New Zealand Society of Actuaries (Inc)

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
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**Review of the Insurance (Prudential Supervision) Act 2010 Options Paper 3: Enforcement and Distress Management**

We welcome the opportunity to make submissions on the consultation paper (Paper 3, Enforcement and Distress Management), which has been published by the Reserve Bank of New Zealand (RBNZ).

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

The main points of our submission are as follows:

- We are supportive of a proportional approach to a range of enforcement tools and penalties and consider they should be explicit (including the capital trigger levels required) and applied consistent with the level of harm inflicted or expected and the insurer compliance with the specific action.
- Within the Ladder of Intervention, we think all powers of Direction should link/unlock with an SCR breach (or expectation of breach). We think the existing IPSA wording provides adequate flexibility and customisation for the supervisor towards the specifics of any situation.
- Within the Ladder of Intervention, we think powers related to appointment of Administrators, Statutory Managers or Liquidators should be graduated between the capital trigger of an SCR and MCR breach (or expectation of breach).
- The experience of some of our members is that the supervisor's own culture of approach is as important in any enforcement or distress management actions as the specific actions. A solely, purely legalistic and written approach may not always be the best approach.

We also have some more general points to make (not linked directly to specific consultation questions):

- We do not see any benefit to requiring documents similar to an ORSA or ICAAP for NZ insurers at this interim stage in the regulation of insurers. An ICAAP may well be a useful addition in due course.

- The supervisor needs to balance the merits of providing warnings linked to non-compliance with maintaining public faith in the industry. While the supervisor may see clear differences between civil and criminal cases, we suspect the public may not. Pecuniary penalties to an insurer may impact the solvency position of the targeted firm and potentially do greater damage than intended.

- We are concerned the Consultation was silent on the matter of an insurer's license conditions being altered. We think this aspect, especially so when the ability to adjust the Minimum Solvency Margin has direct linkage with Enforcement and Distress Management and especially so hen capital triggers are to be applied. Our concern is this provides effectively a dual power to the supervisor that should be addressed. We note the solvency consultation referred to "adjusted" solvency margin and SCR/PCR – we assume this adjustment relates to any non-zero Minimum Solvency Margin within license conditions.
- We think there is merit to considering alternative approaches to setting of the Solvency Margin quantum (which we note is effectively to be the SCR). In practice, we recognise this may be too hard and it may be simpler for a legislative change that enables RBNZ to have discretion to set a negative solvency margin (we think there are macro-economic environments when this may be appropriate). The application of a negative solvency margin would also provide suitable added discretion for RBNZ in connection with a mandatory MCR trigger (if solely a proportion of SCR/PCR) linked to liquidation.

Our main comments link to Section 5 – Ladders of Intervention.

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

Yours sincerely

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President of the New Zealand Society of Actuaries

## Section 2: Enforcement and Penalties

**Section 2.2 Enforcement Powers** – We have no specific comments on Section 2.2

Q 2.2.1 Should IPSA be amended to give the Reserve Bank a specific power to issue written warnings?
Q 2.2.2 Should the Reserve Bank have the power to require public disclosure of warnings under some circumstances?
Q 2.2.3 Should the Reserve Bank have the power to issue enforcement notices? Are there any safeguards that should be attached to this power?
Q 2.2.4 Should the Reserve Bank have the power to accept enforceable undertakings? Should there be any safeguards attached to this power?
Q 2.2.5 Should the Reserve Bank have the power to issue infringement notices for breaches of some reporting requirements?
Q 2.2.6 Should IPSA include provision for the Courts to make pecuniary penalty orders?
Q 2.2.7 Please review your answers to all the questions in this section. Taken together, do you think the proposals you have agreed with will deliver an enforcement regime that is able to ensure compliance with regulatory obligations in a flexible and proportionate fashion?

**Section 2.3 Level of Penalties**

Q 2.3.1 Given inflation and these comparisons, do you think there is a need to review the penalties for offences under IPSA? If so, what kinds of changes do you think should be made?

We observe there has been a historically low inflationary environment since 2011 and so perhaps little need or benefit to any historic adjustment. Any legislation may want to consider the future environment. On balance we do not see merit to any direct inflation linking but in future (not currently) levels of penalties may need to be reviewed periodically (perhaps at 5 to 10 year intervals).

## Section 3: Supervisory Powers

**Section 3.2 Information Gathering and Investigation**

Q 3.2.1 Should the Reserve Bank have a broad power to request information from any person in order to pursue its purposes under IPSA?

We think this is acceptable (including Appointed Actuary) though we think this should not be done in a way that enforces confidentiality (to the relevant insurer) on that party.

In requesting information from individuals, the supervisor should appreciate that the party involved likely has an obligation to the insurer (especially as an employer or client). We think they should have the ability to share in full the nature of any discussions and information with the insurer. This would be in alignment with the current s128 requirement (for auditors and actuaries).

We would not be in favour of a system of oaths or fines linked to such information provision.

Q 3.2.2 Should IPSA introduce a breach reporting regime for insurers?

No specific comments - we are mindful of the s24 notification requirement and think this should remain.

**Section 3.3 Directions**

Q 3.3.1 Should the Reserve Bank have the power to direct insurers not to renew existing business?

We think this should be considered carefully. It may be appropriate for a such a direction to apply to parts of a general insurer's portfolio, but for life insurers it may impose uncertainty and potential hardship on policyholders and even general insurance covers can be restricted in specific circumstances. Vulnerable life insurance policyholders may have limited access to alternative (new) cover due to underwriting constraints.

Q 3.3.2 Should this power be accompanied by any safeguards?

No Comment

## Section 4: Distress Management

**Section 4.2 Purpose Statement for Distress Management** – We have no specific comments on Section 4.2

Q 4.2.1 Should IPSA include a specific purpose clause governing the use of distress management powers (over and above the 'have regard to' principle already included in IPSA)?

Q 4.2.2 Which of the purposes discussed in this subsection do you think should be included in legislation? Should any other purposes be included?

**Section 4.3 Resolution Planning**

Q 4.3.1 Should some or all insurers be required to maintain recovery plans?

We are not in favour of a pre-prepared recovery plan requirement; we think it would not be practical to link to the unknown specifics of an issue or event. We do think there would be merit to the supervisor providing some guidance on a "solvency resolution framework" (see Comment on Q4.3.3) and then requiring a Capital Management Framework or Plan (CMF) to be consistent with the Bank's guidelines on solvency resolution and possibly mandatory for each insurer. In addition, this CMF should be directly commented upon in each insurer's FCR.

Q 4.3.2 If so, how would this requirement be best designed to ensure that it is proportionate to the risk presented by different insurers and the costs of preparing and maintaining such plans?

For a "solvency resolution framework", separate consultations with insurers might help the Bank in establishing an appropriate (solvency resolution) framework that could then be applied consistently amongst all NZ insurers.

Q 4.3.3 Should IPSA also require the Bank to maintain some form of resolution planning for insurers, as the draft DTA does for deposit takers?

We think there is merit to having an explicit set of capital triggers (See Section 5). We are in favour of the bank developing guidelines as to its approach on capital triggers and actions, we refer to this as a solvency resolution framework.

**Section 4.4 Schemes of Arrangement, Compromises, Voluntary Administration and Liquidation** – We have no specific comments on Section 4.4

Q 4.4.1 Are there any improvements that could be made to sections 151-169 of IPSA which set out the Reserve Bank's powers in relation to various insolvency and restructuring processes?

**Section 4.5 Statutory Management** – We have no specific comments on Section 4.5

Q 4.5.1 Should the requirement that the failure of an insurer might create significant harm to the financial system or New Zealand economy be removed from the first part of the test for recommending statutory management?
Q 4.5.2 Alternatively, are there other ways in which the test for initiating statutory management should be modified?
Q 4.5.3 Which resolution powers and duties (if any) should be vested directly in the Reserve Bank? Why?
Q 4.5.4 Should the Minister of Finance have controls, within IPSA, over the use of public funds in resolution – over and above those that the Minister may attach to the provision of public funding? Are any additional forms of accountability necessary?
Q 4.5.5 Should IPSA contain ipso facto provisions and stays on the close out of derivatives contracts equivalent to those in the FMI Act and draft DTA?

## Section 5: Ladders of Intervention

**Section 5.3 Directions**

Q 5.3.1 Should all directions be unlocked once an insurer breaches the SCR or should some be unlocked lower down the 'ladder of intervention'?

Our view is that all of the Directions should be available to the RBNZ in all of the circumstances set out in S143 (a).

We would also note that the term "unlocked" indicates a very clear point at which these directions will be available, whereas the current wording is more flexible, i.e. "has reasonable grounds to believe that…….". Our view is that the current wording is appropriate.

Q 5.3.2 If the latter, which powers should be unlocked later and at what point should they be unlocked?

Our view is that they should all be available once one or more of the criteria of S143(a) (i.e. the RBNZ has "reasonable grounds to believe…") have been met. The level of severity of any potential Directions should be sufficiently clear to all parties, and an insurer should be able to seek a judicial review if it believes that Directions are being applied inappropriately for the circumstances.

Trying to specify exactly what can happen at what step in the proceedings, or at what level of solvency ratio, could be counter-productive in some situations, and make it more difficult to manage a distressed insurer, and potentially make it less likely to facilitate a recovery of the insurer.

**Section 5.4 Administration, Statutory Management and Liquidation**

Q 5.4.1 Should the capital part of the trigger for the Reserve Bank's power to apply for the liquidation of an insurer be altered to refer to an insurer failing to meet its minimum capital requirement?

Yes, we would agree that the Minimum Capital Requirement (MCR) should become the basis for consideration as to liquidation of an insurer. However, we do have some concerns/uncertainty about the basis of determination of MCR (potentially as a set proportion of SCR). The level that MCR is set should give regard to the intention by the Bank for it to correspond to a "non-viability" position for an insurer.

There are benefits to the RBNZ having no discretion once the MCR is breached (or perhaps likely to be breached within next 6 months) on the basis that it is set having future and permanent "non-viability" in mind.

We think the RBNZ/policy should be clear on any distinction between "failing to meet" and "breaching" – we notice these are both used (we think interchangeably with no difference in meaning). We think it would be best for a single phrase to be used and applied.

Q 5.4.2 Should there be a mandatory requirement to place an insurer into liquidation at some point after it breaches its minimum capital requirement? What should that test be?

Yes as indicated above, we think – assuming MCR set with a suitable basis for non-viability – the level/trigger should be 100% MCR.

We are mindful that the MCR may be set in proportion to SCR/PCR (a level of 80% SCR was suggested) and if so then it may be appropriate to consider this differently. Our view would be that at 80% SCR, with SCR set as indicated, this would not be a sensible representative point to treat as "non-viable" and so be a trigger for liquidation.

Q 5.4.3 Do you agree that the capital-related grounds for enabling statutory management should be a breach or likely breach of the minimum capital requirement (bearing in mind that the necessity test would also have to be satisfied)?

Our view is that this is less clear - on the basis liquidation is set at MCR - the capital related trigger for Statutory Management should be above MCR (and clearly below SCR/PCR).
We think the appointment of a Statutory Manager should be discretionary (effectively is through Minister of Finance – though agree better to make it easier to appoint a Statutory Manager) and we agree this trigger would be the enabling point.

Our comments in connection with breach/failure apply here too and similarly the benefit of a basis for assessing “likely” in connection with breach or failure (perhaps as assessed by AA along with a timeframe – maybe 6 months).

Q 5.4.4 If not, what do you think the capital-related trigger for statutory management should be?

We think the trigger could be related to “likely to breach” linked to a clear process including timeframe (not too far into the future but with sufficient time for action).

In practice we think some merit also to considering a somewhat subjective point between MCR and SCR for the Statutory Management trigger – in practice probably the mid-point.

It would be important that such a capital level is clear and transparent.

Q 5.4.5 Should the solvency-related trigger for the appointment of an administrator be that the insurer has failed, is failing or is likely to fail to maintain its minimum capital requirement?

Our comments on breach/failure apply here also. We understand an “administrator” is envisaged as a serious but temporary measure. We think the trigger should be higher than for Statutory Management but still below failure/breach of SCR/PCR – we did not see much discussion on the relative merits of “administrator” compared to “statutory manager” in the consultation and suspect some discretion between these two. In practice we think there is merit to using the same “in between” (MCR and SCR/PCR) trigger point for administrator as statutory management. As above to be explicit and to enable but not enforce appointment of an administrator.

It could be useful to have a further “in-between” (MCR and SCR/PCR) and explicit trigger point.

**Section 5.5 Other IPSA Powers and Duties**

Q 5.5.1 Should the solvency capital requirement replace the ‘solvency margin’ as a trigger for insurer and auditor duties to report solvency problems to the Reserve Bank?

We would support this change for consistency with the proposed ‘two solvency measures’ approach. However, we note the current regime seems to be suitable.

Q 5.5.2 What point on the ladder of intervention would be appropriate for a capital-related trigger of investigation powers?

We believe a reasonable trigger point for investigation powers would be the SCR not expected to be or not being breached in conjunction with reasonable grounds to believe that further deterioration in solvency is likely (e.g. inability of the insurer to produce a credible explanation of the breach &/or recovery plan).

Q 5.5.3 What point on the ladder of intervention would be appropriate for a capital-related trigger of the Reserve Bank's power to require an insurer to produce a legally enforceable recovery plan?

We believe an insurer should be required to produce a recovery plan designed to ensure a breach of the MCR is avoided once the SCR has been breached. We see this as part of the supervisor powers under Directions.

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