to come at the expense of flexibility, increased cost, complexity and raising barriers of entry, that in turn would be reflected in the availability and affordability of insurance to policyholders’ detriment. One also needs to be mindful that any change involves upfront implementation, and potentially ongoing, added cost and complexity that may undermine any potential benefit.</p> <p>As above, we consider that the best approach is to continue with the status quo with appropriate enhancements and refinements based on experience and practice – we do not support more substantial change. This reflects our view that there is no material gap between current regulatory requirements and the appropriate level of policyholder protection. From our perspective, the key aspects for policyholder security are insurers’ risk management and governance, disclosure of financial strength measures and solvency requirements.</p> <p>Below we comment on each of the channels referred to under paragraph 218 specifically. We also refer to the detailed comments above as they relate to each of the specific proposals put forward.</p> <p><i>Comments on channels</i></p>

Question / discussion point	Feedback
	<p><u>Enhancing insurers’ risk management and governance</u></p> <p>While we agree that risk management and governance is an important element of policyholder security, and that sufficient attention needs to be paid to risk and providing for it, insufficient information is provided to comment on what is specifically envisaged in this regard, so it would be appropriate for us to comment on this further at this stage. We envisage that this matter will be expanded upon in a later IPSA consultation which we will provide feedback on in due course and/or progressed as part of the RBNZ ‘s and the FMA’s thematic review of governance.</p> <p><u>Better information to policyholders about risk and financial soundness</u></p> <p>As above, we agree that there are some areas where financial strength disclosure requirements can be improved. We also agree with the stated outcomes of informed policyholder decision-making and incentives for insurers to provide for risk.</p> <p><u>Increasing the level of capital held against risk</u></p> <p>We do not agree that it is necessarily appropriate to increase the level of capital held against risk as an intended outcome in and of itself. Capital requirements are currently being considered via the Solvency Standards review workstream and are much better addressed in that detailed and specific context, with reference to the specific proposals envisaged in that respect.</p> <p>In general terms, while we acknowledge the critical role capital requirements play in supporting policyholder protection, as outlined above, one needs to be conscious of diminishing returns, added costs and consequential impacts on the availability and affordability of insurance if requirements are made too onerous. We also note that Solvency requirements are already expected to increase further as a result of the Solvency Standard review and outputs from new catastrophe modelling.</p> <p><u>Enhancing policyholders’ access to assets in insolvency</u></p> <p>As outlined above, we support the introduction of a policyholder preference in insolvency for general insurance. While the design of this would need to be worked through and the subject of further analysis and consultation, we expect that this should at least extend to outstanding claim amounts owed to consumer policyholders, this being the area of most potential harm in our view.</p>
2. If not, which areas are over-regulated or particularly in need of enhancement?	Please see our response to question 1 above. Our view is that the best approach is to continue with the status quo with appropriate enhancements and refinements based on experience and practice – we do not support more substantial change.
3. Are there any additional measures for policyholder security that the	Other than considering whether the RBNZ’s direction powers under ss 143 to 150 of IPSA should be amended to reflect they could be used to address policyholder security issues, there are none that we are aware of.

Question / discussion point	Feedback
Reserve Bank should consider?	
4. Have we correctly identified the risks that a policyholder guarantee scheme should address?	<p>We do not consider that the risks associated with a policyholder guarantee scheme (PGS) have been adequately outlined in the Options paper. There are additional matters which regard should be had to in this context and we would not support the introduction of such a scheme for general insurance. We expand upon these matters below.</p> <p><i>It is unclear what the problem to be solved is</i></p> <p>The assumption appears to be that there is a problem to be solved here (e.g. potentially incentives towards under-provisioning risks, long-tail events, policyholder protection issues arising from the serious risk of insurer?), but a clearly articulated or evidenced analysis has not been presented for doing so.</p> <p>In any event we believe that such issues are already being appropriately addressed via the current solvency and policyholder protection frameworks under IPSA, including the financial disclosure requirements.⁴⁵ General insurers are already subject to a solvency requirement to hold sufficient capital to withstand a 1:1000-year seismic event and 1:200 year for other (including non-insurance) events, which is significantly above requirements in any other jurisdiction. Solvency requirements are expected to increase further as a result of the Solvency Standard review and outputs from new catastrophe modelling.</p> <p>We also note the differences between depositor and policyholder protection schemes which would make such a scheme less valuable in an insurance context particularly given, as indicated in paragraph 223 of the Options paper, the reduced risk and slower pace of any potential ‘run’ on insurance, the much lower risk of contagion and the significant increased complexity due to the nature and variability of insurance products.</p> <p><i>Lack of alignment with IPSA principles and purpose</i></p> <p>We refer to remarks made in the previous section about the principles and purposes of IPSA, and reiterate that IPSA is not a ‘zero failure regime’ such that, even if there is a possibility that an insurer fails, it should not necessarily follow that this risk should be removed.</p> <p>From the perspective of avoiding unnecessary compliance costs, and insurance market competition, suitability and efficiency, one also needs to be mindful that introducing a PGS would have significant regulatory burden, cost and complexity impacts for insurers. A centralised scheme of this nature would also be fundamentally less efficient than requiring insurers to hold capital in their own right and there would be an opportunity cost associated with siphoning funds out of the insurance industry. In turn there would be flow-on negative impacts in terms of the affordability and affordability of insurance to policyholders’ detriment. In particular, levies insurers would be charged for this scheme would be passed onto their policyholders and the introduction of a PGS scheme would raise barriers of entry and may discourage existing market participants to continue to do so.</p>

⁴⁵ Subject to the enhancements being made discussed above.

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	<p>In evaluating the matters described above, one also needs to consider the appropriate public risk appetite setting, namely whether it is preferable to:</p> <ul style="list-style-type: none"> • incur the considerable upfront cost of developing a PGS as a contingency for the rare possibility of an insurer failure, noting the strong solvency and policyholder protection frameworks already in place), or • address this matter discretely, if and when the matter arises and as deemed necessary, noting that, as acknowledged in paragraph 227 of the Options paper, in the rare case an insurer did fail, they would likely to be able to meet some outstanding claims. <p>Getting public feedback will be an important consideration in this context and we endorse the RBNZ’s approach in conducting public research and surveys in this regard.</p> <p><i>Increased moral risk</i></p> <p>We are also concerned that the introduction of a PGS could reduce market discipline and introduce additional moral risk because policyholders would be insulated from losses and accordingly may be incentivised to take greater risks in terms of the insurer they select. This would be inconsistent with the principle under s 4(d)(ii) of IPISA (recognising the importance of members of the public being responsible for their own decisions related to insurance).</p> <p>If this policyholder behaviour eventuated, in turn this could lead to insurers worryingly loosening their own risk appetite to compete and win business. We query from an insurer moral risk perspective whether introducing a PGS could drive inappropriate corporate behaviour. Specifically, we would be concerned that this may incentivise insurers to hold less capital, leaving the scheme to bear the cost of failure. As we expect the funding of the scheme would be proportional based upon the insurer’s size, we would also be concerned that this scheme may represent the larger, more robustly capitalised and/or regulated insurers subsidising others.</p> <p>These moral risks may put additional pressure on the RBNZ from a supervision perspective. Alternatively, the introduction of the PGS could perversely disincentive supervisory oversight, on the basis that robust supervision is unnecessary because cover under the scheme would be available should an insurer fail.</p> <p><i>Limits to what can be drawn upon from other jurisdictions</i></p> <p>There are limitations about what can be drawn upon from other jurisdictions in this context. In particular:</p> <ul style="list-style-type: none"> • There is no international consistency or identified best practice for PGSs that can be drawn upon.⁴⁶ We also note the comments made in paragraph 225 of the Option Paper, which consistent with our own inquiries confirm that, together with compulsory worker compensation or health insurance, the most common form of coverage under overseas schemes relate to compulsory personal injury and third party motor vehicle coverage and insurance related pension schemes that are not

⁴⁶ We understand that this is due to the absence of any international standards or principles on these schemes.

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	<p>relevant in the New Zealand context. In the general insurance context, this reflects the absence of any compulsory third party motor vehicle insurance regime, and the absence of any material personal injury liability exposures in New Zealand due to our robust public health system and no fault ACC personal injury and worker compensation regime.</p> <ul style="list-style-type: none"> • In considering this matter it is important to have regard to the other unique features of the New Zealand insurance market. As noted above, New Zealand general insurers are already subject to a solvency requirement significantly above any other jurisdictions internationally and it is expected that this will be increased further in due course. Consideration would also need to be given to how New Zealand's unique state operated ACC and EQC insurance schemes would interact with a PGS. <p><i>Additional comments</i></p> <p>If further consideration was given to introducing a PGS (which for the avoidance of doubt, we would not support), the following practical issues associated with it would need to be worked through:</p> <ul style="list-style-type: none"> • Consideration of the efficacy of any scheme in the initial implementation period (e.g. the first ten years of its operation), because assuming it was funded on an ex-ante basis, compensation funds would be still being built up over this period and may be insufficient to cover any insurer failure. There would be a high likelihood that Government / taxpayer assistance would need to be called upon accordingly. • Following on from the above, the concentrated structure of the New Zealand general insurance market could result in contributions being insufficient to build up an adequate fund in any event (e.g. even past the initial implementation period). • There is also a risk that high ex-ante or ex-post industry contribution levels may cause significant financial difficulty for insurers to meet, potentially resulting in their retreat from the market. <p>Additionally, as noted in paragraph 231 of the Options paper, substantial policy work would be required if a PGS was to be considered further. We expect that this would at least need to involve a thorough costs and benefits analysis to understand the implications of introducing a scheme with reference to:</p> <ul style="list-style-type: none"> • a clearly defined objective/purpose and scheme design⁴⁷ • funding requirements • the probability it would be drawn upon, and • moral risks, public risk appetite and costs as outlined above. <p>We consider that it is inappropriate to make any comment on likely costs at this stage because no detail has been provided about the rationale and intended design of any such scheme, including the proposed eligible policyholders, form and extent of coverage, any limits on protection, funding arrangements (e.g. where it will be ex-ante,</p>

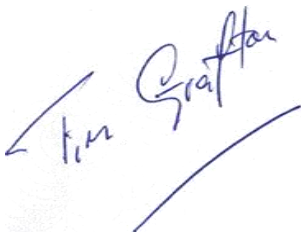
⁴⁷ Including how this scheme would fit with any statutory fund requirements, noting that these may overlap as they both relate to protecting policyholders in the event of insurer failure.

Question / discussion point	Feedback
	ex-post or hybrid funded and whether industry levies would be uniform or risk-based) and what administration and governance arrangements are proposed. Aligned with comments above, we would also caution against relying upon cost estimates based upon other jurisdictions as the contexts are very different.
5. Are there other risks we have not considered that a scheme could also address?	We are not aware of any. Please see our comments directly above querying the merits of introducing a PGS.
6. Are there particular types of insurance for which a scheme is especially important?	As outlined above, it is not considered appropriate or necessary to introduce a PGS for general insurance. Please see our comments in response to question 4 above in this regard. It is not considered appropriate for us to comment on other insurance sectors in this respect.
7. Overall, to what extent do you think a policyholder guarantee scheme is worth considering for New Zealand?	As outlined above, from a general insurance perspective, we do not consider that a PGS is worth considering for New Zealand. Please see our comments in response to question 4 above in this regard.
8. Are there particular kinds of policies that should be covered?	No. As outlined above, from a general insurance perspective, we do not consider that a PGS is worth considering.

3. Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Regulatory Affairs Manager by emailing nickw@icnz.org.nz.

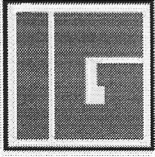
Yours sincerely,



Tim Grafton
Chief Executive



Nick Whalley
Regulatory Affairs Manager



Indemnity & General

Indemnity and General Insurance Company Limited

19 November 2021

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
Wellington

by email to: ipsareview@rbnz.govt.nz

IPSA Review Policyholder Security Consultation

Thank you for the opportunity to provide a submission on your consultation document "Option Paper 2: Policyholder Security".

Introduction

Indemnity & General Insurance Co Ltd (I&G) currently fits into your category of a small insurer operating in a niche market [your section 91]. We provide liability insurance to engineering firms that mostly support the construction, infrastructure, manufacturing and transport industries. Our policy holders are not the general public as they need to be qualified professional engineers in consulting practices.

The general public may have the choice of buying insurance. For consulting engineers, it is compulsory before signing the many certificates that are fundamental to New Zealand's construction, manufacturing and transport industries.

Government departments, territorial authorities and industrial clients typically require liability insurance cover as part of the engagement conditions for consulting engineers. The following clause is a typical example of a proposed insurance requirement for consulting engineers working for the Ministry of Transport. "*8. Unless the insurer has a rating exemption from the Reserve Bank of New Zealand, the public liability and professional indemnity insurance must be provided by an insurer who has a minimum A- Insurer Financial Strength Rating by S&P Global Ratings or an equivalent rating...*" Obtaining a rating is expensive and an A- rating is unlikely for a smaller insurance company like ours with limited diversity in its policy holders, risk locations and lines of insurance, even though I&G has an excellent solvency ratio and has been operating since 1974.

I&G is fully owned by an organization of consulting engineers. Our shareholder's aim is to provide risk management advice and arrange quality insurance cover that matches New Zealand conditions with claims handled locally and promptly. I&G significantly influences policy conditions and claims handling. Along with our large co-insurers we play an important role in providing essential insurance to New Zealand's construction, manufacturing, transport and service sectors.

Our comments and suggestions below relate to our specific situation.

Question 1.1 Small Insurers Exemption from rating.

Yes [your option 2A, section 99]. The exemption should be both retained and the premium cap increased based on the increase in insurance premiums. The increase (since 2010) is much greater than the change in CPI as premiums are influenced by re-insurance costs (escalating due to "natural" disasters) and in our industry, construction costs too.

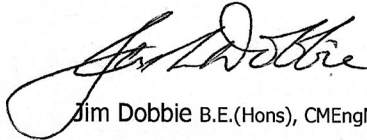
Option 2D requiring higher solvency requirements is also appropriate. Your solvency standards allow this to be a reliable measure.

A further option [Option 2E] is suggested for the updated IPSA Act to allow the Governor of the RBNZ (or his appointee) to grant an insurer a specific exemption from a rating after considering the policy holders security based on:

- the insurer's solvency position and
- the co-insurance and re-insurance arrangements to understand how the risks are shared and
- the impact on policy holders if the insurance company is not permitted to operate.

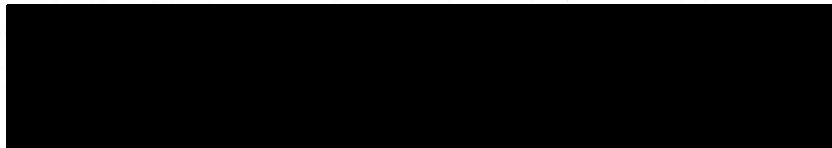
This submission is focused on the premium cap which is the criteria for an exemption from an insurance rating. That cap is now limiting our company from providing insurance to new policy holders. Obtaining a rating is relatively expensive, less favourable for small insurers (irrespective of solvency) and would limit I&G's ability to positively influence the professional indemnity insurance of engineers. These professionals are critical to the construction, manufacturing, transport and service sectors in New Zealand. The reasons for this have previously been presented to RBNZ in our letter of 17 December 2020 and our meeting on 3 June 2021.

Please contact us for any further clarification.



Jim Dobbie B.E.(Hons), CMEngNZ, MInstD

Chairman of Directors



INSURANCE POLICYHOLDER PROTECTION

By press statement dated 31 August, 2021, the Reserve Bank invited feedback on insurance policyholder protection. As one of the two members of the committee established to advise the Bolger Government on this matter as it related to disaster insurance (the other member being Ian McLean, at that time Chairman of the Earthquake Commission), I have a strong interest in this issue.

The background to the establishment of the Brash-McLean Committee in the early nineties was a decision by the Bolger Government that the Earthquake Commission should no longer insure commercial property against earthquake risk and should limit its coverage of residential property to a limit sufficient to cover a basic home, with homeowners taking private insurance for amounts in excess of that limit. The cover was to be on a replacement basis, with the limit set at \$100,000 for dwellings. (It is sobering to reflect – and an indictment on successive Governments over the last 30 years – that when that limit of \$100,000 was set it covered the great bulk of all homes in the country.)

But what responsibility did the government have to ensure that the insurance companies providing that earthquake cover would be able to meet claims after a major earthquake? After all, disaster insurance is tailor-made for crooks. In most markets, consumers can assess a company's quality by watching its day-to-day dealings with consumers, and no scrutiny by the public sector is required. But when the risk being insured against is a very infrequent, but potentially very serious event, no such observations are possible. Property owners could pay insurance premiums for years or decades without making a claim, only to find after a major disaster that the insurance company is "gone no address". It was not hard to convince Ian McLean and me that some form of public sector oversight was needed.

When our committee began its work, the only requirement for insurance companies was that they had at least \$100,000 in capital and had a deposit of at least \$500,000 with the Public Trust, an absolutely derisory amount and totally inadequate as a way of providing some protection to policyholders. The most obvious solution facing the committee was to recommend the establishment of some kind of official supervisory body to provide prudential oversight over any company providing disaster insurance, as most countries have.

After considering all the issues carefully, we did not recommend that solution. In part that was because we had little confidence in the ability of a Wellington-based agency to make the right judgements about the claims-paying ability of private sector insurers because so much of that ability depends not on the balance sheet of those insurers but on the quality of their reinsurance treaties, and that would almost certainly be very hard for a Wellington-based agency to assess. In addition, we reasoned that a traditional supervisory body would specify certain prudential standards to be met, and insurers would aim to comply with those standards but not necessarily to exceed them. If an insurer seemed to be sailing a bit close to the wind, an official agency could cajole and threaten, and *in extremis* cancel the insurer's licence to operate, but in most circumstances would be reluctant to cancel a licence because of the seriousness of such action.

Instead, we recommended that all fire and general insurers (including those providing earthquake insurance of course) be required by law to obtain a claims-paying rating from an approved insurance rating agency, and to disclose that to anybody for whom they were providing insurance, both when the initial contract was signed and on any subsequent renewal.

That system had three advantages. First, it utilized the knowledge of the international rating agencies to assess the local insurers and, importantly, the strength of their reinsurance treaties. Second, by giving visibility to the financial strength of each insurer, we created strong incentives for insurers to increase their financial strength – most people, we reasoned, would be happy to pay a somewhat higher insurance premium for the comfort of knowing that their insurer was very likely to be able to pay out on any claim after a disaster. And third, a claims-paying rating could be adjusted by the rating agency if an insurer was becoming weaker – creating strong incentives for insurers to increase their financial strength or merge with another insurer.

We did not assume that everybody who takes out an insurance policy would be focused on the claims-paying rating of the insurer, and we certainly did not imagine for a single moment that people would have the time or knowledge to make a careful assessment of the financial strength of each insurer. But we assumed that *enough* people would take an interest in the rating, and would have enough brain cells to realise that an insurer rated AAA is more likely to be able to honour an insurance claim than one rated CC, to create very strong incentives for insurers to maximise their financial strength.

We were delighted that the Bolger Government adopted our recommendation, and that system persisted until very recently.

Indeed, in some sense that system still persists. Insurance companies are still obliged to disclose their claims-paying rating when writing, or renewing, an insurance policy. But the incentive to pay attention to the ratings has been greatly diminished since the passage of the Insurance (Prudential Supervision) Act 2010 providing for the Reserve Bank to supervise all licensed insurers and, as with banks, decide whether the directors and management of those insurers are “fit and proper” people. Why bother to pay attention to the financial strength of an insurer as assessed by a specialist insurance company rating agency if the Reserve Bank is going to ensure everything is OK anyway?

There is always going to be political pressure on government to bail out a failing financial institution, be it a bank or an insurance company. The more intensive the supervision of that financial institution by an official agency is, the more the customers of that institution can feel confident that they can ignore its financial strength and rely on the government to bail them out. From the Crown’s point of view, that is a disaster.

Yes, if the Crown is intent on creating the impression that it is preventing financial institutions from failing it should probably at least establish a guarantee fund, by levying all financial institutions covered by that “guarantee”. Much better to have avoided creating the impression that the Crown is providing that guarantee. In the case of insurance companies that is best done by emphasizing their claims-paying rating.

Don Brash
2 September 2021

10th November 2021

Submission on: *Review of the Insurance (Prudential Supervision) Act 2010: Options Paper 2: Policyholder Security*

Your name and organisation

Name	Mel Gorham, Chief Executive Officer
Organisation	Insurance Brokers Association of New Zealand Inc. (IBANZ)

Introduction

IBANZ, its members and financial advice in the general insurance sector

IBANZ has over 100 member firms operating in the general (non-life) insurance market. IBANZ members employ approximately 5,000 staff of which approximately half are currently financial advisers.

IBANZ members place general insurance cover equating to approximately 50% of all general insurance premium (\$3.5 billion) for approximately 1 million New Zealand customers and for approximately 14 of the 30 general insurers operating in New Zealand. The total New Zealand gross written general insurance premium in the 12 months to 30 September 2020 were more than \$6.9 billion.¹

Our detailed submissions are below.

Responses to discussion document questions

Financial strength disclosures

1.1 Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

IBANZ supports the status quo. IBANZ recognises the usefulness of financial strength ratings, as an efficient means by which to convey important financial strength metric which is readily understandable to consumers, and accordingly they should be required in ordinary cases.

However, IBANZ recognises that for smaller insurers (particularly captive insurers or boutique professional group insurers), the cost may

¹ Insurance Council of New Zealand Market Data. An additional approximately \$400 million of cover was placed through Lloyds.

outweigh the benefit, and accordingly IBANZ supports the continuation of the small insurer exemption.

IBANZ considers that if any change is made to the policy settings, it should be to allow an exemption power to allow the RBNZ to permit captive insurers or boutique professional group insurers who exceed the monetary threshold to continue to be exempt from the financial strength requirements, so that they need not constrain growth in their business.

1.2 Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?

IBANZ prefers **status quo** on the basis that it avoids any risk of overseas insurers being deterred from offering insurance in New Zealand. Compliance with local laws can be additionally burdensome for some foreign insurers who need to incorporate bespoke local requirements into their international compliance processes, and this burden is exacerbated by repeated changes being made affecting their established processes. As has been recognised by New Zealand regulators, New Zealand financial adviser and insurance-related laws and expectations have changed considerably recently, and so the threshold for further change should take account of the costs such changes bring and their effects.

It is submitted that the disadvantage of home country preferences, where they exist, are exceeded by the risk diversity benefits of insuring through offshore branches. Home country preferences are relevant only if the foreign insurer cannot meet its obligations, often in the event of a catastrophe at home. This is unlikely to occur at the very time New Zealand has a significant disaster. The converse benefit is that the offshore insurer is likely to have significantly greater access to reserves to meet New Zealand claims when catastrophes occur in New Zealand, and therefore this diversity should be encouraged.

As mentioned above, IBANZ would not support introducing additional disclosure requirements for foreign insurers or reinsurers.

1.3 Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?

IBANZ believes the current financial strength rating and solvency disclosure requirements are sufficient to provide consumers and policyholder's information on the solvency of insurers.

1.4 Out of the options presented in Section 3.4, what is your preferred option or combination or options for public solvency disclosure requirements?

IBANZ supports option one; the status quo. IBANZ:

- prefers no change to the Option 2A to 2D alternatives, but would support the ability for captive insurers or boutique professional group insurers to be able to apply for an exemption to maintain relief from a financial strength rating over the current threshold to avoid inhibiting their growth;
- considers the costs of option 3 (Rotating rating agencies) would considerably exceed any benefit;
- does not support standardised disclosures (option 4), as it would be impractical and duplicative of the current internationally accepted categories; and
- does not support increased solvency disclosures (option 5), as they would not be meaningful to the public, and brokers have sufficient information already.

1.5 If we increase the public disclosure of solvency ratios, what solvency measures do you think would be the most informative to the public?

IBANZ does not support increased public disclosure of solvency ratios on the basis that they would not be meaningful for the public.

1.6 Do you think there is a better public solvency disclosure requirement than the options here? If yes, what disclosure requirement would you like to see?

IBANZ does not support increased public disclosure of solvency ratios on the basis that they would not be meaningful for consumers.

1.7 Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure (as set out in table 3)? If not, what other high level costs or benefits should be considered?

IBANZ agrees with the RBNZ's assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure.

1.8 Are there any other ways in which we might improve financial disclosure to improve policyholders' and other factors ability to assess insurer's financial strength?

IBANZ continues to support increased literacy in schools as a means to improve the public's understanding of the current disclosures and the value of insurance generally.

Solvency Requirements

**2.1 Would it be helpful to replace the language of 'solvency margin' and 'solvency ratio' with either:
 a metric based on the relationship between Actual Solvency Capital and Minimum Solvency Capital, or
 the relationship between stressed assets and stressed liabilities?**

IBANZ believes it would be desirable to replace the expression 'solvency margin' as it is easily misunderstood that a breach of the solvency margin equates with insolvency of the insurer. The margin is not a measure of solvency, rather it is a "buffer" above insolvency.

IBANZ believes the expression 'excess capital' should be preferred.

An insurer's excess capital should be expressed as a percentage of the required 'excess capital' margin.

2.2 Should New Zealand solvency terminology be aligned with international standards? Why or why not?

IBANZ does not see the need to adopt foreign terminology.

2.3 Which international terminology would it be best for New Zealand to align with?

If an international terminology is to be adopted, IBANZ supports aligning with the Australian terminology. However, IBANZ does not see the need to adopt foreign terminology.

IBANZ prefers the Australian terminology to the current New Zealand expressions, for the reasons given above under question 2.1. But prefers the alternative stated in its submission under question 2.1.

2.4 Should IPSA enable a separate standard dealing with Financial Condition Reports? (Why/why not?)

IBANZ does not support a separate standard dealing with Financial Condition Reports. IBANZ believes the New Zealand Society of Actuaries Professional Standard (PS31: Non-Life Insurers Financial Condition Report) provides sufficient protections.

2.5 How useful are s.78 reports? Should they be continued or replaced?

IBANZ considers that section 78 reports are useful, provide useful

information and should be maintained.

2.6 Would it be helpful for IPSA to contemplate more than one solvency control level?

IBANZ supports two 'excess capital' thresholds.

2.7 How many control levels would be useful?

IBANZ supports two 'excess capital' thresholds.

2.8 How should the Reserve Bank's powers relate to the different control levels?

IBANZ supports the concept of the RBNZ having lesser powers when the insurer would begin to become high risk, and greater powers when the insurer is likely to be non-viable, consistent with the international approach.

The approach would enable the RBNZ to take a more graduated approach, as mentioned in the consultation paper.

IBANZ does not support the RBNZ being "required" to take action. The RBNZ's response should be flexible to allow for the range of circumstances that may arise.

2.9 Should powers be unlocked sequentially?

IBANZ supports the powers being graduated (unlocked sequentially), so that the RBNZ has greater powers in the event that the bottom threshold is breached.

2.10 Should powers unlock at the top rung, with the Reserve Bank issuing public guidance on how it intends to use its powers?

No, IBANZ submits that the Reserve Bank's powers should be more limited should only the 'top rung' threshold be breached. IBANZ supports the legislature conferring different powers on the RBNZ depending on the level of risk in the various categories, rather than granting the RBNZ excessive powers for those insurers who fail to reach only the highest threshold, on the basis that the RBNZ can decide, through guidance, when it should exercise those powers. Granting excessive powers to the RBNZ on the basis that it can decide

not to use them would offend the constitutional principle of the "Separation of Powers" and confer too great a discretion on the body who is responsible for enforcement of those powers.

2.11 Should any actions on the part of the Reserve Bank be mandatory when one of the control levels is breached?

IBANZ does not support mandatory actions when one of the control levels is breached. RBNZ should be granted the flexibility to exercise its powers when appropriate, taking account of all the circumstances. Mandatory actions would be too prescriptive, and could lead to unnecessary enforcement action.

2.12 Should a minimum solvency margin of zero be required by default (without the need to specify it in a licence condition)?

IBANZ supports having a default solvency margin of zero, so in the interests of simplicity, it is not necessary to specify a zero margin (when applicable) as a licence condition.

2.13 Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?

IBANZ prefers, for comparability, that the RBNZ maintains a consistent approach to solvency margins and deals with unusual circumstances by additional licence conditions.

IBANZ also recommends that non-standard licence conditions be posted on the Register of licensed insurers in New Zealand posted on the RBNZ website.

2.14 Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?

IBANZ supports the ability to challenge supervisory adjustments or licence conditions, otherwise the RBNZ's powers are unfettered. The powers should continue to be subject to judicial review.

Statutory funds

4.2 Should health or disability insurance assets be held in statutory funds?

IBANZ is opposed to health or disability insurance assets being held in statutory funds. IBANZ considers the solvency standards and reserving

for claims should be sufficient.

4.3 Should general insurance contracts also have assets held in statutory funds?

IBANZ is opposed to general insurance assets be held in statutory funds. IBANZ considers the solvency standards and reserving for claims should be sufficient. Where general insurance may have a significant duration (such as construction/building contract insurance and run off D & O PI insurance), these insurance risks would ordinarily be a small part of an insurer's portfolio.

4.4 If so should that include:

- all general insurance business;**
- assets backing business with a contract boundary over one year;**
- assets backing accepted claims over a particular size, for claims that are likely to take more than one year to settle;**
- some other subset of general insurance business?**

As mentioned in response to question 4.3, IBANZ is opposed to general insurance assets be held in statutory funds. However, if they were, IBANZ prefers the second option, assets backing business with a contract boundary over one year.

4.5 Should all policyholders' be given priority in insolvency over other general creditors?

No. There are many payments that may be important for preserving the insurer's assets for the benefit of policyholders, than payment to policyholders themselves. For example, payment of reinsurance premiums to preserve reinsurance may be more beneficial to policyholders, than prioritising their payments. Imposing a policyholder preference would also cause other creditors to seek greater protection or refusing service, when entering their arrangements, which could be counter-productive.

4.10 Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?

No, the ring-fencing that a statutory fund provides is no different to separate incorporation of the statutory fund assets, which does not require disclosure.

5.3 Are there any additional measures for policyholder security that the Reserve Bank should consider?

IBANZ has not identified further required measures for policyholder security purposes.

5.4 Have we correctly identified the risks that a policyholder guarantee scheme should address?

IBANZ does not think a guarantee scheme is desirable if policyholders or insurers would be levied for it. The additional layer of protection provided by a guarantee would not be positive for policyholders as a class. In fact, levies usually mean that policyholders who select prudently run insurers would subsidise those who choose insurers with more risk, through similar levies being paid for what is effectively shared cover.

5.5 Are there other risks we have not considered that a scheme could also address?

As mentioned in response to its question 5.4, IBANZ is opposed to a policyholder guarantee scheme. IBANZ has not identified further risks that a guarantee scheme could address.

5.6 Are there particular kinds of policy for which a scheme is particularly important?

As mentioned in response to its questions 5.4 and 5.5, IBANZ is opposed to a policyholder guarantee scheme. IBANZ does not consider that a policyholder guarantee scheme would be particularly important for any particular kinds of policy.

5.7 Overall, to what extent do you think a policyholder guarantee scheme is worth considering for New Zealand?

As mentioned in its responses to its questions 5.4 to 5.6, IBANZ is opposed to a policyholder guarantee scheme, and accordingly, it is not worth considering for New Zealand.

5.8 Are there particular kinds of policies that should be covered by a guarantee scheme?

As mentioned in response to its questions 5.4 to 5.7, particularly question 5.6, IBANZ is opposed to a policyholder guarantee scheme. IBANZ does not consider that there are any particular kinds of policies

that should be covered by a guarantee scheme.

If you need any further clarification, please contact me.

Yours faithfully



Melanie Gorham
Chief Executive Officer

New Zealand Captive Insurance Association

PO Box 369
Auckland
Ph: 09 356 9368

15th November 2021

Reserve Bank of New Zealand
Financial System Policy and Analysis - Financial Policy
PO Box 2498
Wellington 6140

By email: ipsareview@rbnz.govt.nz

Dear Sir / Madam

Options Paper 2: Review of the Insurance (Prudential Supervision) Act 2010 – Policyholder Security

Introduction

- 1 This submission to the Reserve Bank of New Zealand on the Options Paper 2 regarding policyholder security as addressed in the Insurance (Prudential Supervision) Act (the '**Act**') is from the New Zealand Captive Insurance Association (the '**Association**').
- 2 This submission has been endorsed by certain members of the Association as well as external parties, listed in the Appendix.
- 3 Our particular interest relating to policyholder security is in respect of the current exemptions for small insurers and whether they should be extended to somewhat larger insurers. This submission deals with that issue alone.
- 4 For the reasons set out below, the Association believes that the maximum gross written premium applied to qualify as a small insurer should be increased to at least \$10 million to ensure all captive insurers are eligible for the exemptions granted to small insurers.

Background

- 5 A captive insurer as defined in section 6(1) of the Act means an insurer that:
 - a is a subsidiary of an entity that is not an insurer (the parent); and
 - b only insures risks of the parent or of other subsidiaries of the parent (or both).
- 6 All captive insurers licensed in New Zealand under the Act are supervised by the Bank's portfolio management team as they have a lower risk profile than other insurers.
- 7 Question 1.1 of the Options Paper asks:

**Do you consider the current exemptions for small insurers should be maintained?
Should they be extended to somewhat larger insurers?**

New Zealand Captive Insurance Association

Response to the Options Paper

- 8 Small insurers are currently exempt from the following requirements of the Act:
- Section 238(1)
- (a) exempting a class of specified persons that have an annual gross premium income (as determined in the manner specified in the regulations) that is less than a specified amount from compliance with—
- i Section 19(1)(d) or (f); or
 - ii Section 60; or
 - iii Any provision of section 81; or
 - iv Subpart 3 of part 2:
- (b) exempting a class of specified persons that have an annual gross premium income (as determined in the manner specified in the regulations) that is less than a specified amount from being—
- i an FMC reporting entity for the purposes of the Financial Markets Conduct Act 2013 by virtue of section 451(h) of that Act:
 - ii an issuer for the purposes of the Financial Reporting Act 1993 by virtue of section 4(1)(da) of that Act:
- 9 Captive insurers are currently only exempt from Section 60 of the Act which is the requirement to have a current financial strength rating.
- 10 The Association's view is that captive insurers **should**, at the minimum, be eligible for the exemptions granted to small insurers on the basis that:
- a The current regulatory regime recognises that captive insurers have a lower risk profile.
 - b As a captive insurer cannot insure third parties they pose less risk to the policyholder and the general public than small insurers therefore under a risk-based regulation approach the Act should reflect the difference in risk profile.
 - c There is no stakeholder that benefits from a captive being required to be an FMC reporting entity, or an issuer for the purpose of the Financial Reporting Act. The requirements of which add to the compliance costs imposed on captives.
- 11 The Association believes that increasing the maximum gross written premium applied to qualify as a small insurer to at least \$10 million could be made without compromising the regulatory environment.
- 12 In the event the RBNZ concludes to not change the gross written premium limit for small insurers we would appreciate if the Act could include captive insurers as those entities exempted under Section 238(1)(a)(b) so that at the very least they were granted the same exemptions as applied to small insurers.

New Zealand Captive Insurance Association

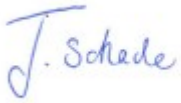
Next steps

13 We would welcome the opportunity to discuss this submission with the Reserve Bank.

14

[REDACTED]

Yours faithfully

A handwritten signature in blue ink that reads "J. Schade". The signature is written in a cursive style with a large initial "J".

Jessica Schade

New Zealand Captive Insurance Association

New Zealand Captive Insurance Association

Schedule

Endorsements

- 15 Captive Owners:
 - a T&G Global Limited
 - b Trustpower Limited
 - c Ovation New Zealand Limited
 - d Scales Corporation Limited
 - e Meridian Energy Limited
 - f Air New Zealand Limited
 - g Unison Networks Limited
 - h CentrePort Limited

- 16 External Parties:
 - a Lockton NZ
 - b Willis Towers Watson
 - c Crombie Lockwood (NZ) Limited
 - d Marsh Limited
 - e EriksensGlobal Limited

15 November 2021

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
Wellington

By email to: ipsareview@rbnz.govt.nz

Dear Sir/Madam

**New Zealand Medical Indemnity Insurance Ltd (NZMII)
Review of the Insurance (Prudential Supervision) Act 2010 (IPSA)**

NZMII welcomes the opportunity to contribute to the Reserve Bank's review, in particular the *Options Paper 2: Policyholder Security*

About NZMII

NZMII is a New Zealand incorporated licensed insurer. It was established in 1999 at the request of the New Zealand Resident Doctors Association to provide professional indemnity insurance for medical malpractice and liability cover from a New Zealand owned and operated company. We received our modified full licence under IPSA on 12 April 2017.

NZMII remains 100% New Zealand owned and operated. Currently, we provide insurance cover and expert medico-legal advice to over 4,000 New Zealand health professionals. By our estimate, we service approximately **[22%]** of the registered doctor liability market in New Zealand.

NZMII's submission

NZMII's submission addresses two questions contained in the *Options Paper*:

Q1.1. Do you consider the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

Q1.4: Out of these options, what is your preferred option or combination of options for public solvency disclosure requirements?

On 28 June 2013 NZMII was licenced as an insurer and up until 17 April 2017 met the exemption requirements for small insurers. As a small insurer the NZMII licence provided exemptions from the following requirements:

IPSA at Section 238(1) provides the following exemptions:

- (a) exempting a class of specified persons that have an annual gross premium income (as determined in the manner specified in the regulations) that is less than a specified amount from compliance with—
 - i Section 19(1)(d) or (f); or
 - ii Section 60; or
 - iii Any provision of section 81; or
 - iv Subpart 3 of part 2:

- (b) exempting a class of specified persons that have an annual gross premium income (as determined in the manner specified in the regulations) that is less than a specified amount from being—
 - i an FMC reporting entity for the purposes of the Financial Markets Conduct Act 2013 by virtue of section 451(h) of that Act:
 - ii an issuer for the purposes of the Financial Reporting Act 1993 by virtue of section 4(1)(da) of that Act:

Regulation 13 of the Insurance (Prudential Supervision) Regulations 2010 set the relevant annual gross written premium at \$1.5 million.

In the financial year to 31 March 2017 NZMII made the conscious decision to write in excess of \$1.5 million in premium meaning that the company would no longer qualify for the exemptions granted to small insurers under the Insurance Prudential Supervision Act 2010 Regulations.

This has resulted in additional compliance costs of approximately \$100,000 per annum, which equates to a 17% increase in our total administration expenses and 5% of our gross written premium. This increase was due to the requirement to hold a financial strength rating together with increased audit, actuarial and management expenses.

To maintain the same level of profitability NZMII had to increase the level of premium charged to health professionals.

Q1.1. Do you consider the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

NZMII supports the current exemptions for small insurers and believe they should be extended to somewhat larger insurers with the \$1.5 million maximum gross written premium requirement increased to \$10 million at a minimum. NZMII supports this on the basis that:

- (a) Insurers that are small, but not quite small enough to qualify for the exemptions, incur significant additional compliance costs, including the requirement to have a financial strength rating prepared annually. This is a material expense, in fact the amount by which it reduces profitability can impact the rating the insurer receives. By way of example, a cost of \$100,000 for this aspect of compliance is 6.7% of \$1.5 million GWP whereas at a more sustainable level of \$10 million GWP it is 1%.
- (b) The cap at any level, is a “blunt instrument”. If the cap is at a higher level the impact of it being surpassed is materially less.
- (c) The disproportionate impact of the costs of compliance above the cap affect the competitiveness of small insurers and inhibit their ability, or even desire, to grow.
- (d) Insurers that are writing less than \$10 million in premium or have an asset base less than \$25 million are unlikely to achieve a rating greater than a ‘B’ from the rating agency. Whilst the company is most likely financially sound the B rating is perceived negatively and may further reduce the ability for the company even at the \$10 million GWP level to increase sales and grow.
- (e) Policyholder comprehension of financial strength ratings and how they work can be low and their value should not be over-estimated. Limited policyholder comprehension could result in policy holders choosing less suitable and/or more expensive product for their needs if they use this as a key metric to choose which insurer to use.

Losing the exemptions available to a small insurer creates another problem in addition to the direct compliance costs incurred. Under the Solvency Standard for Non-life insurers, NZMII is currently required to hold a minimum level of \$3.0 million capital which is almost double the actuarially calculated required minimum capital under the applicable solvency standard. The prudent investment requirements applicable to this “excess” capital result in lower returns to shareholders and higher premiums required to be charged to policyholders. It does not appear logical to apply an arbitrary minimum capital sum if the Solvency Standard creates the right result.

Q1.4: Out of these options, what is your preferred option or combination or options for public solvency disclosure requirements?

NZMII supports option 2A. Increasing the premium cap that small insurers can earn and still apply for an exemption for the reasons outlined above. We believe that the premium cap should be raised to at least \$10 million.

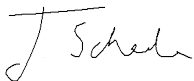
Conclusion

NZMII has operated as a full insurer from 17 April 2017, despite continuing to be a small insurer by New Zealand standards offering a niche insurance product to a limited market.

Since this date NZMII has complied with all regulatory requirements in accordance with our IPISA licence at an increase in cost of over \$100,000 per annum. This has resulted in the need to increase premiums charged to New Zealand health professionals without providing any additional security or benefit.

NZMP would welcome the opportunity to discuss these submissions with the Reserve Bank.

Yours sincerely



Jessica Schade
CEO



Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
WELLINGTON 6140
Via email: ipsareview@rbnz.govt.nz

Monday 15 November 2021

Review of the Insurance (Prudential Supervision) Act 2010 Options Paper 2: Policyholder Security

We welcome the opportunity to make submissions on the consultation paper (Paper 2, Policyholder Security), which has been published by the Reserve Bank of New Zealand (RBNZ).

The New Zealand Society of Actuaries (NZSA) is the professional body for actuaries practicing in New Zealand. Most of the Appointed Actuaries to New Zealand's licensed insurers are members. The Appointed Actuary regime was enacted through the Insurance (Prudential Supervision) Act 2010 (IPSA) and each licensed insurer must have an Appointed Actuary. The Act sets the framework for insurers carrying on business in New Zealand and is of particular interest to many of our members.

The main points of our submission are as follows:

- We consider that the current financial strength rating and solvency disclosures add little value to consumers and policyholders. Confidence in the financial soundness of insurers is achieved through being regulated by the RBNZ and the solvency standard. If public financial strength disclosures are to be maintained, we would support an alternative that was less costly to insurers and more meaningful to consumers. We would be pleased to be involved in further consultation to develop an alternative that would achieve these objectives.
- If the RBNZ were to be given the power to make supervisory adjustments to solvency calculations, then there should be a mechanism to challenge these adjustments. For example, an expert review process could be followed for any supervisory adjustments which are challenged.
- We think that the statutory fund structure provides limited additional protection for yearly renewable term products (YRT) given its short-term nature. However, we do recognise the continuing benefit for life insurance products with a large investment component. Also, given the short-term nature of most general and health insurance business, we do not support the adoption of statutory funds for these business lines.
- We do not support introduction of a policyholder guarantee scheme.

We would be glad to discuss our submission in more detail and would encourage RBNZ to continue its close consultation with industry and key stakeholders on this important topic.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ross Simmonds', is written over a thin horizontal line.

Ross Simmonds
President of the New Zealand Society of Actuaries



1. FINANCIAL STRENGTH DISCLOSURES

When IPSA was going through the consultation phase in 2010, the NZSA submitted that financial strength ratings added little value if a solvency regime was in place. This is still the majority view of members.

In paragraphs 68 to 72 of the consultation paper, the RBNZ indicates that the main purpose of disclosures is to provide information on the relative financial strength of the insurer to the general public. We contend that they are not well understood by the general public so do not fulfil this purpose.

While one of the aims of prudential supervision is so that consumers have confidence in the financial soundness of insurers, this is achieved through the solvency requirements and being regulated by the RBNZ.

The solvency margin disclosure would not be well enough understood by consumers to use them as a comparison between insurers. The solvency ratios of insurers may vary considerably due to differences in the nature of their businesses e.g., the products being underwritten. Therefore, they may not be an accurate reflection of the relative financial strength of insurers. It does have the advantage that it is already calculated for financial statements so is inexpensive to include in disclosures.

If financial strength disclosures are to be maintained, we have the following responses to questions in section 1.

1.1 Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?

We consider that the current exemptions for small insurers should be maintained.

We believe that financial strength ratings add little value to consumers and policyholders. The cost of obtaining a financial strength rating is quite onerous for a small insurer so an extension to the premium cap should be considered.

1.2 Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?

We consider that the current disclosure rules are sufficient.

1.3 Do you consider the current financial strength rating and solvency disclosure to be sufficient to provide consumers and policyholder's information on the solvency of insurers? If no, what information would most help consumers and policyholders?

As stated above, we consider that the current rating and solvency disclosure rules add little value to consumers and policyholders.

We believe that consumers' confidence in the financial soundness of insurers is based on the fact that they are regulated by the RBNZ.

Also refer to responses to option 4 and question 1.6 below.



1.4 Out of these options, what is your preferred option or combination or options for public solvency disclosure requirements?

If financial strength disclosures are to be maintained, our preferred option would be changes to the exemptions for small insurers (option 2). We also believe that having a standardised disclosure (option 4) may provide more meaningful information for policyholders and consumers. We provide more detailed commentary on each of the options below.

Option 1 (status quo)

We do not support the status quo.

Option 2 (exemptions for small insurers)

2A: We support increasing the premium cap for small insurers that can apply for a financial strength rating exemption. We believe that the costs associated with maintaining a financial strength rating exceed the benefits provided by having a rating for a small insurer.

2B: We agree that insurers licensed post 2010, with gross premiums below the cap, should be able to apply for a financial strength rating exemption.

2C: We do not support allowing new insurers a grace period for obtaining a ratings license. Although the costs of obtaining a rating are high, they would not be a barrier to new entrants given there are other substantial costs in starting an insurer.

2D: There may be some merit in the proposal to allow small insurers to opt out of having a financial strength rating in exchange for having a higher solvency requirement.

Option 3 (rotating rating agencies)

We do not support this option of rotating rating agencies.

- It would increase the cost of obtaining a financial strength rating as the new agency needs to build up its knowledge of the insurers.
- The ratings would change over time due to the new agency using a different classification system when there has been no change in financial strength of the insurer. This would be confusing to consumers.

Option 4 (standardise disclosure)

A standardised disclosure would be beneficial if it was more easily understood by the public than the current disclosures.

Option 5 (additional solvency disclosure requirements)

We do not support introducing additional solvency disclosure requirements. A standardised forecast solvency disclosure would be problematic as all companies have different strategies, products, pricing and investment decisions. For example, standardised growth metrics would understate solvency requirements of a fast-growing business.

1.5 If we increase the public disclosure of solvency ratios, what solvency measures do you think would be the most informative to the public?

As noted in response to option 5 in question 1.4 we question the value of increased solvency ratio disclosures for customers.



1.6 Do you think there is a better public solvency disclosure requirement than the options here? If yes, what disclosure requirement would you like to see?

We have not proposed an alternative in this submission but would support an alternative that was less costly to insurers and more meaningful to consumers. We would be pleased to be involved in further consultation to develop an alternative that would achieve these objectives.

1.7 Do you agree with our assessment of the potential costs and benefits of public financial strength ratings and solvency disclosure (as set out in table 3, page 19)? If not, what other high-level costs or benefits should be considered?

We generally agree with the potential costs and benefits set out in table 3, with two exceptions. We consider that rotating rating agencies would not improve market discipline. Rotating rating agencies would also potentially provide less information for consumers, who may be confused by changes in the ratings values as rating agencies are rotated, due to the different rating scales by rating agencies.

1.8 Are there any other ways in which we might improve financial disclosure to improve policyholders' and other interested parties' ability to assess insurer's financial strength?

We have no additional comments in response to this question.

2. SOLVENCY REQUIREMENTS

2.1 Would it be helpful to replace the language of 'solvency margin' and 'solvency ratio' with either:

**A metric based on the relationship between Actual Solvency Capital and Minimum Solvency Capital, or
The relationship between stressed assets and stressed liabilities?**

Our members have differing views on this, but we note that the current terminology has good acceptance and understanding among insurance industry stakeholders. It does not appear to have given rise to any problems involving misunderstanding or misinterpretation, although we note that the solvency ratio measure does give very different results for a "typical" life insurer compared to a "typical" non-life insurer.

2.2 Should New Zealand solvency terminology be aligned with international standards? Why or why not?

We do not have any submission to make on this question, other than to refer to our comments on question 2.1. We note though that there is no consistency between the international standards either.

2.3 Which international terminology would it be best for New Zealand to align with?

We do not have any submission to make on this question, other than to refer to our comments on question 2.1.

2.4 Should IPSA enable a separate standard dealing with Financial Condition Reports? (Why/why not?)

We note that the that the current requirements of Financial Condition Reports are set out in the respective Standards for Life and Non-life Insurance and expanded on in our professional standards no. 21 (Life) and 31 (Non-life).

We do not see a material benefit in separating them out from the respective Solvency Standards into their own separate Standard, but we do note that it may seem slightly odd for the requirements to



be included in a Solvency Standard. Ultimately this is a question for the RBNZ, which may feel that changes to FCR requirements are likely to be needed more frequently than changes to the Solvency requirements. This would provide some justification for having the solvency requirements in a separate Standard.

2.5 How useful are s.78 reports? Should they be continued or replaced?

We feel that S78 reports fulfil an important function in ensuring that any "actuarial" figures in the accounts are consistent with the figures provided by the Appointed Actuary. This may appear to be stating the obvious to some, but this has arisen as an issue with at least one major insurer (no longer trading) in Australia.

We do not see strong justification for expanding the role or content of the S78 report. The recently released revised Draft Solvency Standard suggested that the report be significantly expanded to include more detailed information on the standardising of the balance sheet for solvency reporting purposes. However, the Society's submission recommended against expanding the S78 report in this way, as it is a public document. Instead, we suggested that the Financial Condition Report is a more appropriate avenue for such commentary.

2.6 Would it be helpful for IPSA to contemplate more than one solvency control level?

Our view is that the IPSA already has, in effect, more than one solvency control level. The criteria set out in Section 143 (1) go further than permitting intervention only when a minimum solvency requirement is breached, including situations where a breach is "likely" (with no specified timeframe), and situations where the Company's actions are considered "imprudent" (with no definition of "imprudent"). Any more specific steps could be set out in RBNZ guidelines or as part of the Solvency Standards.

2.7 How many control levels would be useful?

See response to question 2.11 below.

2.8 How should the Reserve Bank's powers relate to the different control levels?

See response to question 2.11 below.

2.9 Should powers be unlocked sequentially?

See response to question 2.11 below.

2.10 Should powers unlock at the top rung, with the Reserve Bank issuing public guidance on how it intends to use its powers?

See response to question 2.11 below.

2.11 Should any actions on the part of the Reserve Bank be mandatory when one of the control levels is breached?

Response to Questions 2.7 to 2.11:

This is a complex area and our members have a range of views on these issues. Some members feel that a "ladder of intervention" framework should comprise guidelines for each level, rather than explicit powers that would only be triggered at specific levels. Each distressed insurer is likely to have characteristics unique to its own situation, and judgement is likely to be required in how specific actions are applied to different degrees of distress. The Reserve Bank would operate under a



full range of powers set out in the Act, but applied, at its discretion, progressively as indicated in its guidelines, but with discretion to apply those powers differently from the guidelines.

2.12 Should a minimum solvency margin of zero be required by default (without the need to specify it in a license condition)?

In our view the IPSA, and the Reserve Bank's solvency requirements, already implicitly require a minimum solvency margin of zero. The IPSA does not need to spell this out further, and individual company licenses simply confirm this.

2.13 Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?

This is potentially quite a contentious issue, and our members have differing views. Some members feel that the RBNZ should have the ability to revise an insurer's solvency calculations. Others feel that this goes to the heart of the role and responsibility of the insurer's Board and Appointed Actuary respectively, and feel that the RBNZ already has sufficient powers under the IPSA, initially via requiring the Insurer to obtain an independent expert actuarial opinion, and progressively via more significant action, to remedy a situation about which they hold concerns.

Also, while the RBNZ could reasonably be expected to have a high level of proficiency on a wide range of actuarial matters, it could not reasonably be expected to be an expert in all areas, and these powers could potentially lead to hasty action that an expert (and a court) might consider unreasonable. We note that the RBNZ already has significant powers to set special license conditions if they have concerns about a particular aspect of an insurer's financial position, and to revise or clarify areas of different interpretations in the Solvency Standard.

2.14 Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?

If the RBNZ were to be given these powers, then our members feel that these powers should be able to be challenged, preferably by a mechanism that did not involve undue legal costs, or extensive delays. For example, an expert-based review process could be followed for any supervisory adjustments which are challenged.

3. TERMINATION VALUES

3.1 Should IPSA contain provisions requiring minimum termination values for policies that store value long-term? Why / why not?

We do not consider that IPSA should require minimum termination values for any policies.

Termination values are not a matter for prudential regulation.

For participating funds, being able to reduce surrender values in times of financial stress is a valuable tool. Introducing minimum termination values may also generate downward pressure when setting bonus rates given a perceived requirement of additional prudence when bonuses have already been declining in recent years.

Lastly, it may also impact the product pricing and development process for certain products with additional costs being passed on to policyholders.

3.2 What would be an appropriate basis for setting minimum termination values?

As we do not support the introduction of minimum termination values, we have not considered what factors should be taken into account when setting the basis.



4. STATUTORY FUNDS

4.1 Is it still appropriate to provide statutory fund treatment for YRT business? Or should statutory funds only apply to business where policyholders build up a store of value over time to fund their later claims (for example, participating business, unit-linked business, investment accounts and annuities).

The main benefit of statutory funds is the segregation and management of assets for the benefit of policyholders. That benefits policyholders of insurance contracts with a large investment component that builds up over time, such as participating, unit-linked, investment account, level-term business and policies which have long-term claim profiles. While of limited scope in New Zealand, annuities also benefit from the asset protection feature of statutory funds with the need to manage large investment assets over time.

Statutory funds provide limited additional protection for YRT business. We acknowledge that these contracts have guaranteed renewability rights and a policyholder may struggle, due to changed health for example, to access a policy on similar terms to their existing cover. However, the issue of protecting policyholders' entitlement to future benefits is more about ensuring the long-term viability of insurance companies through sufficient reserving requirements. This can be dealt with through risk margins and solvency requirements without the need to rely on the statutory fund structure.

It is also arguable whether the current statutory fund arrangements that allow the co-mingling of policies with long term value and YRT business are, in fact, failing to provide suitable levels of protection for the long-term contracts. For example, because transfers can occur between the with profit and non-profit portions of the portfolio.

4.2 Should health or disability insurance assets be held in statutory funds?

We do not support the introduction of statutory funds for health or disability insurance business. This is because, given the short-term nature of the majority of these products (i.e. there is less mismatch between when premiums are received and benefits provided), statutory funds would provide limited additional value to policyholders.

We acknowledge that some policyholders cannot easily switch providers due to deteriorating health. We also agree that some health claims are long term in nature. These features increase the importance of the long-term viability of these businesses. However, that long-term viability should be driven by an effective solvency standard and not an implementation of statutory funds.

4.3 Should general insurance contracts also have assets held in statutory funds?

We do not support the introduction of statutory funds for general insurance business. This is because, like health insurance business, most of the products are short-term in nature. Therefore, we think that the introduction of statutory funds would provide little or no additional value to policyholders.

We acknowledge the long-term tail nature of some claim events. We also note that while most products are short-term, some customers cannot easily switch providers due to poor claims history. However, in line with our comments on health insurers, we believe that the appropriate level of security for policyholders for these issues should be driven by an effective solvency standard.



4.4 If so, should that include:

All general insurance business;

Assets backing business with a contract boundary over one year;

Assets backing accepted claims over a particular size, for claims that are likely to take more than one year to settle;

Some other subset of general insurance business?

We do not have any submission to make on this question, other than to refer to our comments on questions 4.1 to 4.3.

4.5 Should all policyholders be given priority in insolvency over other general creditors?

Customers do not rank ahead of suppliers in other industries. This would be a significant structural change effectively redefining insolvency for the insurance industry. There would likely be many knock-on impacts to consider, for example, consideration would need to be given to the ranking of IRD.

Ultimately, such a customer preference may be detrimental to the functioning of the insurance industry because suppliers and investors would consider this negatively and expect compensation by way of higher returns relative to operating in other markets. This would ultimately lead to higher prices for policyholders.

4.6 Should priority be confined to policy benefits or also include claims for unearned premium?

We do not support having a customer priority outside of statutory funds, but if it were to be applied then it should include unearned premiums as they relate to a service that has not yet been provided. This aligns with the practice of returning unearned premiums to customers upon policy cancellations. Premium refunds are also a key part of the current redress culture and it would also be difficult to explain to consumers why those premiums were not being refunded in an insolvency situation.

4.7 Should IPSA be amended so as to make it more explicit that assets (other than transactional bank accounts) should not be shared across different statutory funds?

If there have been significant abuses, IPSA could be tightened further. However, there needs to be a degree of pragmatism shown in terms of the approach to administration and asset holding arrangements from an overheads expense point of view.

4.8 Should IPSA contain a formal requirement for overseas life insurance branches not exempt from statutory fund requirements to hold statutory funds in the form of a trust?

The Reserve Bank uses its powers under IPSA to apply conditions of licence where it is deemed necessary. These conditions include provision for trusts. Given the limited number of circumstances where this is necessary, we would recommend that continuing to apply individual licencing conditions is the most pragmatic approach going forward.

4.9 If requirements to establish a trust were included, are there any issues about the trust's constitution that should be specified in IPSA?

We do not have any submission to make on this question, other than to refer to our comments on question 4.8.



4.10 Should statutory fund rules include a requirement to keep a register of statutory fund assets? If not, what other mechanisms could be put in place for identifying the assets subject to IPSA's statutory fund provisions?

IPSA already requires that the assets and investments related to the business of the fund are held within that fund. If RBNZ has concerns about the operation of a specific insurer's statutory fund, these could be dealt with through an individual Section 121 information request and subsequent appropriate action.

4.11 Should life insurers with participating life insurance business be required to prepare accounts for capital and retained profits in their statutory funds? Should these be disclosed:

- As a note to the insurers' financial accounts? Or,
- In data returns for participating business provided by the Reserve Bank.

We agree that life insurers with participating business are tracking capital movements as part of their bonus declaration and shareholder share allocation processes. Disclosure of the movement in capital position would aid transparency regarding compliance with IPSA and the participating fund constitutions. The FCR already contains information about bonus declarations and the management of the participating fund. Therefore, we consider this additional information would sit well in the FCR.

5. RISK APPETITE AND OVERALL POLICYHOLDER PROTECTION

5.1 Do stakeholders think that regulation in respect of each of the channels listed in para 218 is broadly appropriate?

We consider that the regulation in respect of each of the channels listed in para 218 to be broadly appropriate.

5.2 If not, which areas are over-regulated or particularly in need of enhancement?

As per our response to 5.1, we consider the regulation in respect of each of the channels listed in para 218 to be broadly appropriate.

5.3 Are there any additional measures for policyholder security that the Reserve Bank should consider?

We suggest that resolution arrangements are an area that the Reserve Bank should give further consideration. From the perspective of policyholders, putting a company into liquidation is an absolute last resort – 'the solution is worse than the problem'. The regulatory goal must be for an 'orderly exit', and policyholders may not even know that this has been engineered by the regulator. We consider this is the most effective way of improving policyholder security in the event of a company failure.

5.4 Have we correctly identified the risks that a policyholder guarantee scheme should address?

The Consultation identifies two potential drivers of risk for policyholders:

- (1) incentives toward under-provisioning risk; and
- (2) tail events.

We agree with the identification of these as potential risks to policyholders. However, we consider that solvency requirements and Risk and Governance requirements should be appropriately designed and calibrated to mitigate these risks within the Reserve Bank's stated risk appetite.

General insurers already have a solvency requirement to hold sufficient capital to withstand a 1:1000-year seismic event and 1:250-year event for other risks (including non-insurance events). We



are unclear what level of protection the Reserve Bank intends a policyholder guarantee scheme to provide.

5.5 Are there other risks we have not considered that a scheme could also address?

No. As noted above we do not consider a further scheme will be required if the solvency and risk management and governance requirements are appropriately calibrated to the Reserve Bank's risk appetite.

We suggest that if additional risks are identified that mitigation to the risks is dealt with, in the first instance, by enhancement to existing Reserve Bank regulations, standards and requirements. If, on completion of the solvency standard review, there are residual risks that are not mitigated within RBNZ's stated risk appetite, then a standalone consultation on a policyholder guarantee scheme could be considered.

5.6 Are there particular kinds of policy for which a scheme is particularly important?

No. As noted above we do not consider a scheme is required.

5.7 Overall, to what extent do you think a policyholder guarantee scheme is worth considering for New Zealand?

We do not consider a policyholder guarantee scheme is required.

In addition to the responses above, our view is:

- A centralised scheme of this nature is fundamentally less efficient than requiring insurers to hold this capital in their own right.
- A policyholder guarantee scheme will likely mean larger, regulated insurers subsidise smaller insurers that are exempt from various regulatory requirements.
- A policyholder guarantee scheme removes the onus of responsibility and introduces moral hazard. For example, the scheme may incentivise insurers to hold minimum levels of capital or offer policies at unsustainably low prices.
- A policyholder guarantee scheme introduces additional costs that would be passed on to customers.

5.8 Are there particular kinds of policies that should be covered by a guarantee scheme?

We do not consider a policyholder guarantee scheme is required for insurance.