Thematic Review - Insurer Disclosures

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RESERVE
BANK
OF NEW ZEALAND
TE PŪTEA MATUA

Licensed Insurer Compliance with Financial Strength Rating and Solvency Disclosures

Insurance Oversight Team

Contents

Executive summary

This paper reports on the findings from a thematic review on compliance with financial strength rating and solvency disclosure requirements undertaken during February to June 2017.

A thematic review looking at disclosure obligations was chosen due to the Reserve Bank's approach to prudential supervision which relies on a 'three pillars' approach. This includes market discipline and providing market participants with information. This has also been an area where a disproportionate level of compliance issues has been noted.

Compliance with financial strength rating and solvency disclosure requirements was assessed for 36 licensed insurers. Participants were grouped into four broad categories of compliance level. The overall level of compliance was found to be well short of the minimum requirements, with 53% of participants assessed as complying at a low or poor level. Only 22% of the sample performed relatively well, ranking good overall, but with some room to improve further. In this group, only three insurers demonstrated excellent compliance.

The most common issues were around not meeting the requirements to disclose the financial strength rating in writing prior to policyholders entering into and/or renewing a contract of insurance; solvency disclosure in financial statements being incomplete or incorrect; and website disclosures being incorrect, incomplete or not updated within the required timeframe.

Several themes have been identified from the review. Small insurers, overseas insurers and insurers with more complexity performed worse – for a variety of possible reasons. For small insurers, this could be because of lack of resource and/or focus, whereas for overseas insurers this could be a lack of knowledge of the New Zealand requirements and/or because of additional requirements around the disclosure of overseas policyholder preferences.

The review has also identified approaches used by some insurers to achieve effective disclosure where other insurers could adopt similar approaches, such as online sales processes and related parties advertising insurance.

The level of compliance was generally disappointing and needs to markedly improve. Insurers that performed the worst have been provided with specific feedback and asked to provide a written response on the issues identified. Other insurers have been informed of their assessment and urged to refer to this report to identify improvements that can be made. The Reserve Bank will undertake further assessment of compliance with disclosure obligations to ensure that standards improve and compliance obligations are being met.

Introduction

1. The Insurance (Prudential Supervision) Act 2010 (the Act) states that in achieving the purpose of the Act the Reserve Bank must take into account certain principles that are relevant to the performance of functions or the exercise of powers conferred on the Reserve Bank by the Act. These principles include sections 4(d) and 4(e), which are the "*importance of recognising that members of the public are responsible for their own decisions relating to insurance*" and "*the desirability of providing to the public adequate information to enable members of the public to make those decisions*".

2. The Reserve Bank's approach to prudential supervision relies on a 'three pillars' approach: self-discipline, market discipline, and regulatory discipline. An aim of the market discipline pillar is to reduce the information asymmetry between licensed entities and market participants, and hence the importance of disclosures.

3. The thematic review on compliance with disclosure requirements was chosen due to the Reserve Bank's supervisory approach and the importance of disclosures as part of the market discipline pillar. Disclosures have also been an area where a disproportionate level of compliance related issues have been identified. The supervisory approach was outlined in a speech by Peter Brady, Manager Insurance Oversight – The Reserve Bank's approach to supervising insurers, and the role of directors in February 2014:

Our supervisory framework seeks to reduce this information asymmetry by requiring insurers to disclose information to the public, in order to help policyholders and professional users of information make informed decisions. The disclosures for policyholders are in the areas of solvency and financial strength ratings. Ratings are simple aggregate metrics of the financial health of an insurer. To assist comparison, we publish on our website the ratings of all non-exempt insurers. For professional market participants, we require insurers to produce and disclose actuarial reviews and opinions of solvency alongside the published financial statements. The overall aim of these disclosures is to help incentivise insurers to operate prudently, and at the same time to ensure that a 'fair game' is available to policyholders.

4. The importance of disclosures is also included in the International Association of Insurance Supervisors' Insurance Core Principles (ICP). The ICP statements prescribe the essential elements that must be present in the supervisory regime to promote a financially sound insurance sector and provide adequate policyholder protection. This includes ICP20 on Public Disclosure:

   The supervisor requires insurers to disclose relevant, comprehensive and adequate information on a timely basis in order to give policyholders and market participants a clear view of their business activities, performance and financial position. This is expected to enhance market discipline and understanding of the risks to which an insurer is exposed and the manner in which those risks are managed.

5. The Reserve Bank recently underwent a Financial Sector Assessment Program (FSAP) review by the International Monetary Fund: Financial System Stability Assessment. The FSAP review reinforces the importance of the market discipline pillar and the role of disclosures in achieving effectiveness in this area.

6. A Review of the Insurance (Prudential Supervision) Act was outlined in March 2017. The Issues Paper sets out the areas that the review will look at, including the general disclosure and financial strength rating requirements.

   This thematic review has highlighted some areas that have caused some confusion. The findings in this report will be useful in relevant aspects of the review of the Act. We may also develop a guideline that would clarify and help the industry to interpret the requirements correctly.

7. The objectives of the thematic review are to:

   - Assess the quality of disclosure compliance among a sample of licensed insurers;
   - Identify common themes and areas where additional guidance could be issued and/or where regulatory requirements could be reviewed; and
   - Share the findings with all insurers and other interested parties to improve compliance across the industry.

Disclosure requirements and methodology

Requirements

8. The requirements relating to financial strength rating are set out in sections 60-72 of the Act. The solvency disclosure requirements are set out in the Solvency Standard(s) or for overseas insurers as conditions of a section 59 solvency exemption notice, where applicable. Insurers are responsible for understanding the full requirements of the legislation and standards. The following is a summary only, and does not fully reflect the obligations – refer to the legislation for the full wording of the requirements.

Financial strength rating

9. This review looked at the financial strength rating disclosure obligations for insurers as set out below:

    - Insurers are required to disclose the financial strength rating, agency, and scale in writing to policyholders before entering into or renewing a contract of insurance. The rating, agency, and scale must be disclosed and must be clear and prominent. If this is not reasonably practicable to do so before entering into or renewing, the requirements (other than the scale) may be disclosed orally and then complete disclosure provided in writing as soon as it becomes practicable (section 64).

    - Small insurers that are not required to have a financial strength rating, are required to disclose this in writing, together with the reason, before entering into or renewing a contract of insurance (section 65).

    - If a website that is maintained by, or on behalf of, a licensed insurer contains information or advertising about the insurer's insurance products, that website must include financial strength rating disclosures. Disclosures must have the rating, agency, and scale, or a prominent link to a website that has those requirements (section 67).

    - Any advertisement that refers to a financial strength rating, must state clearly and prominently the rating and agency, and that the scale of which the rating forms part is available for inspection at every office in New Zealand of the insurer (section 68).

    - Insurers must not disclose a rating from a non-approved agency or distribute an advertisement relating to any of the insurer's insurance products that refers to a rating from a non-approved agency (section 70).

    - If an overseas policyholder preference applies, the insurer must disclose the nature and extent of the overseas policyholder preference in the prescribed circumstances and in the prescribed manner (section 61 and section 72).

Solvency

10. Requirements for the disclosure of key components of the solvency calculations are set out within the applicable Solvency Standard(s) or as conditions of a section 59 exemption notice for relevant overseas insurers. In summary, a licensed insurer must disclose, on a legal entity basis, the following:

    - Actual Solvency Capital;

    - Minimum Solvency Capital;

- Solvency Margin; and
- Solvency Ratio

for each solvency margin required to be maintained under its condition of licence, and in total. For example, a life insurer would disclose these values for each life fund, and the company as a whole. The disclosure is required in the New Zealand financial statements, including prior year comparatives.

For solvency exempt insurers, the disclosure should be the home jurisdiction equivalent of the specified requirements, in the New Zealand branch financial statements.

Disclosure on the insurer's website (if any) of the specified requirements, is required within 10 working days following the required date for submission of the solvency return.

Methodology

11. Material was obtained from insurers under a section 121 notice, from 36 insurers who were chosen based on a mix of size and type of insurer. The selection provides a broad range of insurers, including life, non-life, health, small insurers, bancassurers, overseas insurers, and member associations.

12. A risk based supervisory framework determines the approach to supervision, which results in licensed insurers falling into one of two groups – Designated insurers or Portfolio managed insurers (see further detail below). Regardless of which group a licensed insurer falls into, the minimum regulatory requirements apply and as such, in terms of this assessment, all insurers were assessed against the same minimum regulatory requirements, regardless of size.

    Designated insurers. Licensed insurers requiring a greater intensity of supervision. Supervision of these insurers is designed to enable early identification and resolution of prudential issues. In addition to compliance monitoring, supervisors build an understanding of the business model, strategy, governance and risks. Analysis and review of information provided to the Reserve Bank is accompanied with regular and structured engagement.

    Portfolio managed insurers. Prudential oversight is oriented towards ensuring requirements are met and that supervisory matters are resolved promptly. Our objective is to understand risk across the portfolio and to identify, at a high-level, risks or issues affecting groups of licensed insurers or market segments.

13. The information requested related to documentation produced by insurers to provide to prospective and existing policyholders. This information is used by policyholders to make informed decisions on whether to purchase or renew with a particular insurer.

14. The material we requested was based on up to four products from each insurer selected. We asked insurers to provide a list of all current products and to divide that list into quarters, and select the first product in each quarter grouping. For those products selected, they were asked to provide the following documents that were applicable:

    - Product brochure

- Application form
- Telemarketing script – new sale/renewal
- Telephone sales recordings
- Online sales
- Quotation forms
- Policy wording
- Welcome letter
- Anniversary/renewal notice
- Advertisements
- Website disclosure
- Financial statement disclosure

Insurers were also prompted to provide any other material that illustrates how disclosure is achieved.

15. The review looked at how disclosure is made to prospective and existing policyholders across various distribution channels, such as telephone, online, intermediaries, and in person at a branch.

16. The review was desk-based and the information was used to assess how insurers are complying with the requirements. The following pages outline our findings.

Findings

Financial strength rating

17. The following findings are a high level summary of the common financial strength rating disclosure issues and themes we identified through the review. These were based on a sample of insurers and their products across the various distribution channels and associated sales process for each insurer. The findings should be read in that context.

18. ***Disclosure in writing on entering and renewal***
This disclosure requirement was where we most commonly identified issues. Insurers are required to disclose the financial strength rating, agency, and scale in writing, before policyholders enter into or renew a contract of insurance. Or, if this is not reasonably practicable before entering into or renewing, the requirements (other than the scale) may be disclosed orally and then complete disclosure provided in writing as soon as it becomes practicable.

Compliance with disclosure requirements was assessed across a range of distribution channels, such as telephone, online, intermediaries, and in person at a branch. A large number of insurers are either not disclosing on entering or renewing a contract of insurance, not complying fully, or not complying consistently. Disclosure before entering into a new contract was generally done better than for renewals of business.

Telephone sales often included a standardised process where the representative is prompted to play a mandatory recorded message containing various important information, including the financial strength rating and agency, during the sales call. This practice ensures good controls and consistency and reduces the risk of errors and omissions. Full written disclosure then follows, including the financial strength rating scale, in a welcome letter, quotation form or such like. This practice meets the disclosure requirements.

Internet sales revealed a range of practices. Some insurers met the requirement of disclosing the financial strength rating, agency, and scale in a clear and prominent manner (see next section for guidance on clear and prominent) by explicitly including this in the online narrative. In doing so, they appear to recognise the value of this as part of providing a prospective policyholder with relevant information to enable them to make an informed choice. Other insurers appear to treat this more as a compliance requirement, with the information forming part of the 'Terms and Conditions' or 'Declarations' type of window. Some make specific reference to the window containing the financial strength rating.

However, in some cases, attention is not drawn to the content containing the financial strength rating information at all. This relies on the policyholder reading and understanding a large volume of content, which is sometimes embedded in a policy wording document. In many of these cases, the applicant was required to indicate that they had read and understood the content before the sale could complete. Regardless of whether an applicant indicates that the content has been read and understood, disclosure must be clear and prominent to be effective. Some of the practices described would not be adequate and do not meet the requirements. We do not consider that an online sales process where a large amount of content is presented meets the requirements. At the least, attention should be drawn to the content containing important information such as the financial strength rating.

A few insurers that sell insurance on the telephone email a large amount of information such as a policy wording, containing the financial strength rating, to a prospective policyholder during the call. We do not consider the practice of electronically presenting a large amount of information such as a policy wording during a telephone call, as effective disclosure of the financial strength rating. It would not meet the requirements for this to be clear and prominent.

In terms of the requirement to provide the financial strength scale in writing before entering into a contract of insurance, if it is not reasonably practicable to do this before, it may be disclosed as soon as it is reasonably practicable. We saw many insurers not including the scale as part of the online sales process, presumably relying on this not being reasonably practicable and instead providing this in writing thereafter. In most of these cases we could not see why it would not be reasonably practicable to include the scale together with the rating and agency in the online process.

There were also some insurers who disclosed the financial strength rating, but were missing the scale of the rating or had a rating listed with an obsolete date (i.e. a rating dated as 2011 for a product sold in 2016). Current financial strength rating is defined as a rating given not earlier than one year before that date. Common practice is to not include a date, which is sufficient as the date is not a requirement as long as the rating itself is current.

Several issues related to the disclosure requirements on renewal. Nine insurers did not include any disclosures at all on renewal. There are different practices around renewal or anniversary, depending on the type of insurance. Non-life insurance contracts are for a defined term (usually one year) and a renewal notice is sent to the policyholder, which is required to have financial strength rating disclosures. What constitutes a renewal in life insurance contracts is less clear-cut, but general practice is for an anniversary statement or similar to be sent annually, such as where a contract re-rates for age and/or indexation type increases. Even where there is no change to the contract or price terms, insurers will often communicate with their customers annually as a conservation measure and to recognise that customers may exercise their choice to continue or discontinue at any time. We consider that a communication with a customer at such times is a decision point for a policyholder. The financial strength rating should be disclosed as part of this communication, if any, as this can help the policyholder make an informed decision. Ratings might also have changed since the outset.

19. Clear and prominent

A key part of disclosures is that it must be clear and prominent to be effective as required by section 64(4). There were mixed practices in this area. Twelve insurers had a combination of having their financial strength rating disclosures in fine print or in a location that was not prominent, e.g. in the footer or embedded in a lengthy document, and included as part of other terms and conditions online. Being clear and prominent is an essential aspect for disclosures to be effective. This applies across all distribution channels.

The meaning of clear and prominent should be interpreted with the common meanings of the terms and in the context of the specific disclosure requirements and principles of the Act. The following are characteristics that explain the expectations:

Clear

- Easily readable, in a degree of contrast from the immediate background and in the same font size as other characters, i.e. not in fine print. Website links must have labels that accurately describe the content.

Some insurers use a general term that contains both financial strength rating and solvency disclosures. Appropriate labels include: ‘About us’, ‘Financial Strength’, ‘Financial Strength Rating and Solvency’. We came across links that were described as ‘Regulatory disclosures’, ‘Legal information’, etc which would not be considered clear. Some insurers have included solvency disclosures in a tab labelled ‘Financial Strength Rating’ which would not be considered clear.

Prominent

- Accessible, through clear links/location, without requiring lengthy searches through multiple web pages and policy documentation. On a website this would preferably be on the Home Page or one to two clicks away and provided it is through clear links/labels.

- In written communication this should be in an obvious place or clearly titled, i.e. disclosure should not be buried in the middle of the policy document. Written documents with a table of contents should clearly indicate the page the financial strength rating disclosure is on.

- Position – the location of the financial strength rating is also a factor in determining if it is prominent. For example, in an application form this should be before, with, or directly in line of sight of the signature requirement. Disclosure in a footer of a document may not be considered prominent especially if it is in fine print and/or lower contrast.

Some insurers had check boxes that policyholders had to tick to confirm that they had read lengthy disclosures. If this approach is used it should, at the least, prominently refer to the attached content, including important information such as the financial strength rating. The approach referred to earlier, of digitally presenting a large document such as a policy wording to a prospective policyholder by email during the sales call, would not constitute effective disclosure.

20. *Overseas policyholder preference*

Seven overseas insurers that are subject to an overseas policyholder preference were included in the review. Compliance with this section was poor, with no insurers fully complying with the requirements. The overseas policyholder preference, where it applies, is important information for customers to be able to make an informed decision, as this could have a significant impact on New Zealand policyholders in times of distress.

The overseas policyholder preference is required to appear with, or immediately after, any text that discloses the financial strength rating. It must be clear and prominent. Three insurers failed to have the overseas policyholder preference accompany financial strength rating disclosures. Three insurers failed to make financial strength rating disclosures before entering or renewing insurance, and therefore also failed to disclose the overseas policyholder preference. There were instances where the overseas policyholder preference disclosure was in a much smaller font than the financial strength rating or was in a separate place. This downplays the existence of an overseas policyholder preference and would not meet the standards required to be considered clear and prominent.

21. *Websites / Related party websites*

Insurers that maintain a website, or have one maintained on behalf of them, that contains advertising about their insurance products, must clearly and prominently disclose the financial strength rating, agency, and scale, or contain a prominent link to another website that does so. Compliance with this requirement was varied.

Clear and prominent disclosure was an issue identified with websites. Issues included vague labelling of links and location of these links. Some links require significant scrolling to get to the information or are included in places that may not be logical for prospective or existing policyholders to find. Several insurers mention the financial strength rating in multiple pages on the website, but in one or more pages, omit the agency or the scale. Although insurers often have one main page for financial strength rating (and solvency) disclosures, the legislation requires that the rating, agency, and scale must be present in all instances.

A website ‘maintained on behalf of’ would include groups such as banks that are related to a licensed insurer, or member type associations where such websites include information or advertising of their related party’s insurance products. Some related party websites have dealt with financial strength disclosure well by including a page dedicated to this which is easily located. Some have even included information for non-related parties where they offer products of unrelated insurers on their website. This provides prospective and existing policyholders with this information over a range of products and providers in a single view, rather than having to search through individual products/pages. We consider this to be an example of best practice.

One website had additional information explaining what financial strength ratings are and why they are important. The website used simple terminology in a neutral manner to convey the information to users of the website. This enhances the effectiveness of the disclosure and we welcome initiatives of this sort.

22. *Distribution channels*

The review included looking at various distribution channels and their associated materials, including telephone scripts, voice recordings, and some intermediary materials. Insurers that sold business over the telephone provided scripts that representatives are supposed to read out during the course of a sale, including financial strength rating disclosures. We were also provided with some telephone sales recordings. In some instances the representative failed to disclose the financial strength rating, despite this being included in the telephone script process. The disclosure is required to be made orally before the contract is entered into or renewed, and then followed up in writing as soon as it becomes practicable. Insurers must ensure appropriate quality control on such distribution channels. Automated recordings played during a telephone sale was a common way to ensure the disclosure was correctly and consistently made.

Another common distribution channel used by insurers is where the insurer is not the direct point of contact for a policyholder. Instead there is an intermediary, such as a broker or other licenced insurer. For example, where a non-life insurer cross-sells a life insurance product underwritten by another insurer, or where a related party sells insurance products as part of a wider group of products. As an example, banks sell a wide range of products such as life insurance and credit card repayment insurance, in partnership with a bancassurer.

The review included looking at intermediated business. However, we did not receive a significant amount of material in this area. We were provided with some material given by licensed insurers to intermediaries that specified financial strength rating disclosure was to be made to policyholders. However, there were a number of examples of disclosures not made by the intermediary before entering or renewing a contract. Often these documents are not on the licensed insurers branded documents, but this does not discharge the requirement to disclose to policyholders. It is the licensed insurer's responsibility to ensure disclosure is made.

23. *Small insurers*

Small insurers are a class of insurer who qualify for certain exemptions, including not having a financial strength rating. However, small insurers must disclose that they do not have a current financial strength rating and the reason why they are not required to have one, before entering or renewing a contract. Four small insurers were included in the sample and three insurers fully complied with the requirements. Although small insurers are exempt from having a financial strength rating, this is a relevant factor for policyholders to know before they make a buying decision.

24. Other areas where issues were identified included:

- Other types of ratings were referred to without being clearly explained. For example, issuer credit ratings were sometimes disclosed, as were ratings of the reinsurers without explaining how this is relevant. The review identified some insurers disclosing the financial strength rating of their reinsurance partners. The disclosure of reinsurer ratings should not be more prominent than the licensed insurer's own rating, otherwise it could confuse and downplay the licensed insurer's rating. This might not be considered to be clear and prominent.

- Reference to legislation that is outdated, such as the Insurance Companies (Ratings and Inspections) Act 1994. Some of these cases also referred to this being the reason that the insurer is not required to have a financial strength rating. This legislation was repealed on the passing of the Insurance (Prudential Supervision) Act 2010, which requires most licensed insurers to have a financial strength rating. It is evident in these cases that there are poor controls in relation to document management, as those insurers do have a financial strength rating, and this is required to be disclosed.

- Advertising materials, such as brochures, marketing documents, and other insurer branded documents, were requested as part of the review. Most of them did not contain the financial strength rating and therefore were not subject to the requirements of section 68. Where insurers did disclose the financial strength rating in advertising, the common methods used to meet the requirements were to disclose the rating, agency, and a reference to the scale being available at the branch, The other method was to disclose the rating, agency, and scale. The latter method is considered best practice as the rating scale provides important context.

Solvency

25. Solvency disclosure requirements are driven by the applicable Solvency Standard(s) or conditions of section 59 exemptions for overseas insurers, where applicable. These are summarised as disclosure of solvency calculations in the financial statements and on the insurer's website (if any). For overseas insurers this applies to the New Zealand branch financial statements only. The requirements are relatively straightforward and this area was reviewed and expanded as part of the review of the Solvency Standards in December 2014. In summary, the required disclosure of the solvency calculations is the Actual Solvency Capital, Minimum Solvency Capital, Solvency Margin, and Solvency Ratio.

26. Compliance with the financial statement disclosure of the solvency calculations was varied. Several insurers omitted one or more of the required solvency components. It is important that all four components are disclosed, as they need to be read within the context of each other. Life insurers are also required to disclose the solvency calculations for each life fund and the total across all life funds. For some insurers, omitting one or more of the solvency components has been an ongoing issue that has been identified, but compliance remains patchy.

27. Most insurers include in their financial statements additional disclosures such as a brief description of their capital management policy or their capital targets. Additional disclosures can help to outline how the insurer manages capital internally within the scope of the applicable Solvency Standard. However, there were also

instances where insurers used different terminology or included additional figures to the solvency calculations, This may cause confusion, such as where the Fixed Capital Amount is greater than the calculated minimum solvency capital. Additional disclosures should be meaningful, separate, and distinct from the required disclosures, including the calculated minimum solvency capital which in the example used is the Fixed Capital Amount. Additional disclosures should not have the effect of confusing or downplaying where regulatory requirements/minimums apply.

28. Nine overseas insurers were included in our sample. Compliance by this group of insurers was particularly poor, with only two insurers fully complying with the requirements. This was largely related to the omission of one or more of the home jurisdiction equivalent of the solvency components. Overseas insurers granted an exemption from section 59 have an exemption from the solvency being calculated under New Zealand requirements, but solvency disclosure using the home jurisdiction equivalent requirements must occur. We also noted with overseas insurers that the currency of the disclosure was not clear in the New Zealand branch financial statements. Some disclosures had been converted to New Zealand dollars (the presentational currency for most insurers), but some had left these in the home jurisdiction currency without being clearly labelled.

29. The Solvency Standards require the solvency calculations to be disclosed on the insurer's website (if any) and that this must be done within 10 working days following the required date for submission of the annual and half yearly solvency return. Many insurers have failed to update their website within the required timeframe. Insurers are responsible for maintaining their website and should include this in their financial reporting processes.

Summary of findings

31. Assessing the financial strength rating and solvency disclosure requirements together, participants were grouped into four broad categories of compliance level. The categories are:

- Good – compliance with the requirements was of a generally good overall standard with most requirements met, but with some improvement still possible.
- Mixed – compliance with the requirements was mixed with some aspects not fully compliant, inconsistencies and needing some improvement.
- Low – compliance with the requirements was either generally low or there were some instances of non-compliance with improvement needed.
- Poor – compliance with the requirements was low overall and/or some aspects of material non-compliance, requiring remediation.

Figure 1

	Compliance Level			
	Good	Mixed	Low	Poor
Designated	19%	9%	14%	6%
Portfolio	3%	17%	6%	28%
	22%	25%	20%	33%

Figure 2

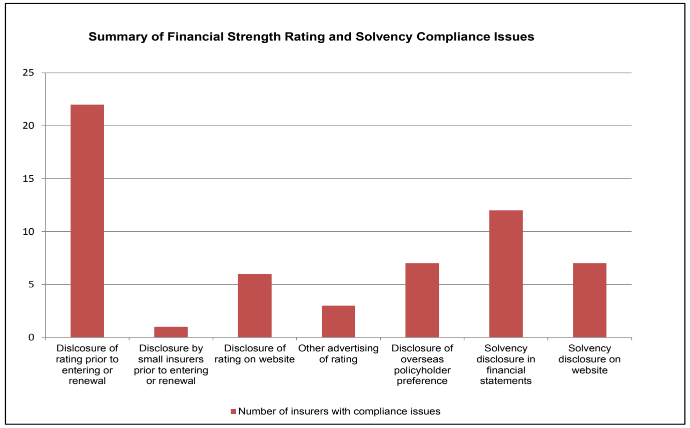

Figure 1 shows where insurers were grouped based on their compliance level. The categories that insurers have been grouped into are judgmental and some compliance areas are weighted higher than others.

32. Of the 36 insurers included in the review, only eight were classed as having a Good level of compliance. The remaining insurers were all considered to have some issues across their disclosures – some being fairly minor, but others were material breaches of the legislation or the Solvency Standards. The insurers in the Low and Poor categories are falling well below the disclosure requirements. It is clear that there is a difference in the compliance level between designated and portfolio managed insurers. See the Commentary section for further detail.

Figure 2 shows the number of insurers that had compliance issues in a given area of the disclosure requirements.

33. Areas of poor compliance were where financial strength rating disclosures were required prior to policyholders entering into or renewing a contract of insurance (section 64). Twenty-two of the 36 sampled insurers had one or more issues in this area. Solvency disclosure in the financial statements was also relatively weak, where 12 of the 36 of the sampled insurers had one or more issues. This was followed by solvency disclosure on websites and disclosure of the overseas policyholder preference.

Commentary

34. Overall, the level of compliance with disclosure obligations is well short of the standard required, with 53% of participants assessed as complying at a Low or Poor level. Among these two categories there was a mixture of generally low compliance, inconsistency and examples of material non-disclosure.

35. Smaller, portfolio managed insurers generally scored significantly worse in the review than designated managed insurers. Overall, 33% of surveyed insurers scored poorly and most of these were portfolio managed insurers. This is in line with our understanding and supervisory insights which indicate that smaller insurers either do not fully understand their compliance obligations, and/or operational processes do not ensure consistency and continuity, such as when key people change. Smaller insurers may also lack adequate expertise in the area of compliance due to less dedicated resource or focus in this area.

36. The results of this thematic review were compared with the results of the thematic review on the Quality of Risk Governance issued in February 2015. Most insurers that performed well in the Risk Governance thematic review also demonstrated a good level of compliance with disclosure obligations, with a few exceptions. This suggests a correlation between having good risk governance and culture with operational oversight and compliance throughout the whole organisation.

37. Overseas insurers included in the thematic review demonstrated a comparatively lower level of compliance with obligations. This is partly due to Australian non-life insurers being subject to an additional obligation around the requirement to disclose the nature and extent of the overseas policyholder preference, in the manner specified, when it discloses its financial strength rating. This finding suggests a lack of understanding, and potentially focus, on the New Zealand requirements for overseas insurers.

38. Insurers that are more complex for reasons such as multiple distribution channels, brands, legacy products, and/or systems etc, did not perform well in some respects. Insurers need to ensure that compliance obligations are not affected by this sort of complexity, and that operational processes and controls are adequate to manage the business.

39. The sample did not return many examples of intermediary branded disclosures. Some insurers said that processes ensure this happens, or they provided material that is provided to intermediaries which instructs them on compliance requirements. The impression we got from some of the commentary is that insurers may not undertake explicit checks that disclosures are occurring, but rather rely on the instructions provided. Insurers should be aware that responsibility rests with them to ensure compliance obligations are being met, that these obligations cannot be discharged, and that reasonable checks may also be appropriate.

40. Some insurers said that when compiling their submission they had self-identified issues. They submitted both original and amended documentation in those instances. This suggests that the disclosure requirements are not fully understood and/or do not appear to form part of regular internal control checks for some insurers. Licensed insurers are required to comply with the regulatory requirements, which include operating in a prudent manner by having the resources (and expertise) required to adequately manage the business and to have sufficient internal controls in place. We strongly encourage insurers to look at their processes to ensure that their operational and compliance processes are robust and timely to meet the obligations.

41. The disclosure requirements for many appeared to be viewed as a compliance exercise rather than giving it profile and providing this important information for policyholders to assist in their buying

decisions. Insurers that wanted to promote their ratings generally complied better than those that appear less keen to disclose their rating – for example insurers with an overseas policyholder preference.

42. Five insurers failed to meet the timeframe to provide information as required by the section 121 notice. A few insurers also put very little effort into providing the information, which was poorly labelled and it was hard to determine how the materials addressed the requirements of the notice. Insurers are reminded that it is an offence not to comply with statutory notices.

43. The points above are not definitive statements, but observations seen through the review and our supervisory experience. Some insights have previously been anecdotal, but the review has added further context to our supervision of insurers.

44. Overall, the level of compliance was well short of the minimum requirements. Compliance with disclosure requirements is a cornerstone of the Reserve Bank's approach to prudential supervision, which relies on a 'three pillars' approach: self-discipline, market discipline, and regulatory discipline. Disclosure requirements fall within the market discipline pillar and is an important element to ensuring the purposes and principles of the Act are met. The Reserve Bank has provided insurers that performed to a low or poor level with specific feedback and is requiring them to provide a written response on the issues identified. These insurers have also been advised that the Reserve Bank reserves the option to take into account the full compliance record should any future breaches occur. Insurers that performed to a level of compliance classified as mixed have been provided with general feedback and urged to refer to this report to identify improvements that can be made.

45. To ensure that standards improve and compliance obligations are being met the Reserve Bank will undertake further assessment of compliance with disclosure obligations. This will take the form of a follow-up thematic review and is likely to include some existing participants together with a sample of insurers not previously included.