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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

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[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 holdings 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
1. Financial strength disclosures	
1. Do you consider that the current exemptions for small insurers should be maintained? Should they be extended to somewhat larger insurers?	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). 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. 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.

[14] See paragraph 225 of the Options paper.

Question / discussion point	Feedback
2. Do you think that the current disclosure rules for an overseas policyholder preference are sufficient?	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: • 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.
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?	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] We would not support the introduction of additional or alternative disclosure requirements (e.g. as described in paragraph 72 of the Options Paper) given: • 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 disclosure 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. 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

[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
	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. 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: • 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]
4. Out of these options, what is your preferred option or combination or options for public solvency disclosure requirements?	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. Detailed feedback on each option proposed is set out below. *Option 1 (status quo)* We support the status quo with the enhancements, as outlined in response to question 3 above. *Option 2 (Change the exemptions for small insurers)*

[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
	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. 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). We do not support Option 2C because: • 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. 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 meaningfully comment. *Option 3 (Rotating rating agencies)* We do not support the proposal to rotate rating agencies because: • 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. 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.

Question / discussion point	Feedback
	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. *Option 4 (Standardise disclosure – different rating agency ratings)* 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. 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. Specifically, we would not support: • 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
	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. *Option 5 (Increase solvency disclosure requirements)* 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. 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 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 useful reference point in that respect. 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. 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. We agree that any proposals here, if progressed, would need to be worked through in conjunction with separate Solvency Standard review workstream.
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?	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. *Providing increased understanding (rather than information)* 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. 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. 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. *Other costs of alternative and/or additional disclosures* 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 .

Question / discussion point	Feedback
	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. *Consideration of other beneficiaries of disclosures* 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. 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.
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?	As indicated in an earlier submission,[21] s 64 of IPSA needs to be redrafted. Specifically: • 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. Please also see our responses to questions 1, 3 and 4 above.
2. Solvency standards	

[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
1. Would it be helpful to replace the language of 'solvency margin' and 'solvency ratio' with either: 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?	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. Additionally: • 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.
2. Should New Zealand solvency terminology be aligned with international standards? Why or why not?	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]
3. Which international terminology would it be best for New Zealand to align with?	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. 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'.
4. Should IPSA enable a separate standard dealing with Financial Condition Reports? (Why/why not?)	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. 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

[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
	expertise of the Appointed Actuary. If that is the intention, consideration should be given to whether the responsibility for this report bests sits with the insurer itself, with the Appointed Actuary's input (rather than with them directly).
5. How useful are s.78 reports? Should they be continued or replaced?	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. 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.
6. Would it be helpful for IPSA to contemplate more than one solvency control level?	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. 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.
7. How many control levels would be useful?	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.
8. How should the Reserve Bank's powers relate to the different control levels?	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. 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.
9. Should powers be unlocked sequentially?	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.

[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?	As noted above: • 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?	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.
12. Should a minimum solvency margin of zero be required by default (without the need to specify it in a license condition)?	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).
13. Would you support the Reserve Bank being allowed to make supervisory adjustments within the solvency calculation?	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. 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.
14. Should there be a mechanism by which supervisory adjustments can be challenged? If so, what should the mechanism be?	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 individually 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. Consideration should also be given to where the cost of the challenge should lie, including in circumstances where the adjustment is upheld.
3. Termination values	

[27] Footnote 25 above.

Question / discussion point	Feedback
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 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. 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. 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.
2. What would be an appropriate basis for setting minimum termination values?	As noted above: • 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. Without resiling from the above position, if such a requirement was considered necessary: • 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.
4. Statutory funds	
1. Is it still appropriate to provide statutory	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.

[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
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).	
2. Should health and disability insurance assets be held in statutory funds?	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.
3. Should general insurance contracts also have assets held in statutory funds?	As explained in detail below, a statutory fund requirement is neither necessary nor appropriate for general insurance. *Statutory fund requirements reflect and address unique features of life insurance* 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. 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: • 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.

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	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: • <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. 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. *Long-term general insurance issues are different to long-term life insurance ones* 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. Addressing each of the examples cited in support of this position in turn: • <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
	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. • <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. 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. *Unclear what problem a statutory requirement would solved and the costs involved*

[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.

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	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. 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. 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. 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. *Other comments* 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. 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. 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.
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.

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requirements apply to: 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?	
5. Should all policyholders be given priority in insolvency over other general creditors?	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] We also note the following in this regard: • 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.

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	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] 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. In designing the preference, the following would need to be considered: • 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]
6. Should priority be confined to policy benefits or also include claims for unearned premium?	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. 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. 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

[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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	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.
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?	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. 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.
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 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.
9. If requirements to establish a trust were included, are there any issues about the trust's constitution that should be specified in IPSA?	This question follows on from the previous one and we repeat our remarks in that respect.
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?	This question follows on from the previous one and we repeat our response to question 8 in this respect.

Question / discussion point	Feedback
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: a. As a note to the insurers financial accounts? Or, b. In data returns for participating businesses provided by the Reserve Bank?	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.
5. Risk appetite and overall policyholder protection	
1. Do stakeholders think that regulation in respect of each of the channels listed in para 217 is broadly appropriate?	*General comments* 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. 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. 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. 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. *Comments on channels*

Question / discussion point	Feedback
	<u>Enhancing insurers' risk management and governance</u> 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. <u>Better information to policyholders about risk and financial soundness</u> 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. <u>Increasing the level of capital held against risk</u> 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. 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. <u>Enhancing policyholders' access to assets in insolvency</u> 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.
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?	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. *It is unclear what the problem to be solved is* 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. 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. 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. *Lack of alignment with IPSA principles and purpose* 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. 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.

[45] Subject to the enhancements being made discussed above.

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	In evaluating the matters described above, one also needs to consider the appropriate public risk appetite setting, namely whether it is preferable to: • 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. 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. *Increased moral risk* 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 IPSA (recognising the importance of members of the public being responsible for their own decisions related to insurance). 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. 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. *Limits to what can be drawn upon from other jurisdictions* There are limitations about what can be drawn upon from other jurisdictions in this context. In particular: • 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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	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. • 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. *Additional comments* 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: • 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. 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: • a clearly defined objective/purpose and scheme design[47] • funding requirements • the probability it would be drawn upon, and • moral risks, public risk appetite and costs as outlined above. 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,

[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.

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	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