Reserve Bank of New Zealand
Te Pūtea Matua

Review of the Insurance (Prudential Supervision) Act (2010).

Public feedback statement
Consultation on Scope of the Act and Overseas Insurers

22 July 2021

Current Information Available

Information about the review, including the Terms of Reference, is available on the Reserve Bank website at:

https://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/review-of-the-insurance-prudential-supervision-act-2010

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Background

In November 2020, the Reserve Bank issued an IPSA Review consultation paper on the Scope of the Act and Overseas Insurers. The consultation closed on 19th March. The consultation document discussed:

- The definition of 'contracts of insurance'
- The definition of 'carrying on business in New Zealand'
- Treatment of overseas branches
- Treatment of overseas reinsurers
- Group supervision
- Outsourcing policy

In total, 24 submissions were received from insurers, law firms, industry and professional bodies, as well as two individual respondents. This paper summarises the submissions received and provides initial RBNZ responses.

This statement will discuss each of the consultation document's sections in turn.

Definition of 'contracts of insurance'

This section of the consultation paper asked whether the current definition of 'contracts of insurance' was effectively delineating the boundary of insurance activity that should be prudentially regulated under IPSA.

It invited any proposals for changing the definition and canvassed the possibility of adding a 'deem in' power.

Summary of submissions

The majority of respondents were broadly happy with the way the defintion of contracts of insurance is currently working.

Most submissions suggested that a deem in power, would be helpful. It would allow the Reserve Bank to declare that specific types of contract not captured by the current IPSA definition of contracts of insurance should nonetheless be considered to be contracts of insurance. That would be useful to allow flexibility in the face of future developments in the industry, particularly insurtech.

However, respondents emphasised that a deem in power should be subject to appropriate procedural safeguards. Several submissions referred to the FMA's designation powers under ss.562-4 of the Financial Markets Conduct Act 2013, which prescribe the circumstances in which a designation is appropriate and require consultation with those affected. Some felt a deem in power should only operate by way of regulation.

No respondents felt that RBNZ guidance was an appropriate way of delineating definitional boundaries given how central the issue was to the operation of the Act, though some felt publishing clear explanations of how boundary decisions had been made would be helpful.

A small number of particular boundary issues were raised in submissions. Several submissions raised the issue of discretionary benefit providers, who provide insurance-like products, except that claims payments are not a right but are rather at the discretion of the provider. Some also raised the possibility that some kinds of indemnities could be restructured as 'waivers' in order to avoid capture by IPSA regulation. One submission raised the question of parametric or index insurance.[1] Another asked us to consider tightening the exception for not for profit trade associations offering insurance that is 'ancillary or incidental' to their primary purpose contained in s.8(3) of IPSA.

Where boundary issues were raised, submissions often suggested strengthening IPSA's restrictions on the use of insurance-like words in s.219 and sometimes suggested public education about the implications that follow from a contract falling outside IPSA's scope. One submission suggested introducing a rule that prevented businesses from holding themselves out as providers of insurance, analagous to rules for offering financial advice, and that restricted the use of words like 'insurer' and 'insurance' where they have potential to mislead.

There was no support for removing captive insurers from the scope of IPSA.

Two submissions questioned the language in the current definition of contracts of insurance, asking whether phrases like 'except where the context otherwise requires' created unnecessary ambiguity.

RBNZ response:

- The Reserve Bank will not make any major changes to the definition of contracts of insurance.
- We will revisit some of the boundary issues raised to consider whether the boundaries could usefully be re-drawn without creating unintended consequences.
- We will liaise with other agencies about the regulation of some of the boundary cases.
- We will review restrictions on the use of language around 'insurance' and associated terms.

[1] Parametric or index insurance pays out a fixed sum if a specified event takes place (such as the movement of an index, or the occurence of a weather event of particular severity). The key difference from 'traditional' insurance is that the payout is not dependent on the actual loss suffered by the policyholder.

‘Carrying on business in New Zealand’

This section asked whether the way ‘carrying on business in New Zealand’ is currently defined is appropriate. In particular, it asked whether there is need for greater clarity about the minimum threshold at which an insurer is considered to be conducting business *in New Zealand*.

Summary of submissions

Most respondents would like to see a new definition of carrying on business in New Zealand that is insurance-focussed. A common theme in submissions was that the Companies Act definition referred to by IPSA tended towards an emphasis on the physical location of the company and its administration, whereas what was important was an entity’s degree of involvement in covering New Zealand risk (although that concept would need to be defined).

However, a strong majority of submitters felt that a premium threshold was not an appropriate way to delineate the boundary. Some made the normative case that policyholders should receive the same protection regardless of how much premium their insurer was writing (or where it was based). Others made practical observations about the difficulty of setting a threshold that was not arbitrary or open to ‘gaming’ and that didn’t create problems for businesses approaching that threshold (or that crossed it as premium volumes fluctuated from year to year).

Several submitters noted that current ambiguity might have the effect of leaving the practical boundary largely in the hands of foreign insurers, who needed to make their own determinations of the legal risk involved in not applying for a license. The Law Society suggested that all entities providing insurance to New Zealand should either be licensed or have a specific s.9 exemption (under an amended s.9 process).

A particularly long and thoughtful submission on this question from the Insurance Council of New Zealand illustrated the complexity of making ‘ideal’ decisions about the appropriate threshold for licensing. They suggested that capture was more important where: there was a New Zealand risk, a New Zealand insured or where the product was being advertised to or was easily accessible by New Zealanders. Meanwhile, a new definition should try to avoid capturing situations where an overseas provider was insuring atypical risk, risks that could not reasonably be placed with a New Zealand insurer, insurance that was part of a global programme (including the New Zealand member of a global group), or (re)insurance to a New Zealand insurance provider.

Meanwhile, the Insurance Brokers’ Association of New Zealand advised us against overly tightening restrictions on New Zealanders’ access to overseas insurers, particularly if that would prevent them obtaining niche cover for their clients. They noted that the Australian Direct Offshore Foreign Insurers regime can be overly restrictive.

Overseas captive insurers also asked for greater clarity that they would remain exempt from IPSA requirements.

Most respondents felt that uncertainty should be resolved through a clearer statutory definition, rather than through Reserve Bank guidance.

RBNZ response:

- The Reserve Bank notes two overlapping issues here: one about certainty of definition; and another about appropriate limits to the scope of cross-border provision of insurance by foreign entities not licensed under IPSA.
- Aspects of some submissions seemed to imply unrealistic expectations about the Reserve Bank's ability to monitor all 'New Zealand' insurance contracts and to exercise effective jursidiction over foreign entities in a proportionate way.
- Nonetheless we appreciate the issue around clarity of definition and will give this issue further consideration in the light of the useful discussion in stakeholders' submissions.

Policyholder in New Zealand test

Currently, insurers can only be considered to be carrying on business in New Zealand if they have a New Zealand policyholder. The options paper noted that an insurance company based in New Zealand but only writing business overseas would not be licensed or regulated under IPSA. Whilst such an entity is explicitly prohibited from claiming that it *is* regulated in New Zealand, the paper asked whether reputational risk might still arise.

Summary of submissions

Almost all submissions were in favour of removing the policyholder in New Zealand test from the definition of carrying on business in New Zealand because of reputational risk.

RBNZ response:

- The Reserve Bank will give serious consideration to the removal of the policyholder in New Zealand test, bearing in mind IPSA's purposes and the potential cost and complexity of supervising relevant entities

Overseas insurers

This section asked whether the current treatment of overseas branches was appropriate. It also canvassed the possibility of either requiring some branches to incorporate or including a requirement to hold assets in New Zealand.

Summary of submissions

The submissions showed little consensus on this issue with all of the options canvassed by the Reserve Bank receiving support from at least some submissions.

Generally though, there was little support for universal compulsory incorporation. Most submitters thought this was a disproportionate response, given that branch structures provide potential benefits (cross-border risk pooling and potential parental support) as well as risks.

A majority of submitters thought some form of assets in New Zealand requirement was worth considering. For some that was to level the playing field between branches and incorporated entities while for others it was primarily about policyholder protection, given the transaction costs involved in pursuing claims via an overseas insolvency regime. Where submitters expressed a preference for the amount of assets required, most felt that it should be set according to home country solvency requirements for the branch business.

Some suggested that life insurers should be requried to incorporate because of the long-term relationships to policyholders involved in life insurance. Others suggested incorporation was unnecessary for life insurers but the statutory fund exemption for overseas branches should be removed, to level the playing field for solvency requirements.

RBNZ response:

- The Reserve Bank will carefully consider a range of possible options for the treatment of overseas branches in the light of the considerations raised in submissions. In particular, we recognise the benefits branches bring in terms of competition and capacity, whilst also recognising the desirability of a level playing field.

Overseas reinsurance

This section asked whether the treatment of overseas reinsurance might differ from that of insurance more broadly. It also asked whether there was a need for tighter rules about how insurers manage their own reinsurance risk.

Summary of submissions

All submissions emphasised the importance of overseas reinsurance to the New Zealand market and the need to avoid limiting access through any additional regulation of overseas reinsurers.

Submissions were more mixed as to whether or not it was appropriate to exercise greater oversight over insurers' management of their reinsurance programmes. Some submitters felt that the existing risk capital charge and appointed actuary's assessment of reinsurance in financial condition reports were adequate. Others felt that the importance of reinsurance to the New Zealand market meant that there should be some explicit requirement to operate and document an appropriate process of risk management for reinsurance.

RBNZ response:

- The Reserve Bank will seek to avoid imposing regulatory requirements that might deter overseas reinsurance providers from being active in the New Zealand market. We will continue to consider whether current oversight of insurers' management of reinsurance risk is appropriate, weighing up the commercial sensitivity of reinsurance management against its role in policyholder security.

Group supervision

This section asked whether the Reserve Bank should be exercising more comprehensive supervision at the level of corporate groups.

Summary of submissions

Submissions on this issue were mixed. Some respondents questioned the importance of group-level supervision, pointing out that the examples referred to in the paper were large global insurers during the GFC and suggesting that group supervision is largely necessary to deal with the risks posed by cross-border groups. Some were concerned that the RBNZ wanted to acquire group supervision powers over the parent group of NZ-based subsidaries, which they saw as innapropriate.

Others acknowledged the need for group supervision in principle but felt that the complexity of the issues would stretch insurer and RBNZ capacity in ways that might outweigh the benefits group supervision could deliver.

Several submitters agreed that it was important non-operating holding companies were not used to underpin equity in subsidiaries with inferior capital at the group level and felt the RBNZ should have the option to regulate non-operating holding companies.

Several submitters noted the powers that already exist in IPSA to reduce group risk (broader risk management requirements, actuarial assessments in the FCR, powers to direct and obtain information from associated entities and the like).

Many submitters felt that it was difficult to comment in detail on a proposal that was set out at a high-level and in ways that appeared confusing in terms of the intended coverage of any group supervision obligations.

RBNZ response:

- The Reserve Bank notes that group supervision is a complex issue that can be facilitated by a variety of diferent mechanisms. It is clear from the submissions that we did not communicate as effectively as we meant to about the scope of group oversight that we had in mind.
- For cross-border groups, there are well-established norms for the supervisory division of labour . A 'lead supervisor', usually the supervisor where the head of group is licensed, is appointed to have primary oversight of the group, including group-wide risk management. Supervisors that have subsidiaries within their jurisdictions are then consulted as part of a supervisory college. The Reserve Bank has no intention of altering that arrangement or attempting to acquire powers to direct whole-of-group management via a New Zealand-based subsidiary.
- The primary focus of any group-based supervision requirement would be groups that have a group structure headquartered in New Zealand. In particular, we would be considering additional risk management requirements for the 'head of group' and whether the Reserve Bank should have powers to license non-operating holding companies.
- New Zealand subsidiaridies of overseas groups were discussed because it might be worth considering restrictions or reporting requirements on intra-group transactions in order to protect New Zealand subsidiaries in the event that their parent companies were in distress. However, we were not suggesting the need to acquire more active powers to direct group parents based overseas.
- Whilst some submissions expressed scepticism over the necessity or value of group supervision, we note that group supervision is accepted international practice, forms a core part of the IAIS core principles and was a recommendation of both the Trowbridge Report and the IMF FSAP. Group-level risk is not something that only materialises in cross-border transactions but can also create problems for groups based in a single jurisdiction.
- The Reserve Bank will continue to consider possible options for group-based supervision but agrees that more focussed consultation would be appropriate before introducing any particular requirements.

Outsourcing policy

This section of the paper asked whether there should be specific rules to ensure that insurers' processes for outsourcing and control of outsourced functions were appropriate.

Summary of submissions

A clear majority of submitters felt that it was appropriate to introduce rules for outsourcing policy, so long as the rules had an appropriate scope, were principles-based, not unnecessarily onerous and aligned with international requirements (particularly those of the Australian Prudential Regulation Authority). A minority felt that these rules were unnecessary because they would increase compliance costs and / or because appropriate outsourcing policy was already implicit in other IPSA requirements.

An overwhelming majority felt that business continuity should not be a central consideration of outsourcing requirements, though some submitters felt that it might be appropriate to require insurers to consider business continuity risk in some other way.

RBNZ response:

- The Reserve Bank will explore options for regulation of outsourcing bearing in mind the need to ensure that any rules are principles-based and pragmatic in scope