



Insurance Industry Update

December 2013

MESSAGE FROM TOBY FIENNES – HEAD OF PRUDENTIAL SUPERVISION

2013 has been a big and unprecedented year for the industry and for us at the Reserve Bank. As it draws to a close and we all look forward to a well-deserved summer break, here are some brief personal reflections on licensing.

The regulatory framework was new to everybody. The insurance industry responded wonderfully well to the licensing challenge, and got the bulk of the information to us in a timely way. This meant that we were able to license all 99 insurers several days before the ultimate deadline.

I was pleased to note that there was great engagement between supervisors and insurers, and a genuine willingness to deal with one another. This is a mindset I trust that both we and the industry will carry forward into business as usual (BAU). Not every insurer will see eye to eye with the Reserve Bank on every issue but we do expect that, with the benefit of the licensing process behind us, the first instinct of both sides will be to sit down and explore each other's point of view.

Of course, this only marks the end of the first chapter. As we turn our thoughts to BAU here are three reflections:

1. We will continue to be lightly resourced by international standards. The supervision team comprises a mere 10 people. As well as minimising the burden on taxpayers, we believe this approach is the right one for New Zealand, consistent with the philosophy of Board and management having primary responsibility for managing the business and its risks. It does, though put the onus on the supervisors to be truly risk-based and to develop smart monitoring tools.
2. We have identified a number of areas in the solvency standards that need to be clarified. Expect some consultation on this topic over 2014.
3. We need to develop a targeted engagement plan with all insurers. Given our philosophy and resource constraints, our interactions will tend to be at a high level (Board, CEO, Appointed Actuary etc).

But that is a 2014 story. Meanwhile, thank you again for working with us in making licensing a success, have a relaxed and merry Christmas and a Happy New Year.



GENERAL UPDATE

Our focus is currently on implementing business as usual processes and designing a supervisory framework. The supervisory framework is being considered in the context of what is appropriate to the New Zealand environment and in line with the Reserve Bank's risk-based philosophy of prudential supervision. As part of this, thought is being given to engagement, thematic reviews and other supervisory techniques.

One element of effective supervision is quantitative analysis and we will be working towards defining requirements in terms of what regular data and statistical returns will be required. It is likely that further detail on this will be provided some time in 2014.

In the meantime, the Reserve Bank will continue to actively monitor routine compliance requirements and liaise with insurers on areas that need improvement, such as timeliness of financial reporting and meeting disclosure requirements, to name a couple of areas.

Appointed Actuaries hold a key legislated role under the Insurance (Prudential Supervision) Act 2010 (IPSA) and should ensure they fully understand their obligations and that they have the capacity to fulfill these obligations. Section 127 of IPSA requires disclosure of information where the licensed insurer is failing to, or is likely to fail to, maintain a solvency margin. There have been examples where

interaction with the Reserve Bank by the Appointed Actuary has not been as proactive as expected.

SOLVENCY RETURNS

Late in November 2013 the [insurer solvency return](#) was updated on the Reserve Bank website. All insurers are required to complete this return, except New Zealand branches of overseas insurers that have a solvency exemption. Insurers are asked to switch from the earlier version to the latest version as soon as it is practical to do so, and no later than the first solvency return dated in 2014.

Each solvency return must be accompanied with signatures by two directors (or the New Zealand Chief Executive Officer in the case of an overseas insurer), the relevant financial statements, and any other supporting documents (e.g. at full year the financial condition report and auditor report on the solvency return). The Appointed Actuary must have either completed or reviewed the solvency return before it is submitted to the Reserve Bank.

Instructions on how to submit the solvency return are included in the solvency return spread sheet on our website and a [guide to completing the solvency return](#) has been issued. Feedback on the solvency return and the guide are welcomed, to facilitate future improvements.

AUDITOR REVIEW OF SOLVENCY RETURN

The solvency margin at balance date, required to be disclosed in financial statements and on an insurer's website, must match the solvency margin submitted to the Reserve Bank. Therefore, if an insurer has not completed the auditor's review of the solvency return at the time of finalising their full year financial statements, this can result in a need to restate financial statements and update solvency disclosures. The end-to-end process for solvency returns must be factored into full-year and half-year reporting processes.

POLICY INITIATIVES

The Reserve Bank continues to work with the insurance industry regarding insurers' measurement of solvency by improving the Reserve Bank's solvency standards in certain areas. An update of our work on the solvency standards is as follows:

Quality of capital held by insurers. A summary of submissions received on this consultation paper will be published on the Reserve Bank's website and the Reserve Bank intends to update the solvency standards for the necessary changes in due course.

Financial reinsurance. On 24 October 2013 the Reserve Bank issued a second consultation paper on the solvency treatment of financial reinsurance. Submissions received on this paper will be considered in development of the Reserve Bank's policy position in this area.

Guarantees. Following submissions to the Reserve Bank's earlier proposals, a further

industry consultation paper discussing the solvency treatment of guarantees will be published shortly on the Reserve Bank's website.

Off-balance sheet exposures. The intention is to clarify the existing requirement to include off-balance sheet exposures that represent contingent liabilities within solvency calculations. The Reserve Bank is performing further work in this area and will consult with the industry in due course.

Revised solvency standards. The intention is to publish revised solvency standards during Q1 2014, capturing as many of the above revisions as possible.

Other upcoming initiatives. The Reserve Bank plans to consult the industry in relation to the level at which related products are grouped at for life solvency calculation purposes and a review of the treatment of taxation within the solvency standards is also planned.

REGISTER OF LICENSED INSURERS

Under the Insurance (Prudential Supervision) Act 2010, the public register of licensed insurers that the Reserve Bank keeps must include the current financial strength rating of each licensed insurer (unless the insurer is not required to have such a rating).

In October 2013 the Reserve Bank published the [Financial strength rating](#) of licensed insurers that are required to have a current financial strength rating from an approved rating agency.

The ratings in the table on the website are as disclosed to the Reserve Bank. Reasonable efforts have been made to ensure that these are up-to-date but the Reserve Bank cannot guarantee that a rating will be the most up-to-date in all circumstances as we rely on the licensed insurer notifying us about changes in defined timeframes.

Further detail can be found on the Reserve Bank website.

STATUTORY FUND REPORTING

In our December 2012 update, we discussed various matters relating to statutory funds relevant to life insurers not subject to an exemption under section 119 of IPISA. Included in this was mention of a requirement for certain statements and reports to be provided to the Reserve Bank after a statutory fund has been in place for a full financial year. The requirement was expressed as:

Within five months and twenty days following the first balance date after any statutory fund is established, the insurer must provide:

1. *a statement from its board that outlines how the board ensures the company complies with section 87 of IPISA “Duty of life insurer in relation to statutory funds”; and*
2. *a report from its compliance or internal audit function, appointed actuary or an independent third party (such as an audit firm) that demonstrates that the*

insurer is complying or able to comply with IPISA Part 2, Subpart 3 “Statutory funds of life insurers” and the regulations.

The requirement has since been reviewed. The original timing for the requirement effectively assumed that statutory funds would all be set up on the first day of a financial year. In the event, many insurers established their statutory funds at other dates. In addition, part one of the original requirement referred to section 87 of IPISA. We intend to broaden this to include section 105 “Duty of directors in relation to statutory funds”, for completeness.

We intend to seek the required information by way of a notice under section 121 of IPISA that will set out what is required, and the date on which the reports are due. In general, if an insurer set up its statutory fund at the beginning of a financial year, then the original date as above will still apply. For other insurers, we propose to require the information at a date that is two years from the date of establishment of the fund. For relevant life insurers, we will be in contact in due course regarding this.

This newsletter is intended to provide an update on licensing and related matters. It is not policy or legal advice in itself and should not be interpreted in isolation.

If you are an insurer and have any questions, please call your assigned supervisor or send an email to insurance@rbnz.govt.nz.