

Insurance Regulation

December 2014 update

Revised solvency standards and more

New Zealand has undergone major changes in the regulation of its insurers over the last 5 years. It is hard to believe that at one time we had a regime which was principally dependent on a \$0.5 million bond.

On 17 December 2014 the RBNZ issued an update covering:

- Revised solvency standards
- Variable annuities consultation
- Licence amendments
- Insurer data collection
- Risk Governance review
- Section 78 reports
- Financial strength rating reviews.

Revised solvency standards

Revised standards were issued for life and non-life insurers, captives, non-life insurers in run-off and a standard for Civic Assurance.

The standards were all consulted on and incorporate feedback from insurers and additional changes.

The standards commence 1 January 2015 except for certain provisions which relate to reinsurance. Insurers will be required to calculate a solvency margin under the new standards as at and from their 2015 balance date.

The main changes for non-life companies are:

- revisions to the definition of capital;
- the solvency treatment of reinsurance;
- the solvency treatment of guarantees.

The revised standards also incorporate a number of amendments aimed at clarifying the application of the solvency standards.

Definition of capital

The interpretation of what constitutes capital has been open for discussion between the RBNZ and the industry over the past few years.

RBNZ have taken one section in the previous non-life standard (S40) and have added a lengthy appendix clarifying what constitutes capital for the purposes of the standard.



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Reinsurance treatment

The RBNZ have recognised that the reinsurance counterparty may not be a reinsurer but an alternative counterparty or may be subject to the issue rating of an asset. Consequently there are two extra tables in the non-life standard to assess counterparty grades for assets based on whether the asset is short or long term.

Guarantees

The RBNZ has circulated a number of discussion documents on the treatment of guarantees and this has attracted significant feedback. As a consequence, the non-life solvency standard now includes an appendix detailing how guarantees should be treated.

In summary, guarantees need to:

- be provided by an issuer of high credit rating
- not be a related party
- be legally enforceable
- be irrevocable prior to maturity and unconditional

In addition, the full benefit of the guarantee can only be recognised when the term of the guarantee exceeds the maturity term of the asset or else a haircut may apply.

Clarifications

Asset concentration charge

The asset concentration risk capital charge applies additional charges where there is a concentration of assets held by one counterparty. Prior to the December 2014 update it was theoretically possible to incur charges greater than the value of the assets.

The RBNZ have amended the wording in the non-life standard to specifically limit the maximum charge for any asset to 100% of its value.

Contingent liabilities

The RBNZ have amended their wording of how contingent liabilities should be assessed and have prescribed a more detailed approach to quantifying them. Previously, the asset risk capital charge included all known contingent liabilities and off balance sheet exposures "whether or not the contingent liabilities are disclosed within the NZ GAAP financial statements.". This provided some

difficulties for Appointed Actuaries where the accounting standards (IAS37) stipulated that something was not a contingent liability but the solvency standard suggested it might be.

The revised non-life solvency standard has been amended to include all IAS37 compliant contingent liabilities and notes that the Appointed Actuary can include other contingent liabilities that are outside of the financial statements if they pose a material risk.

Financial Condition report

In the event that the Appointed Actuary includes additional contingent liabilities in the solvency calculation, they must comment on these in the Financial Condition Report. Specifically they must note their potential size, probability of occurrence and detail what steps the insurer is taking to manage the risk.

Variable annuities consultation

The area of variable annuities is of great interest to the market as the need to provide effective financial products providing income to retirees grows. Based on the consultation received to date the RBNZ will be issuing a solvency standard in the 1st quarter of 2015.

Licence amendments

The new solvency standards will flow through to individual insurers' licensing requirements. The RBNZ will be working through these with each insurer in advance of their 2015 balance date.

Insurer data collection

The RBNZ is looking to expand the data it collects from insurers and will be requesting financial and exposure data from insurers with annual premium income exceeding \$50 million or assets total assets above \$500 million – referred to as the Quarterly

Insurer Survey. Following consultation in 2014 the RBNZ issued a paper in November summarising submissions on its proposals. The plan is to commence collecting the data from the June 2015 quarter.

Separately the RBNZ is reviewing the insurer solvency return spreadsheet and a new template will be issued early this year.

Risk Governance review

The RBNZ has worked with a sample of insurers to review the quality of risk governance with insurers.

Once the RBNZ has shared its feedback to the insurers who participated in the review they will publish feedback on their website.

Section 78 reports

Overseas insurers are required, when lodging financial statements with the NZ Companies Office, to include a section 78 report. They have noted that some companies' filings have been rejected where this report is not included.

Financial strength rating reviews

Most licensed insurers are required to have a current financial strength rating and the RBNZ maintains a public register of the information. The RBNZ is asking insurers to ensure they advise them each time the review is updated.

A copy of the Insurance Industry Update can be found courtesy of the link below.

www.rbnz.govt.nz/regulation_and_supervision/insurers/publications/5973985.pdf

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