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Insurance – Proposed Regulatory Regime

Background

Historically, NZ's insurance industry has been lightly regulated compared to those in most of the world's modern economies.

Work began several years ago to bring NZ's insurance regulation more into line with international norms and April 2009 saw a major milestone with the release of the RBNZ's draft Insurance (Prudential Supervision) Bill for stakeholder consultation.

The exact timetable for the new regulatory regime is not yet known but it could be as early as mid-2010. As the new regulatory environment will be a substantial break from the past we understand that the RBNZ will be meeting with each insurer to discuss a "path to compliance".

Draft Insurance (Prudential Supervision) Bill

The draft bill runs to 177 pages and sets out a comprehensive new regulatory structure for general, health and life insurance companies. We understand that there has been a lot of feedback from stakeholders and it will be interesting to see what changes are made to the bill as a result.

The stated purposes of the legislation are to "promote the maintenance of a sound and efficient insurance sector" and "to promote public confidence in the insurance sector".

Key requirements for licensed insurers include:

- Insurance companies that carry on business in NZ must be licensed.
- The directors and certain staff of insurers must be "Fit and Proper".
- Approval for transfers and amalgamations.
- Solvency standards.
- Disclosed credit ratings.
- Risk management programme.
- Appointed actuary (more about this later).
- Statutory fund for life insurance.
- Whistleblowing responsibilities.
- Statutory management provisions.

The RBNZ will be the regulator with powers including specifying regular reporting requirements, investigations and dealing with "distressed" insurers.

Many other issues are set out in detail and we refer the reader to the many summaries and commentaries provided by various advisory and professional groups.

Draft solvency standard for non-life insurance

Apart from the usual legal requirements under company law, there are no statutory solvency standards applicable to NZ non-life insurers (although a $500k deposit is required and property insurers must disclose a credit rating).

The ICNZ has solvency rules for its members, as does the Health Funds Association, but as membership of those organisations is voluntary the solvency rules are effectively voluntary also. However, many NZ insurers are owned by offshore groups, and the NZ insurance industry, in premium terms at least, is largely owned by Australian companies so many NZ insurers are to some extent regulated according to offshore rules. For life insurers, the actuary must comply with the NZ Society of Actuaries' (NZSA) life insurance solvency standards.

In July the RBNZ released a draft "Solvency Standard For Non-Life Insurance Business" developed by the RBNZ in conjunction with the NZSA. A review of the solvency standard for life insurance business, also in conjunction with the NZSA, is expected to commence shortly.

A number of stakeholders will have reviewed the non-life standard under the consultation process which closed on 31 August.

The draft standard is consistent with internationally accepted approaches to risk based solvency assessment and is broadly based on the solvency standards as required by the Australian Prudential Regulatory Authority (APRA). A key difference from APRA's solvency rules is that many of the calculations are based on figures derived directly from a company's financial statements prepared under IFRS accounting standards.

The draft solvency standard, as well as providing the basis for the solvency calculations, also summarises a number of the draft bill's requirement for insurers, including:

- Maintain and disclose solvency at all times, and have procedures in place to ensure this.
- Appoint an Appointed Actuary (AA).
- Have the AA assess certain elements of the financial statements (in accordance with actuarial standards).
- Report to the RBNZ a likely failure to meet solvency standards (a minimum 12 month prospective assessment of solvency is envisaged).

- Provide an annual solvency return to the RBNZ within 3 months of financial year end:
  - Audited solvency return in specified form.
  - Directors' attestation.
  - Audited financial statements.
  - Audit report on the solvency return.
  - Financial Condition Report (FCR) produced by the AA (including a review of the solvency calculations).
- A half yearly solvency return is also required.

Solvency calculations

In summary, the solvency calculations specify rules for the determination of an insurer's:

- "Actual Solvency Capital" (ASC).
- "Minimum Solvency Capital" (MSC).

The ASC must exceed the MSC at all times, and ideally a "buffer" above this level would be held.

The ASC is in essence a conservative calculation of the insurer's net assets, based on adjusted figures from the financial statements.

The MSC is calculated by a formula that applies a range of factors to various components of the insurer's financial statements (adjusted as necessary). Companies with a higher risk profile will generate a higher MSC and therefore need to hold a higher ASC.

Some of the issues considered in calculating the MSC include:

- Insurance liabilities by class of business.
- Assets held.
- Reinsurance arrangements.
- Catastrophe or aggregation risks.

The intention is that insurers that meet the solvency requirements will have a satisfactorily small probability of failing to pay legitimate claims.

Financial condition report

NZ actuaries have been preparing FCR's for life insurers for many years. We are aware that some NZ general insurers also have FCR's prepared, sometimes resulting from the regulatory requirements of their parent companies.

Ideally, the FCR is a confidential document that provides the directors and senior management of an insurer with an overall view of its financial condition. This would typically include a prospective view of the company's solvency as well as an assessment of its assets and insurance liabilities, premium adequacy and an overview of its operations. APRA also requires comment on the insurer's risk management programme and reinsurance arrangements.

For the draft standard the FCR's scope is limited to considerations relating to the application of the solvency standard, including:

- Identification of the risks to meeting solvency standards and comment on steps taken to address them.
- Prospective view of solvency having regard to business plans and external environment.
- Comment on the composition of the ASC.
- Comment on the insurance liabilities.
- Comment on asset liability mismatch risks.

Final word

The proposed regulatory environment is a major change and insurers should be seeking legal, accounting and actuarial advice as to their responsibilities under and responses to the new environment.

Although final form and timing of both the bill and the solvency standards are not yet known, we are following developments closely, and indeed contributing where relevant.

Any readers interested in more details are invited to contact Melville Jessup Weaver.

ABOUT MELVILLE JESSUP WEAVER

Melville Jessup Weaver is a New Zealand firm of consulting actuaries. The areas in which we provide advice include superannuation, employee benefits, life insurance, general insurance, health insurance, asset consulting, accident insurance and information technology. The firm was established in 1992 and has offices in Auckland and Wellington.

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