Review of the Insurance Solvency Standards.

Public feedback statement
Consultation on Structure and IFRS 17

22 July 2021

Current Information Available

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

https://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/review-of-the-insurance-solvency-standards

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Glossary

CTV	Current Termination Value
IAIS	International Association of Insurance Supervisors
ICAAP	Internal Capital Adequacy Assessment Process
ICP	Insurance Core Principles, issued by the IAIS
IFRS	International Financial Reporting Standards
IFRS 4	Accounting for Insurance Contracts (old standard)
IFRS 17	Accounting for Insurance Contracts (new standard)
IPSA	Insurance (Prudential Supervision) Act 2010
LAGIC	Australia's Life and General Insurance Capital framework
ORSA	Own Risk and Solvency Assessment
RPG	Related Product Groups under IFRS 4
SF	Statutory fund
VaR	Value at Risk – the capital required to absorb risk with a given probability

Key elements of feedback

- The idea of having a **purpose statement** is broadly supported, but a tighter definition of diversity is desired by respondents.
- Many respondents supported the **total balance sheet approach** in principle, but there are concerns about its practicality.
- Some respondents commented that there is little to gain by applying additional capital requirements to **"sectorally important" insurers**.
- Respondents tended to favour rationalisation of the solvency standards into two or three documents, but were largely opposed to having a **single standard** for all insurers
- There was most support for the option of solvency standards applying only to **insurers and statutory funds**.
- Some respondents thought that the current treatment of **non-insurance subsidiaries** may undervalue them on an economic basis
- There was strong support for options that determine capital by re-using parts of the **IFRS (17) balance sheet**, with necessary adaptation for solvency purposes.
- **Fair value adjustments** were seen by some as unnecessary and burdensome, given that many IFRS treatments are based on fair value.
- There was strong support for maintaining the visibility of **insurance receivables** and the application of capital charges to them.
- **Tax effects** were not expected to be major, according to some respondents, relating mainly to revaluation of deferred tax items as a function of policy liabilities.
- The idea of a **ladder of intervention** received solid support, with a 1-in-200 criterion proposed for the calibration of the top rung. There was less clarity regarding the calibration of the bottom rung.
- Some respondents did not want supervisory powers to be triggered automatically, but at the discretion of the RBNZ.
- Introduction of an **ICAAP or ORSA** was generally supported, although some respondents cautioned against an overly complex approach, especially in relation to smaller insurers.
- There was good support for the idea of introducing well-founded **supervisory adjustments** to solvency requirements.
- Many respondents would welcome the introduction of a **diversification benefit**, but some would want this to be determined using a simple risk hierarchy.
- Respondents generally agreed that **operational risk** requires more attention but some thought that it would be difficult to calibrate a corresponding capital charge.
- Removal of the "Policy and Other Liabilities" element of the **Life Insurance Risk Capital Charge** received broad support.
- Many respondents supported **policy groupings** that were similar to the existing classes or Related Product Groups, however some proposed less granular groupings such as statutory funds.

Background

In November 2020, the Reserve Bank opened a solvency standard review consultation _ "Structure and IFRS 17" ("Structures Consultation") _ which closed on 18 February 2021. The consultation document discussed a number of areas relating to the structure of the solvency standards, including:

- The principles and purpose(s) of the solvency standard
- Application of the solvency standards to sectors and funds
- Potential solutions to accommodate IFRS 17
- How a ladder of intervention / buffering framework might look in New Zealand.
- Introducing diversification benefits and a more comprehensive coverage of risk
- Specific components of solvency calculation requiring urgent attention

In total, 23 submissions were received from insurers, consultancies, industry and professional bodies, as well as three individual respondents (all actuaries). This paper summarises the submissions received and provides initial RBNZ responses.

This statement will discuss each of the consultation document's sections in turn.

Principles & purpose

The first section of the consultation document discussed three topics:

- The utility of an explicit purpose statement in the solvency standards;
- The concept of a total balance sheet, to recognise second order effects and the interaction between assets and liabilities; and
- Whether "sectorally important" insurers should be treated differently from non-sectorally important insurers.

Purpose statement

There was general support for the addition of a purpose statement, so that key stakeholders are able to understand what drives minimum capital requirements. However, most respondents felt that the utility of the purpose statement could be improved if "adversity" was more clearly defined.

In this context, solvency standards could include the likelihood of the fulfilment of obligations by an insurer. There was general agreement among respondents that this should be in line with international jurisdictions (i.e. a 1-in-200 year event) - this is seen as a level of capital required to facilitate business as usual. Some respondents recognised a need to address separately concentrated catastrophe risk (particularly geologic risk), suggesting that some mix of a risk appetite and a reinsurance prescription may be the way to proceed.

Further to this, respondents were asked whether solvency risks should be assumed to crystallise immediately, in the short-term (say one year) or over the long-term. The general sentiment was that crystallising solvency risks in the short-term would be appropriate. However, the types of risk that different insurers are exposed to should also be considered – including (somewhat paradoxically) long-term risks.

RBNZ response:

- We note the need for more clarity about what “adversity” means and will seek to address this in the interim solvency standards.
- We will review the catastrophe charge for geologic risk during stage 2 of the Solvency Standards Review (2022 – 2023)
- We plan to use a short-term horizon for solvency calculations, while considering long-term risks through other mechanisms.

Total balance sheet approach

The paper also asked respondents to express their views on a total balance sheet approach. Under such an approach solvency stresses are applied to all items on the insurer’s balance sheet so that interactions between assets and liabilities can be taken into account.

Most respondents agreed that the approach has a good theoretical basis. There was, however, general agreement that the approach would be complex to implement and may result in reduced consistency across the insurance industry.

RBNZ response:

- We acknowledge the view that implementing a total balance sheet approach could add complexity to solvency standards and reduce consistency.
- We plan to implement the total balance sheet approach using an appropriate mix of pragmatism, prescription and judgement.

Major insurers

The consultation paper highlighted the possibility of recognising “systemically or sectorally important” insurers. This is due to the events surrounding the Global Financial Crisis, where the failure of several large insurers led to stress throughout the financial system due to their interconnectedness.

While we acknowleged that a failure of an insurer in New Zealand was unlikely to cause catastrophic damage to the financial system as a whole, we also recognised that the failure of certain insurers could damage the sector’s ability to fulfil its role in the broader economy.

Accordingly, the paper asked respondents if they thought there were “sectorally important” insurers in New Zealand. If so, what would be the advantages and disadvantages of imposing higher capital requirements on them?

Respondents expressed the view that there would be no additional benefit in recognising “systemically important” insurers. This is because the New Zealand market is very small by global standards and New Zealand insurance companies are not as interconnected as foreign insurance companies are.

RBNZ response:

- We agree that applying additional capital requirements to "sectorally important" insurers is unlikely to provide material benefits in the New Zealand context.
- We remain concerned about the possible impact of the failure of a major insurer upon our efficiency mandate, in particular the availability of insurance and the competitiveness of the market.

Application of the Standard

Industry Sectors

The consultation paper asked respondents to comment on how effectively existing solvency standards address various sectors and sub-sectors of the industry. It also asked how the standards should apply to each subdivision. Further to this, we asked if health insurers should have their own specific solvency standard.

Overall, respondents were satisfied with how existing solvency standards address particular sectors. However, some respondents noted that health and life insurance differ quite a lot from other types of insurance, so increasing this differentiation should be reflected in solvency standards going forward.

There was no consensus on whether health insurance should have its own solvency standard or approach. For those that felt health insurance should not have its own standard, the major reason given was that the non-life solvency standard already requires insurers to account for long-term risk, and additional complexity should be avoided.

For those that felt health insurance should have its own standard, the major reason given was that health insurance may fall under life or non-life categories, which can lead to unintended consequences and inconsistencies.

The paper presented readers with some options on how the solvency standards should apply to industry sectors. These options are shown below.

Option	Description
1	Sector-differentiated status quo – separate Life and Non-Life Standards
2	Single solvency framework covering all sectors and subsectors
3	Rationalisation – folding the variable annuity standard into the life standard, and the three non-life standards into a single document

Most respondents expressed strong support for option 3, and there was some support for option 1, but very little support for option 2. The general sentiment was that life insurers and non-life insurers are large sectors in their own right and have different risk profiles. Therefore, a single solvency standard that covers all sectors and subsectors would add to complexity – which was the reason that there was little support for option 2.

RBNZ response:

- We note the issues raised by respondents about implementing a single solvency framework, as well as the support for rationalisation.
- We are committed to maintaining an efficient documentary framework while recognising the idiosyncrasies of differing lines of business.

Statutory and other funds

We asked respondents to comment on how effectively solvency standards address statutory and other life funds.

Most life insurers only have one statutory fund, and so respondents questioned whether they actually provide additional security for policyholders. More clarification is also wanted on the purposes of statutory funds, and on how solvency standards are applied to business outside statutory funds. Lastly, some respondents stated that non-life insurers should continue to be exempted from having a statutory fund (see footnote 10 of the consultation document).

Most respondents did not have a view on whether solvency standards should incorporate IPSA's effective floor on statutory fund assets. Some respondents wanted more clarity on what writing the floor into standards would achieve.

The paper presented respondents with some options on how the solvency standards should apply to statutory and other funds. These options are shown below.

Option	Description
1	Status quo - life insurers have solvency requirements for statutory funds and the insurer as a whole; non-life insurers have requirements only at the insurer level.
2	All business allocated to "insurance funds". Solvency requirements are only applied at the insurer level, although these requirements will be a function of fund solvency.

Respondents expressed strong support for option 1. Respondents were largely against option 2 as they felt there was a lack of clarity surrounding how the "insurance funds" would be allocated and how solvency tests would be applied.

RBNZ response:

- We recognise the need to understand the purposes of statutory funds and will consider these as part of an upcoming IPSA Review paper. We note that IPSA does not currently require non-life insurers to maintain statutory funds.
- We believe that a reference in the solvency standards to the IPSA floor on assets may be useful in ensuring that this floor is maintained and that the relevant provisions of IPSA operate properly.
- We agree that standards should be applied to insurers and statutory funds only, without recognising other fund structures.

Consolidation

The consultation paper asked whether respondents viewed the current treatment of insurance and non-insurance subsidiaries in the solvency standards as appropriate.

Respondents had mixed views on this. For those that felt solvency standards are appropriate in their treatment of insurance and non-insurance subsidiaries, the main reason given was that the standards provide a consistent way of comparing groups of insurers (whether that be across insurance companies, or groups within an insurance company). A common theme was that individual entities should be able to stand on their own.

For those that felt solvency standards are not appropriate in treating insurance and non-insurance subsidiaries, the main reason given was that current standards do not reflect subsidiaries' economic contribution/risk and their impact on the overall solvency position of the insurer.

The paper then followed up and asked respondents what they thought would be a better treatment of insurance and non-insurance subsidiaries (given that they felt that current solvency standards are not appropriate in treating insurance and non-insurance subsidiaries). Respondents suggested using a 'look through' approach, where the assets and liabilities of the subsidiary would be stressed and added to the solvency balance sheet of the insurer (using appropriate valuation techniques).

RBNZ response

- We note respondents' concerns about current solvency standards not reflecting subsidiaries' economic contribution and risk to the overall solvency position of the insurer.
- We will investigate potential alternative treatments

IFRS 17

The next section of the consultation paper discussed a number of potential responses to the new IFRS 17 accounting standard, centred on the idea of standardising the balance sheet to economic value, as indicated by ICP 14.

The discussion was divided into sections covering technical provisions, non-technical insurance items, and other non-insurance items. Accordingly, we will structure the discussion in this paper in a similar manner to the consultation paper.

Technical Provisions

The paper presented a number of high-level proposals to deal with technical provisions, as shown below.

Option	Description
1	Continue requiring IFRS 4 for solvency purposes, even after transition to IFRS 17.
2	Use IFRS 17 accounts without any modifications for solvency purposes.
3a	Allow choice of IFRS 17 valuation method, but prescribe assumptions and parameters.
3b	Prescribe an IFRS 17 valuation method, as well as assumptions and parameters.
3c	Prescribe a non-IFRS 17 valuation method (for technical provisions only).
4	Ignore IFRS 17 balance sheet entirely, and specify a method to calculate all items.[1]

We expressed our initial preference in the consultation paper for option 3b or 3c, as we were of the view that these options would achieve an optimal balance between efficiency and economic reality.

Respondents expressed a range of views. Most respondents agreed that option 1 would not be feasible due to the additional burden of calculating two sets of accounts. Objections to option 2 centred on the significant amounts of judgement allowed in the IFRS (17) balance sheet. A majority expressed a preference for some form of option 3 and did not support option 4 due to the undue burden this would impose on the industry.

There was also a mix of views within option 3. There was general support for the RBNZ's preference for options 3b or 3c to achieve consistency and economic reality. Some general insurers expressed support for option 3a, noting that this option leverages off an internationally recognised standard while at the same time facilitating consistency by allowing the RBNZ to set parameters. It was also noted that there is likely to be little variability in the valuation of general insurance products across the industry.

Reasons given against option 3a included the possibility of similar products being treated differently due to the judgements involved. Some also mentioned the possibility of selecting separate options for the different industry sectors, e.g. 3c for life, 3a for non-life.

A general sentiment amongst respondents related to the need for clarity, sooner rather than later. Respondents were concerned that the method proposed by the RBNZ would require significant reworking and add further implementation costs to their IFRS 17 projects.

RBNZ response:

- We note respondents' concerns for early clarity and the burden of reworking systems and processes to satisfy regulatory requirements.
- In alignment with IPSA's principles and the solvency review principles, we will endeavour to minimise the regulatory burden on industry and continue to consult extensively with industry to achieve an optimal outcome.
- We will continue to be guided by ICP 14's requirements to read available capital from an economic balance sheet.

[1] This option relates not only to technical provisions but to the balance sheet as a whole.

Non-insurance items

The consultation paper did not propose any explicit solutions with regard to non-technical items. Instead, we asked what the treatment of non-insurance items would be, and if an adjustment to bring all items on the balance sheet to fair value would be appropriate.

The responses indicated that non-technical items on the balance sheet are currently measured using the applicable accounting standard. For example, investments and other financial assets are measured using IFRS 9, while leases are measured using IFRS 16. This results in some items on the balance sheet being measured using fair value through profit and loss, and others using other approaches such as amortised cost. This treatment is expected to continue even after transition to IFRS 17, as all other IFRSs will continue to apply.

There were mixed views around whether or not a fair value adjustment would be appropriate. A small number of respondents were of the view that a fair value adjustment would be appropriate for solvency purposes.

The majority of respondents, however, were of the view that while the concept had some merit (as it would provide a consistent basis of measurement across insurers and items on the balance sheet), calculating the fair value of some items would require significant effort. They cautioned that the benefits of implementing a fair value adjustment should be very carefully weighed against the costs. In addition, for some assets other measurement methods may be more suitable than fair value. It was suggested instead that the applicable accounting standards continue to be used for non-technical items.

RBNZ response:

- We note industry's concerns about the potential regulatory burden imposed by a fair value adjustment.
- Were such an adjustment to be applied, we would seek to limit it to those items where the adjustment is material.

Insurance receivables

The paper also canvassed respondents' views on the importance of having visibility of insurance receivables from a solvency perspective. In general, respondents felt that it was important to retain visibility of insurance receivables, in particular reinsurance recovery receivables and third party (e.g. broker) premium receivables.

Credit risk relating to premium receivable directly from the policyholder was deemed low, as the insurer has the ability to cancel automatically the policyholder's cover after a certain period of non-payment.

Conversely, credit risk attaching to premiums receivable from a third party (e.g. a broker) was deemed significant. The insurer recognises the premium as soon as it has been paid by the policyholder to the broker, creating a premium receivable asset. However, if the broker fails to pass the premium to the insurer, the insurer does not have the ability to cancel automatically the policy or decline claims due to the reputational risks that would arise.

There were mixed views regarding reinsurance recovery receivables. The majority of respondents felt that the credit risk associated with reinsurance recovery receivables is significant, as if the reinsurer fails to pay the recoveries, the insurer will have to pay claims out of its own resources. A few respondents felt that the strong credit rating of reinsurer counterparties meant that the associated credit risk was less significant.

Other comments included

- caution against double counting of the impairment provision;
- that insurers are likely to maintain current systems and functionality to monitor payables;
- that there are potential differences in credit risk between payables from regulated and unregulated entities (e.g. reinsurers vs brokers), which should be reflected in different risk charges.

RBNZ response:

- We note the differences in credit risk between the different types of insurance receivables
- We also note that IFRS 17 incorporates credit-related impairment, and hence there is a risk of double counting.
- It is likely that we will continue to require visibility for all insurance receivables, regardless of the level of credit risk.

Tax

In an attempt to understand tax impacts of IFRS 17, the consultation paper also requested respondents' views on potential tax impacts, and any flow on effects on other balance sheet elements.

Respondents expressed lack of clarity around tax impacts, but were of the view that tax impacts would primarily be related to deferred tax items on policy liabilities. However, the view was that any change in deferred tax would be consistent with the change in policy liabilities. Respondents did not expect any significant changes in tax legislation (except for those necessary to maintain the status quo).

Ladder of intervention

This section of the consultation paper discussed the implementation of a ladder of intervention framework in New Zealand. The paper asked if respondents felt if a ladder of intervention framework would be beneficial in New Zealand, as well as what such a framework could potentially look like. In particular, we asked

- what situations the top and bottom rungs of the ladder should represent;
- which quantitative measures should define the rungs of the ladder;
- how to assess an insurer's solvency position; and
- whether an ICAAP or ORSA should complement a ladder of intervention framework.

The framework

We put forward a number of measures to define the solvency control levels, as well as measures by which to assess the insurer's solvency positions against the control levels. Options for defining the solvency control levels included Value at Risk ("VaR") and scenario-based measures. Measures of insurer solvency positions included solvency ratio, stressed assets/stressed liabilities and probability of failure.

There were mixed responses to whether or not the framework is appropriate in New Zealand. Some respondents felt that a ladder of intervention framework would be beneficial due to the greater clarity and flexibility relative to the existing binary framework. Another benefit of ladders of intervention cited by respondents included early intervention and thus better outcomes for policyholders. Others felt that a ladder of intervention framework would be overly complex, and coming up with a meaningful and objective set of triggers for supervisory action would be difficult.

Calibration of the rungs

There was general agreement amongst respondents that the top rung of the ladder should be pegged at the 1-in-200 probability of failure, in order to align with international jurisdictions. If the level at which supervisory intervention was increased above the 1-in-200 then insurers would by default hold that level of capital, effectively resulting in increased capital requirements.

Other suggestions for the level of the top rung included the RBNZ's minimum desired level of capital or 100-105% of the current requirement. Many respondents also noted the importance of assessing insurers' positions on a case-by-case basis.

There was a wider range of responses as to the level at which the lower rung of the ladder should be set. There was agreement that determination of the level at which an insurer's operations is no longer viable is difficult and subjective. It needs to be assessed against some working definition of 'viability'; for example, is an insurer unviable when it has no realistic prospect of raising capital or of returning to the top rung? This also needs to be determined on a case-by-case basis including consideration of whether stresses are industry-wide or insurer-specific.

Measures of strength

There were also varying, and at times contrasting, views to what the appropriate measures would be to define solvency control levels and assess the insurer's solvency position.

Some respondents were of the view that probability-based measures are complex to understand and implement, while the solvency ratio is simple and easy to understand, and hence appropriate for use in a New Zealand context. Others felt that the solvency ratio in its current form would not be appropriate, as it may be distorted by the Deferred Acquisition Cost asset ("DAC") implicit in the negative policy liabilities of many life insurers.

The solvency ratio may also not be proportionate for every insurer. For example, a solvency ratio of 105% may mean different probabilities of failure from one insurer to the next. Those who did not support the solvency ratio preferred instead a probability-based measure such as the VaR, acknowledging that despite being more complex to implement, it is a more robust method of communicating financial strength.

Capital management

Respondents had mixed views regarding the introduction of an ICAAP/ORSA-type framework to complement a ladder of intervention.

Reasons cited in support of an ICAAP included better visibility and management of capital and risks by the company's Board and management. Reasons cited against an ICAAP included the additional complexity and compliance burden on insurers. Other noteworthy points raised included:

- ICAAP is preferable to ORSA as many insurers are able to leverage off the ICAAP framework of their Australian parents, though there is some overlap between ICAAP and ORSA; and
- A fully-fledged ICAAP framework may be overly burdensome for small insurers. Respondents suggested a simplified framework could be introduced for small insurers.

Miscellaneous comments

- There was a question as to whether more powers are needed under IPSA, or simply a clearer indication of which powers will be available and when;
- Depending on the measure used, different ladders may be needed for different industry sectors (life, general, health);
- It is important to take into account qualitative factors as well as quantitative (solvency) factors. It is not simply about solvency triggers but also about changes in risks;
- We should be cautious around the term "probability of failure" as it could be misinterpreted by policyholders; and
- The RBNZ's powers should be flexible rather than be mandated responses.

RBNZ response:

- We agree that the top rung of the ladder should be fixed according to the 1 in 200 criterion, noting however the need for full coverage of material risks and for a heightened criterion for seismic risk.
- We will consider how to calibrate a bottom rung that both represents a reasonable lower bound for 'viability', and is pragmatic to operate.
- For simplicity, the top and bottom rungs are likely to be the only solvency control levels. These will be the levels at which, post-IPSA Review, powers become available to the RBNZ.
- The RBNZ will retain some discretion – an insurer passing through a solvency control level will not trigger the mandatory use of powers.
- Insurers need to own their own capital management processes, so we are likely to introduce some requirements in this area.

Solvency calculation

This section of the consultation paper covered a number of matters relating to solvency calculations, including whether to use deductions or charges, supervisory adjustments, hierarchy of risks, restructuring of the life insurance risk charge, and grouping of policies.

Deductions vs charges

In this section of the consultation paper, we asked whether the current method of fully deducting "inadmissible assets", i.e. those assets that are deemed to have no value in a wind-up, is appropriate.

We related this treatment to the rungs of the ladder, and asked whether at the top rung of the ladder, a less conservative approach was warranted. If a more nuanced approach was to be adopted, we asked if dealing with inadmissible assets using a risk charge would be more appropriate than deductions.

There were mixed responses. Some respondents did not view the current treatment of deductions and charges as problematic. Others were of the view that if a going concern valuation was to be assumed, then the current treatment (full deduction of certain intangible assets) is too conservative. Some respondents noted the distinction between truly intangible assets that will not be available to pay claims to policyholders, and others that may have value in a going concern scenario.

There were, however, some reservations about allowing for these effects through the resilience risk charge, given the purpose and complexity of the resilience risk charge. In addition, increasing the resilience risk charge may lead insurers to reassess the buffers they hold above the regulatory requirement.

In place of an increase in the resilience risk capital charge, some respondents suggested instead a partial deduction from capital. This will not impact the solvency margin, but will impact the solvency ratio and avoid a "buffers on buffers" situation.

Other comments included:

- Moving a deduction to the resilience risk charge will have an impact on the solvency ratio rather than the solvency margin; and
- Currently there are a small number of deductions from the IFRS balance sheet, however new accounting standards may require more adjustments to ensure capital is comparable across insurers.

RBNZ response:

- We note the impact of changes to deductions and resilience risk charges on the solvency ratio.
- The RBNZ will seek to apply deductions and other adjustments to the IFRS balance sheet in line with the ICP 14 principle that capital should be read off an economic balance sheet.
- Resilience capital charges will reflect adverse circumstances as mandated by ICP 17.

Supervisory adjustments

We then asked if it would be appropriate for the Reserve Bank to have the power to adjust insurers' solvency calculations in some circumstances, by way of a supervisory adjustment similar to the LAGIC framework. The supervisory adjustment would form part of the solvency requirement and would be reflected in the solvency ratio.

Most respondents were in support of supervisory adjustments, stating that it would give the regulator more flexibility to deal with emerging issues. A few respondents expressed some reservations. For example, if there was a difference in opinion between the regulator and the regulated entity, whose opinion would prevail?

Regarding the form that supervisory adjustments could take, some respondents noted that the methods listed are sufficient in most cases. Others added some different forms, including adjustments to the methodology or specific solvency calculation parameters, or limiting the volumes of new business that can be written. Some noted though there may be other forms, it is important to have flexibility and not limit the form that supervisory adjustments could take.

Other comments relating to supervisory adjustments included:

- The importance of transparency and clear communication, including clarity on the role of supervisory adjustments, and on when and how they would apply (e.g. trigger points). A robust and defensible framework is needed.
- Caution against disclosing the supervisory adjustments, in case doing so would exacerbate a fragile situation. Respondents agreed that the supervisory adjustment should form part of the solvency requirement, but the amount of supervisory adjustment should not be disclosed.
- Supervisory adjustments should be the exception and not the form. Some things should be dealt with in the solvency standards, e.g. if a risk charge is not covered in the solvency standard then the solvency standard should be updated to reflect this rather than imposing a supervisory adjustment.
- There should be a mechanism to challenge the supervisory adjustment

RBNZ response:

- We note the general support for the introduction of supervisory adjustments.
- We note comments that the framework should be transparent and clear, but also cognisant of the potentially harmful effects of disclosure.
- Supervisory adjustments will require changes to IPSA, so we will not be able to implement them at this stage.

Risk hierarchy and diversification

The consultation paper asked whether insurers should derive a capital benefit for having diverse sources of risk, and solicited thoughts on developing a more formal hierarchy of risks to support such a benefit.

Some respondents stated that a full range of risks should be covered by the solvency framework, while others envisaged only major risks being addressed. The general view was that a Solvency II-style risk hierarchy might be too complex and costly to implement given the scale and nature of the New Zealand insurance market, although there was some support for simplified hierarchies such as that used in LAGIC.

It was generally held that there should be an allowance for operational risk somewhere in the framework (and some respondents believed it was already implicit in certain capital charges). Some respondents, however, expressed doubt that an operational risk charge could be appropriately calibrated to an individual insurer's profile, and for that reason suggested it should be considered instead as part of general risk management, the insurer's ICAAP process or the Appointed Actuary's review of financial condition.

There was general support for introduction of some form of diversification benefit. As ever, this was tempered by a desire to avoid complexity and cost.

RBNZ response:

- We note the general support for the introduction of a diversification benefit supported by a simplified hierarchy of risks, and for the framework to address operational risk in some way.
- Whilst we understand the concerns about calibrating operational risk charges, we believe that a standardised approach will be fairest to all insurers

Life insurance risk charge

This section of the consultation paper discussed the nature of the life insurance risk charge. Currently the life insurance risk charge takes the form of a stressed liability, rather than a stress on the liability. This treatment is different to the other risk charges, including the non-life insurance risk charge. We asked the question if the life insurance risk charge should be restructured to reflect a true capital charge, i.e. moving the policy and other liability deduction inside the insurance risk charge.

Respondents were generally supportive of restructuring the insurance risk charge. Reasons in support of restructuring the insurance risk charge included closer alignment with international jurisdictions, that it would be more intuitive as the insurance risk charge would be a true capital charge, and that most insurers are already doing this for internal reporting purposes.

Other comments relating to restructuring the life insurance risk charge included:

- The change may lead to significant changes in the solvency ratio
- In some cases the insurance risk charge may end up being negative
- Deducting policy liabilities from the insurance risk charge distorts the comparability and meaningfulness of the solvency ratio. On the other hand, other respondents were of the view that this would increase comparability and be fairer for insurers with different levels of acquisition costs.

RBNZ response:

- We note the general support for moving the deduction of policy and other liabilities within the Insurance Risk Capital Charge and, subject to consideration of unintended consequences, intend to proceed with this change.

Grouping of policies

At certain stages in the solvency calculation, policies need to be grouped. A number of grouping approaches were proposed, including IFRS 17-based grouping, insurer-level, SF-level, and regulatory groupings. We expressed our preference for regulatory grouping (though we did not specify what those regulatory groupings would look like).

There was a variety of responses with regard to the appropriate level of regulatory grouping. Most respondents were of the view that IFRS 17 portfolios and groups are not appropriate for capital purposes. One respondent, however, indicated a preference to use IFRS 17 groupings for capital purposes, noting that maintaining multiple groupings may increase compliance costs.

Some life insurers indicated a preference for grouping at SF-level, while others indicated a preference for regulatory groupings that are aligned with the current RPG definition. Another grouping level suggested by respondents that was not mentioned in the consultation paper was a separation of participating life from non-participating life business.

In general, general insurers indicated a preference for regulatory groupings that are aligned with the current definition of classes, noting that most insurers are likely to continue managing their business at a "class" level.

Other comments were provided as follows:

- Grouping should be aligned with the purpose/intention of solvency standard;
- We should distinguish between reporting and capital purposes;
- We should allow cross-subsidies;
- The CTV floor for life business is extreme and should only apply at insurer or SF- level;
- There is a trade-off between the benefits of diversification and holding adequate capital;
- There shouldn't be too many groups; and
- It is important to consult and communicate early on this matter.

RBNZ response:

- We are likely to continue with our plan for regulatory groupings based upon 'saleable portfolios';
- To the extent possible, we will take into account pragmatic solutions to minimise complexity and cost.

Have your say

Stakeholders are welcome to provide feedback and information to the Reserve Bank at any time. While no feedback is specifically sought on this summary paper, we would welcome your views at any point during the Review.

Please provide any further comments using the email address insurancesolvency@rbnz.govt.nz.

Further information about the Review can be found on our website: https://www.rbnz.govt.nz/regulation-and-supervision/insurers/consultations-and-policy-development-for-insurers/active-policy-development/review-of-the-insurance-solvency-standards