Quantitative Impact Assessment.

Draft Interim Solvency Standard

August 2021

Reserve Bank of New Zealand
Te Pūtea Matua

Introduction

This document provides guidance for insurers participating in the assessment of the quantitative impact of the draft interim solvency standard. We wish to thank those who have agreed to undertake this exercise.

The sections below provide instructions for completing the template, guidance for the treatment of solvency licence conditions that insurers may be subject to, and text on the interpretation of the standard for the purposes of the Quantitative Impact Assessment.

Completion of the template

Please complete the attached template with a reporting date equal to the most recent financial year end for which you have submitted a Solvency Return. This will enable us to compare outcomes between the Draft Interim Solvency Standard and the existing standards, informing future development.

The template consists of a cover page, four 'Return' tabs and four corresponding 'Workings' tabs.

- All insurers must complete the cover page.
- The 'Consolidated' tabs need to be completed if the insurer owns other insurers, but can be omitted otherwise. A separate template should be completed for each subsidiary insurer.
- The 'Insurer' tabs should be completed by every insurer. For this purpose, the 'insurer' tab values incorporate any Statutory Fund values.
- The 'Statutory Fund 1' and 'Statutory Fund 2' tabs should be completed for any Statutory funds of the insurer. If there are no statutory funds, these tabs may be omitted.
- Completion of 'workings' tabs is optional. However, if they are used there should be a separate 'workings' tab for each 'return' tab completed.

We encourage participants to use the 'Workings' tabs provided to give the RBNZ additional information about your solvency calculations. We have provided some possible calculation structures in this tab. However, you should feel free to take other approaches if more suited to your business.

Please provide full commentaries in response to the questions posed in the template. This will improve our understanding of your submission. Note that these commentaries may include any questions/comments on the return itself.

We have provided the facility for Solvency Liabilities and Current Termination Values to be entered for all product classes (including general insurance classes). We do not expect these fields to be entered, unless there are ''long-term insurance contracts' in those classes.

Submissions are due by 5pm on 1 October 2021 and should be sent to insurancesolvency@rbnz.govt.nz, along with any questions you may have about the exercise.

Treatment of licence conditions

Please assume that the following Entities (where 'Entity' is as defined in the standard) will have a licence condition that makes them subject to the draft standard:

- Insurers (on both a consolidated and solo basis)
- Statutory funds (on a solo basis only)

Existing solvency licence conditions relating to non-statutory life funds should be ignored.

Please assume for the purposes of this exercise that licence conditions requiring minimum capital amounts relating to low interest rates and/or business run-off will be rescinded. (Note that this in no way represents a commitment on behalf of the RBNZ to remove these conditions once the draft standard comes into force.)

Interpretation of the standard

Guidance may be required with respect to solvency treatments for the purposes of the impact assessment, in order to clarify or remediate areas of the standard as published. This guidance is set out in the text below. References to 'paragraphs' are references to paragraphs of the Draft Interim Solvency Standard published on July 22, 2021.

Note that while this guidance may indicate the directions that may be taken by future versions of the standard, these notes in no way bind the RBNZ to apply the treatments described.

Introduction Section

1. Paragraph 6 of the standard should be taken to read as follows: "This solvency standard applies to every licensed insurer that carries on insurance business in New Zealand, and that:

    i. Is not an overseas licensed insurer that is not required to comply with this solvency standard, or a part of this solvency standard, to the extent it has been granted an exemption under section 59(1) of the Act; and

    ii. Is required by a condition of licence to maintain a solvency margin in accordance with this solvency standard."

2. 'Future insurability' (paragraph 20, definition of 'Short-term Insurance Contract') should be taken to mean a contractual right of the policyholder to either

    i. at the end of the current contract term, renew their cover on pre-defined terms with no new underwriting (medical or otherwise); or

    ii. at any time during the contract term, increase their cover on pre-defined terms with no new underwriting (medical or otherwise)

3. The word 'licensed' should be removed from the definition of 'Reinsurer' in paragraph 20.

Capital Resources

4. While 'insurance contract' follows the IPSA definition, insurers may unbundle insurance contracts to the extent that this would be allowed under IFRS 17 (paragraph 29).

5. Adjustments for non-financial risk (paragraph 29(iv)) should be determined using net-of-reinsurance cash-flows.

6. In the definition of the Solvency Reinsurance Balance (Paragraph 20) and in the three tests in Appendix 8 of the standard, reinsurance premiums to be included in payments or income to the reinsurer should be reduced by 10% as an approximate allowance for the reinsurer's profit margin. Cash flows up until the point where the arrangement can be fully repriced should be included in the tests and in the solvency reinsurance balance.

Capital Requirements

7. All capital charges contributing to the PCR should be determined on a net-of-tax basis, in accordance with Appendix 8 of the standard (even if not specifically mentioned in the text describing the capital charge calculation).

8. The 1 in 1000 year loss return period mentioned in paragraph 57 does not relate to the non-earthquake extreme event mentioned in paragraph 56(iii). This remains calibrated to a loss return period of 1 in 250 years.

9. The best estimate liability (paragraphs 20 and 63) used as a base for the solvency liability calculation is risk-adjusted, i.e. it includes adjustments for non-financial risk. The solvency liability is a recalculation of the (risk adjusted) best estimate liability under stressed assumptions.

10. The interest rate risk charge (paragraph 79) should be applied to standardised insurance items rather than GAAP items.

11. In determining the interest rate risk charge, different treatments should be applied depending on whether a single discount rate is applied to all cash flows or different discount rates are applied to individual cash-flows based on the term of each cash-flow. In the former case, the 'current interest rate' mentioned in paragraph 80 should be the single discount rate, while in the latter case the 'current interest rate' will be different for each cash-flow.

12. Where a business combination has taken place in the preceding two financial years, gross written premium should be summed across the preceding entities for the purpose of the operational risk charge (paragraph 105).

13. Assume that the allowance for leases in the *distressed wind up capital charge* (paragraph 109(iii)) is removed. Instead the excess of the value of <u>all</u> right of use assets over the corresponding lease liability recognised under NZ IFRS 16 should attract a 100% *other credit risk capital charge* (paragraph 103).

14. The prescribed solvency assumption for health claims inflation (Appendix 5 paragraph 10) is 1% per annum in addition to the best estimate assumptions for medical expense inflation (not 101% of best estimate assumptions).

15. The prescribed solvency assumptions for long-term non-life insurance claims (Appendix 5 paragraph 10) shall be determined by increasing best estimate assumptions for claims by the same percentages as used in the underwriting risk charge (paragraph 53 - claims yet to be incurred) and the claims run-off charge (paragraph 54 - claims already incurred) respectively.