



**RESERVE
BANK**

O F N E W Z E A L A N D
T E P Ū T E A M A T U A

Review of Insurance Solvency Standards

October 2020

Current Information Available

Information about the review, including the Terms of Reference, is available on the Reserve Bank website at:

<http://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/solvency-standard-review>

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Glossary

IAIS	<u>International Association of Insurance Supervisors</u>
IASB	<u>International Accounting Standards Board</u>
ICP	<u>Insurance Core Principles</u>
IFRS 17	<u>International Financial Reporting Standard 17</u>
IMF	<u>International Monetary Fund</u>
IPSA	<u>Insurance (Prudential Supervision) Act 2010</u>
FMA	<u>Financial Markets Authority</u>
FSAP	<u>The IMF Financial Sector Assessment Programme</u>
RBNZ	<u>Reserve Bank of New Zealand</u>
Regulations	<u>Insurance (Prudential Supervision) Regulations 2010</u>
IPSA Review	<u>Review of the Insurance (Prudential Supervision) Act 2010</u>

1. Introduction

1. The Reserve Bank is undertaking a review of the solvency standards issued under IPSA. Feedback is invited on the principles and timeline presented in this paper.
2. Since the current form of the standards was introduced in 2014, there have been a number of developments that militate in favour of review. These include
 - The IMF FSAP review of New Zealand's financial sector. This review recommended closer adherence to the IAIS [Insurance Core Principles](#). ICP 17 (Capital Adequacy) is particularly relevant to solvency and requires, among others, a total balance sheet approach and a graduated approach to supervision.
 - The Trowbridge/Scholtens [review](#) of the Reserve Bank's supervision of CBL (in liquidation). This review also recommended a graduated approach to supervision, along with clarified approaches to asset charges and solvency projections.
 - A [thematic review](#) of the appointed actuary regime for insurers. Among other things, this review recommended certain improvements to insurer financial condition reports (which are empowered by provisions in the solvency standards).
 - The publication of new insurance accounting standards (IFRS 17) by the International Accounting Standards Board. These make major changes to the presentation of balance sheets and the determination of capital, so have a direct bearing on solvency.
 - A [review](#) of the structure and level of registered bank capital requirements.
 - The experience of RBNZ supervisors in overseeing the action of the standards.
 - Feedback from insurers and other market participants on a wide range of issues.

2. Review of the Solvency Standards

3. Best practice regulatory stewardship¹ includes monitoring and reviewing existing regulations at appropriate intervals to ensure they are robust and fit-for-purpose. The Review of Solvency Standards is designed to help the Reserve Bank fulfil its regulatory stewardship responsibility, by monitoring and reviewing New Zealand's system for measuring and reporting on insurance capital.
4. Section 55 of IPSA authorises the Reserve Bank to issue solvency standards that establish the minimum amount of capital to be maintained by insurers. The Reserve Bank currently has several solvency standards on issue, the principal ones being the Solvency Standard for Life Insurance Business 2014 and the Solvency Standard for Non-Life Insurance Business 2014.

¹ <https://treasury.govt.nz/information-and-services/regulation/regulatory-stewardship>

5. New Zealand’s insurance accounting follows a set of financial reporting standards known as IFRS 4, released by the Insurance Accounting Standards Board (“IASB”). The IASB is currently in the process of replacing IFRS 4 with a new standard IFRS 17, which represents a radical overhaul of the way insurance contracts are accounted for. As the solvency standards use the NZ IFRS 4 balance sheets as a base to determine minimum capital requirements, it is necessary to re-frame the solvency standards to allow for IFRS 17 and avoid unintended consequences.
6. In recent years there have been various reviews containing recommendations for the administration of solvency in New Zealand. These include the IMF’s 2016 review of New Zealand’s financial sector, the Trowbridge-Scholten review of the Reserve Bank’s supervision of CBL, and the thematic review of the role of the Appointed Actuary.
7. There have been developments internationally, for example, the introduction of Solvency II in Europe, the introduction of a new insurance capital regime in Australia and the development of an international capital standard under the auspices of the International Association of Insurance Supervisors. Our prudential and regulatory frameworks need to be both a good fit for New Zealand and have full regard to international standards and good practice.
8. There are also a myriad of other minor to moderate issues that have been identified through reviews and other means over the years the standards have been in operation.
9. We anticipate revisions to the solvency standards in two waves. The first wave will deal with structural changes to the standards, including those to facilitate IFRS 17 and a graduated approach to supervision. The second wave will deal with changes to individual components of the standards.
10. Through the process, we intend to interact intensively with relevant government agencies, industry organisations and professional organisations. We have established a Reference Group, comprising senior staff from other insurance sector regulatory agencies, to ensure that they have full line of sight and the opportunity for full, detailed input into the work. An Insurance Forum is also being established with all Council of Financial Regulator (“COFR”) agencies and providing for regular participation by industry bodies.

3. Principles

11. As with the recently completed Bank Capital Review, we have decided that a set of principles should be established at the outset to guide the Solvency Standards Review. The proposed principles set out below have been adapted from those used in the Bank Capital Review, as we wish to have broad consistency of approach between the two sectors.

Proposed Solvency Standard Review Principles	
1	We will have regard to international comparability, particularly LAGIC (Australia), Solvency II (Europe), International Capital Standard (IAIS) and the Insurance Core Principles (IAIS), with the caveat that principle number 2 will take precedence.
2	We take a substance over form approach and tailor our requirements to New Zealand. This principle will take precedence over international comparability.

Proposed Solvency Standard Review Principles	
3	Capital must readily absorb losses before losses are imposed on policyholders.
4	Capital requirements should be set in relation to risks that may impact insurer balance sheets.
5	Insurers should be subject to a single method of determining capital requirements and the use of judgement should be limited to the extent possible.
6	Capital requirements of New Zealand insurers should be conservative relative to those of international peers, reflecting the Reserve Bank's regulatory approach.
7	The solvency framework should be practical to administer and minimise unnecessary complexity and compliance costs.
8	The solvency framework should be transparent to enable effective market discipline.

12. The review will also take account of the principles and purposes of the legislation that enables the solvency standards – the Insurance (Prudential Supervision) Act 2010.

4. Timeline

13. We envisage the review taking place broadly according to the timeline in the following diagram.

Consultations	2020	2021				2022				2023			
	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Principles of review	■												
Structural changes		■	■										
Interim standard				■	■								
Calibration exercise				■	■								
Asset charges						■	■						
Liability charges								■	■				
Other components										■	■		
Final standard												■	■
Calibration exercise												■	■

14. The double vertical lines indicate points at which new solvency standards will be issued, and break the project naturally into two phases.
15. In Phase 1 (Q4 2020 – Q4 2021 inclusive), we will firstly consult on the principles underlying the review, and then on the proposed structural changes. Next we will write a draft standard, invite comment and undertake a calibration exercise with insurers (to highlight any unintended outcomes of the new standard). Finally an interim standard will be issued around the end of 2021 that will allow insurers to prepare with confidence for the introduction of IFRS 17 and implement the major recommendations of the FSAP and Trowbridge-Scholtens reviews.
16. Phase 2 (Q1 2022 – Q4 2023) will take a similar approach, except that the subject matter will be the detail of capital charges and other components of the standard. A final standard will issued in late 2023.

5. Have your say

17. Stakeholders are welcome throughout the Review to provide comment and information to the Reserve Bank. At this time we are particularly seeking commentary on the principles and the timeline set out above.
18. Please use this email - insurancesolvency@rbnz.govt.nz - to provide comments.
19. Comments or submissions should be received by 12 November 2020.