Reserve Bank of New Zealand
Te Pūtea Matua

Second Amendment of the Interim Solvency Standard

Consultation Paper

27 September 2023

CONSULTATION PAPER

General Information

Information about the review is available on the Reserve Bank website at:

Review of the Insurance Solvency Standards - Reserve Bank of New Zealand - Te Pūtea Matua (rbnz.govt.nz)

Submission Contact Details

The Reserve Bank of New Zealand – Te Pūtea Matua invites submissions on this consultation paper by 5pm on 8 November 2023.

Please note the disclosure on the publication of submissions below.

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Publication of Submissions:

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Respondents who request that all or part of their submission be treated as confidential should provide reasons why this information should be withheld if a request is made for it under the Official Information Act 1982 (‘**OIA**’). These reasons should refer to section 105 of Banking (Prudential Supervision) Act 1989, section 54 of the Non-Bank Deposit Takers Act, section 135 of the Insurance (Prudential) Supervision Act 2010 (as applicable); or the grounds for withholding information under the OIA. If an OIA request for redacted information is made, we will make our own assessment of what must be released taking into account the respondent’s views.

We plan to publish an anonymised summary of the responses received in respect of this Consultation Paper.

Glossary

CEP	Credit, equity and property
DAC	Deferred Acquisition Cost
DTA	Deferred Tax Asset
GAAP	Generally Accepted Accounting Principles
GMM	The NZ IFRS 17 General Measurement Model
IAIS	International Association of Insurance Supervisors
ICP	Insurance Core Principles published by the IAIS
IPSA	Insurance (Prudential Supervision) Act 2010
IPSA Review	Review of the Insurance (Prudential Supervision) Act 2010
ISS	Interim Solvency Standard 2023
LRC	Liability for Remaining Coverage
LTIRCC	Long-term Insurance Risk Capital Charge
MCR	Minimum Capital Requirement
NZ IFRS	The New Zealand application of International Financial Reporting Standards, mandated by the External Reporting Board.
NZ IFRS 4	International Financial Reporting Standard 4 – Insurance Contracts
NZ IFRS 17	International Financial Reporting Standard 17 – Insurance Contracts
PAA	The NZ IFRS 17 Premium Allocation Approach
RBNZ	Reserve Bank of New Zealand
SLRC	Standardised liability for remaining coverage
Solvency II	The European Union's prudential framework for insurers
Stage 1	The first stage of the Review, relating to the ISS
Stage 2	The second stage of the Review, leading up to a final solvency standard
The Review	Review of the insurance solvency standards
UWRCC	Underwriting Risk Capital Charge

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1 Executive Summary

1.1 Background

1.1.1 New Zealand's insurance sector is regulated under the Insurance (Prudential Supervision) Act 2010 ("IPSA"). Prudential supervision of insurance entities focuses on the regulation and monitoring of insurers, with the purposes being to promote the maintenance of a sound and efficient insurance sector and to promote public confidence in the insurance sector.

1.1.2 Part of promoting the maintenance of a sound and efficient insurance sector involves imposing minimum amounts of capital that insurers must hold. These regulatory capital requirements serve the purpose of increasing the likelihood that insurers will be able to pay claims and meet obligations to policyholders.

1.1.3 The Reserve Bank's capital requirements for insurers are specified in solvency standards, which prescribe how regulatory capital is to be calculated. The current key standard is the Interim Solvency Standard, supported by a Guide to help users interpret the standard. Solvency standards are issued under section 55 of IPSA.

1.2 The Review

1.2.1 In October 2020, we announced the start of the Solvency Standards Review ("the Review") alongside the IPSA Review. The first stage of the Review, which addressed structural changes and other issues that required immediate attention (including NZ IFRS 17), resulted in the introduction of the Interim Solvency Standard 2023 (ISS). The ISS has been in force since 1 January 2023.

1.2.2 On 6 June 2023, we released the Interim Solvency Standard Amendment Standard 2023 which addressed some minor or technical issues identified in the ISS. The amendments came into effect on 1 August 2023.

1.2.3 This consultation paper discusses how we might address errors and ambiguity of a non-minor nature in the ISS, which would be covered in a further amendment of the ISS. Depending on the outcomes of the consultation, we plan to release an amendment standard near the end of February 2024, to be effective from 1 June 2024.

1.2.4 The second stage of the Review, which will address the determination of individual components of the solvency requirements and will result in the final Solvency Standard, will be deferred for a short period of time to allow work on the amended standard to conclude.

1.3 Scope

1.3.1 Since the ISS was published in October 2022, some stakeholders have raised concerns about a small number of errors and some ambiguity in the interpretation of some parts of the ISS. On 6 June 2023, we released a technical amendment which corrected some minor or technical errors, however, more significant errors weren't addressed at the time, as the correction of these errors would have required consultation with stakeholders[1].

1 IPSA s235 allows for minor technical amendments to be made to the Solvency Standard without the requirement for a full consultation with stakeholders.

1.3.2 This consultation document is intended to lead to a second amendment of the ISS. It addresses known issues with the ISS and proposes changes in keeping with the original principles and intentions of the Review. Issues that have already been addressed are out of scope.

1.4 Feedback sought

1.4.1 For this consultation paper, we are seeking feedback aimed at correcting errors and improving the operation of the ISS within the scope of the Stage 1 changes (i.e. the transition to NZ IFRS 17 and the structural changes in the regime put in place through the ISS). We are also seeking feedback on the wording of the amendment standard and on the associated guide.

1.4.2 This consultation will not consider Stage 2 issues, including new methodologies and parameterisation.

1.5 Proposed changes that affect the solvency ratio

1.5.1 In this second amendment, we propose a number of improvements to the ISS that impact on the determination of the solvency ratio. These include:

- Re-basing the UWRCC so that it appropriately reflects the pricing risks that insurers are subject to.
- Reinstating credit risk capital charges on interest-sensitive assets.
- Stating explicitly that reinsurance cash-flows related to future primary contracts should be excluded from the definition of "insurance items", allowing the value of such reinsurance to flow through to solvency capital at its IFRS valuation.
- Clarifying that insurance contract clauses allowing early termination by the insurer should not establish a contract boundary.
- Clarifying how tax, acquisition expenses and risk adjustments are to be handled in the "modified PAA" valuation method of paragraph 30.
- Partially addressing the potential double-counting of discretions.
- Clarifying the valuation of intangibles and of reinsurance assets in dispute.
- Using expense loadings to trigger the run-off period rather than actual expenses.

1.6 Other proposed changes

1.6.1 We do not expect the following proposed changes to have a material impact on the solvency ratio:

- Transferring all guidance into a separate document.
- Exemption from the requirement to publish annual solvency return figures on insurer websites (while maintaining the requirement to publish interim solvency return figures).

- Clarifying that run-off can be triggered by a licence condition, including a condition which imposes significant restriction of new business.
- Improving clarity by introducing IPSA-related definitions for life, health and general insurance.
- Clarifying the definition of taxation expense.
- Removing the clause relating to the apportionment of repayable amounts.
- Various other minor typographical changes such as italicisation of defined terms and correction of paragraph references.

1.7 Other issues raised by stakeholders

1.7.1 In section 3 we also discuss some other issues raised by stakeholders which we do not intend to address in the second amendment of the ISS. In some of these cases, we have responded by adding to the Guide that accompanies the ISS.

2 Proposed Changes That Affect the Solvency Ratio

Solvency Capital

2.1 Deferred reinsurance expense

2.1.1 Reinsurance arrangements for non-life business tend to cover business already on the books as well as business likely to be written in the year of cover. Under NZ IFRS 17, payment of a reinsurance premium generates a reinsurance asset in the primary insurer's accounts, as it creates the expectation of future claim payments to the primary insurer.

2.1.2 One interpretation of the ISS, however, is that any such reinsurance asset is classified as an "insurance item". The standard removes NZ IFRS insurance items and replaces them with standardised insurance items. Under Paragraph 28(ii)(c) "outwards reinsurance cash-flows relating to primary insurance not yet contracted" are specifically excluded in the determination of outwards insurance items.

2.1.3 Such an interpretation undervalues solvency capital (as there will be benefits received by the insurer in respect of the future contracts, and these have already been paid for). It also generates volatility in solvency capital, as the undervaluation will gradually diminish as the future contracts are written and claims eventuate but will also increase with every reinsurance payment.

2.1.4 This interpretation was not, however, what we intended when we drafted the ISS. We wanted to keep reinsurance of future primary contracts out of the perimeter of insurance items, as the value of insurance items is used to generate capital charges. We did not, however, intend for reinsurance premiums paid against future primary contracts to generate no contribution to the primary insurer's solvency capital.

2.1.5 We propose to add a phrase to the end of paragraph 22(i) to make our intention explicit and specifically exclude from the definition of "insurance items" any cash-flows related to reinsurance of future primary contracts. This will allow the value of such reinsurance to flow through to solvency capital at its IFRS valuation, as a non-insurance item.

2.2 Contract boundaries for long-term insurance

2.2.1 In Sub-paragraph 28(v), the ISS states that a contract boundary "must not extend beyond the point at which the licensed insurer has the unilateral right to terminate, re-price or re-underwrite an individual insurance contract". This is based on wording from ICP 14, and in particular paragraph 14.8.3. Paragraph 14.8.5 of this ICP makes it clear that the intention of this wording was to provide for a contract boundary at the end of the policy anniversary for typical forms of non-life insurance, while requiring a later boundary for (long-term) life and health insurances.

2.2.2 Some insurance contracts written in the New Zealand market allow for early cancellation at the discretion of the insurer. We understand that some insurers are interpreting such clauses as establishing a contract boundary under sub-paragraph 28(v). However, our intention was to allow for the contractual benefit or coverage term to establish the boundary of the contract.

2.2.3 A further issue with the wording of the second sentence of sub-paragraph 28(v) is that claims incurred before the date the insurer has the right to terminate, re-price or re-underwrite may be excluded if they are paid after that date. Such cash-flows are intrinsic to the insurance contract and should be hypothesised.

2.2.4 We propose removal of the second sentence of sub-paragraph 28(v). This would allow contract boundaries to fall at the end of the term over which benefits may be paid in normal circumstances. Note that this would set a contract boundary for most major non-life insurance classes of a little over one year (the coverage period plus whatever time is required to pay claims incurred during the coverage period), while for most life insurance classes the boundary would be a little beyond the maturity or expiry of the contract (allowing for any prolongation by guaranteed renewability).

2.3 Modified PAA valuation – tax adjustments

2.3.1 A stakeholder has noted that adjustments made to generate the standardised insurance items under a GMM calculation are offset by accompanying tax adjustments. Therefore, to maintain consistency, it would be appropriate to include analogous tax adjustments in the modified PAA method. We agree.

2.3.2 We propose changing the wording of paragraph 30 to "The NZ IFRS 17 Premium Allocation Approach may optionally be used to standardise liabilities for remaining coverage (and related tax items) under short-term insurance contracts, by applying the following modifications:"

2.4 Modified PAA valuation – netting of acquisition expense

2.4.1 Stakeholders have raised concerns about what is required in terms of DAC assets under the modified Premium Allocation Approach (paragraph 30).

2.4.2 The purpose of paragraph 30(ii) is to ensure that the SLRC is net of acquisition cash-flows under sub-paragraphs 55(a)(ii) and 55(b)(ii) of NZ IFRS 17. This implies the creation of a DAC asset that is *implicit* in the liability for remaining coverage rather than explicit elsewhere on the balance sheet. This implicit asset is gradually reduced (by increasing the SLRC) on subsequent recognition as acquisition expenses are recognised over time.

2.4.3 Three potential issues have been raised with this approach to acquisition expenses:

- Insurers may not be able to determine liabilities net of acquisition expenses as they may not have retained historic information about the expenses paid;
- The DACs in respect of this business sit elsewhere on the balance sheet and so cannot form part of the LRC or SLRC; and
- Acquisition expense deductions may be so high that the SLRC may be small or negative, resulting in a negative UWRCC.

2.4.4 On the first point, these are generally expenses from within the last year or so. We believe insurers should have systems capable of tracking such amounts, particularly considering that they have been able to meet the requirements of NZ IFRS 4 liability adequacy tests.

2.4.5 On the second point, NZ IFRS 17.28C requires derecognition of explicit DACs where acquisition expenses are included in the liability measurement under NZ IFRS 17.55(a)(ii).

2.4.6 With respect to the third point, we have no problem with a small or negative PAA liability contributing to solvency capital, as in this case solvency capital will already have been reduced by large acquisition expense outflows. However, we do need to ensure that the base for determining the UWRCC is appropriate to the pricing risk.

2.4.7 We propose to reduce confusion by removing reference to DAC assets and changing paragraph 30(ii) to simply read that "IFRS17.59(a) must not be applied".

2.4.8 We will also indicate in the Guide that the purpose of the modified PAA approach is to approximate the standardised liability under paragraph 28 and the economic value of the unexpired risk.

2.5 Modified PAA valuation – granularity for risk adjustments

2.5.1 As set out in Paragraph 28, standardised insurance items must ordinarily be determined using a modified version of the GMM. Paragraph 28(iv) asks that any adjustments for non-financial risk be included in standardised insurance items and sets out their required calibration. The sub-paragraph also asks that calibrations be performed at a level no higher than the product class.

2.5.2 While this wording is appropriate for long-term business, we acknowledge that this might not be appropriate for short-term business. Here, it may be appropriate to perform calibrations at a higher level, given that insurers with short-term business are more likely to run off, rather than sell, their portfolios in resolution.

2.5.3 Paragraph 30 sets out an alternative method for valuing short-term insurance contracts (the modified PAA method).

2.5.4 We propose to modify sub-paragraph 30(iii) by removing the reference to performing calculations at the product class level and include wording to reflect that the profit margin may be determined across all business valued under this paragraph.

2.6 Intangibles and solvency ratios

2.6.1 A number of stakeholders have raised concerns about the solvency ratio outcomes under the ISS. Solvency ratios have generally reduced compared with the previous standards because solvency capital is generally larger than the old "actual solvency capital" while the prescribed capital requirement is generally larger than the old "minimum solvency capital". These increases have two main sources:

- Amounts that were formally deducted from capital (for example, intangibles) are now included in a capital charge instead.
- For life insurers, an artificial NZ IFRS 4 liability – the present value of future profit margins – no longer features in either solvency capital or the prescribed capital requirement.

2.6.2 Stakeholders have suggested that the lower solvency ratios under the ISS may have negative effects:

- Misalignment with other jurisdictions, particularly Australia;
- Inappropriate insurer solvency targets set relative to other jurisdictions;
- A potential loss of confidence in the New Zealand insurance industry by users of the ratios who won't understand why they are low; and
- Ratios for insurers with intangibles and/or deferred tax assets being unfairly lower than similar insurers with no such assets.

2.6.3 Our view on the concerns raised in the preceding paragraph is as follows:

- The ISS targets an economic valuation of capital (including allowing best-estimate value for assets included in the deferred wind-up charge). This is in line with ICP 14.4 and many leading international jurisdictions, including the European Union's Solvency II.
- We encourage insurers to work with their stakeholders to establish internal solvency targets that make sense under the ISS.
- We have released alongside this consultation paper an article which aims to educate potential users of solvency ratios about the impact of the ISS.
- Insurers with intangibles and deferred tax assets have larger balance sheets and more risk than other insurers. Given the same dollar solvency margin, it is appropriate that such insurers exhibit lower solvency ratios.

2.6.4 We remain committed to an economic valuation of capital, as this both adheres to international standards and provides a robust and objective valuation philosophy.

2.6.5 There is, however, room to explore the paradigm under which solvency capital is valued – going concern or wind-up – and we plan to consider this in stage 2 of the Review in conjunction with work to improve the MCR measure.

2.6.6 It may be appropriate, however, to allow the Appointed Actuary to reduce to economic value any items covered by the Distressed Wind-up Charge. Such items are often difficult to value and the Appointed Actuary may form an opinion that the IFRS value is over-stated.

2.6.7 We propose to introduce a new sub-paragraph – 38(iv) – which deducts any amount that, in the opinion of the Appointed Actuary, is in excess of the economic value of items covered by the Distressed Wind-up Charge.

2.7 Embedded obligations test

2.7.1 We have identified some ambiguity in the embedded obligations test in Appendix 2, paragraph 27, in respect of references to "amounts".

2.7.2 We have suggested some wording in the amendment standard that clarifies which "amounts" are being referred to. We also propose to discuss the test in the Guide to provide further clarity.

Capital Requirements

2.8 UWRCC underspecified

2.8.1 The purpose of the underwriting risk capital charge (UWRCC) is to allow for the risk that premiums have been set too low relative to the risks insured and expenses to be incurred.

2.8.2 Under the NZ IFRS 17 Premium Allocation Approach (PAA), the liability for remaining coverage increases with premiums received and reduces as premiums are earned. This means that policies using the PAA simplification will have significantly lower capital charges if they have monthly or quarterly premiums rather than annual premiums.

2.8.3 We propose changing the base for the UWRCC to the expected amount of claims and expenses to be incurred during the remaining coverage period.

2.9 Reinsurance disputes

2.9.1 Paragraph 104 sets out the capital charge for reinsurance disputes. The calculation of the capital charge calls for the value of the asset in the licensed insurer's financial statements to be compared to the value of the asset reported by the reinsurer.

2.9.2 However, the value of the asset has already been standardised in the solvency capital measure, so it is inappropriate to establish a capital charge based on the IFRS value.

2.9.3 We propose we update paragraph 104 to reflect that the standardised value of the asset should be compared to the reinsurer's valuation.

2.10 Credit risk on interest-sensitive assets

2.10.1 The ISS introduced a modern risk hierarchy to facilitate (in stage 2 of the Review) an approach that allows for diversification of risk. The old Credit, Equity and Property (CEP) risk was broken into its constituent risks, with separate capital charges for each. Paragraph 96 was introduced to the standard to ensure that assets that were subject to a single CEP capital charge didn't become subject to multiple capital charges as a result of the new hierarchy.

2.10.2 However, paragraph 96 is currently drafted such that it applies to all market risk capital charges, not just the equity and property risk capital charges. This meant that, in particular, bond holdings were no longer subject to the credit risk capital charge, by virtue of having been subject to the interest rate risk capital charge (as interest rate risk is a component of market risk).

2.10.3 Stakeholders have pointed out that this could lead to insurers taking on credit exposure without having to increase capital accordingly.

2.10.4 We propose reinstating the treatment in prior standards by removing paragraph 96, and instead modifying paragraph 106(i) to specifically exclude items subject to the equity and property risk capital charges from the other credit risk capital charge.

2.11 Run-off term

2.11.1 In sub-paragraph 126, we state that the run-off term commences on the later of the solvency determination date and the start of the financial year in which annual maintenance expenses are expected to fall below NZ$1,000,000, increased with expected inflation from 1 January 2023 as appropriate.

2.11.2 The business run-off charge should, however, be based on expense loadings rather than actual expenses, as we wish to identify the point at which the in-force business isn't capable of covering the insurer's expenses. The run-off term should commence when the in-force book of the business is no longer able to support its minimum annual expense (deemed to be NZ$1,000,000).

2.11.3 We propose we update sub-paragraph 126(i)(b) to reflect that the charge be based off loadings released.

2.12 Double counting of discretions

2.12.1 Credit for discretionary reduction in policyholder benefits (for with profit products) is separately determined for equity, property, currency risk, credit and interest rate risks in paragraph 49 of the ISS. There is, however, no clause which ensures that credit taken overall does not exceed future discretionary benefits.

2.12.2 We don't think it makes sense to restrict the discretions usable for each capital charge, as the shocks are supposed to be independent of each other. In the final solvency standard, we will consider recognising the independence of the shocks through the diversification allowance.

2.12.3 We want to ensure that the credit taken for discretions is no larger than the pre-mitigation capital charge and we therefore propose we update paragraph 49 to reflect that any capital charge determined under paragraphs 56 to 126 to be negative shall be set to zero dollars.

2.13 Impact analysis

2.13.1 We have received some feedback on estimated impacts for the more significant issues discussed above. We have provided an indicative assessment of their impacts in Table 1 but would like to understand them better.

2.13.2 To this end, we ask respondent insurers to indicate to us the impacts of each issue and proposed resolution on solvency capital and the prescribed capital requirement listed in the table below. We will use this information – in an aggregated and non-attributable manner – to produce estimated impacts in dollars, for inclusion in regulatory impact analysis.

Table 1: Impact analysis

Consultation topic	Paragraph	Estimated impact
Underwriting risk capital charge	2.8	High (reduction in charges)
Credit risk on interest-sensitive assets	2.10	Medium (reduction in charges)
Deferred reinsurance expense	2.1	Medium (decrease in solv. Capital)
Modified PAA	2.3-2.5	Low (reduction in charges)
Long-term insurance contract boundary	2.2	Insufficient data
Double counting of discretions	2.12	Insufficient data

**Sources: stakeholder input and RBNZ internal analysis*

3 Other Proposed Changes

Solvency Capital

3.1 Taxation expense

3.1.1 The ISS requires certain items to be included in fulfilment cash-flows when calculating standardised insurance items using the GMM. One of the items to be included as per paragraph 28(iii)(c) is “Taxation relating to future cash-flows under the insurance contract”.

3.1.2 Stakeholders asked for clarity, noting that tax is typically calculated on future cash flows with an adjustment for certain accruals and tax reserves. The unwind or build-up of tax reserves can result in significant differences in amounts and timing of tax.

3.1.3 We propose changing “taxation” in paragraph 28(iii)(c) to “taxation expense” and to define taxation expense as “tax paid plus the increase in taxation liabilities over the period”.

3.2 Apportionment of repayable amounts

3.2.1 In clause 29 of Appendix 2, the ISS requires that a sound and principled basis be used in apportioning any repayable amount to the appropriate product classes, if such apportionment is necessary, in determining the repayable amount adjustment.

3.2.2 This paragraph is carried over from the previous life solvency standard,[2] which required the repayable amount to be added to the insurance risk capital charge for each related product group. Since the ISS requires that insurers deduct the repayable amount (in aggregate) from capital, this clause is no longer required.

3.2.3 We propose we remove clause 29 in Appendix 2.

Capital Requirements

3.3 LTIRCC underspecified

3.3.1 Some stakeholders raised concerns that policies using the GMM may attract significantly lower capital charges than under the previous non-life standard[3], resulting in negative underwriting risk capital charges in some cases, when applying paragraphs 28 and 56.

3.3.2 For policies valued under the GMM method, we require a recalculation of the liability under stressed assumptions. Where the standardised liability is negative, the stressed liability is likely to be less negative, resulting in an appropriate positive long-term insurance risk capital charge (LTIRCC). The long-term insurance charge is not a direct function of the standardised liability, and a negative standardised liability should not therefore result in a negative charge.

3.3.3 We propose that we explicitly state in the ISS that:

- Capital charges must be non-negative.
- Policies valued using GMM must be subject to the LTIRCC, not the UWRCC.

3.4 Run-off

3.4.1 Paragraph 17 sets out three criteria for determining if a *solvency entity* is in *run-off*. One of these is that: "the Reserve Bank has issued a direction to the licensed insurer in respect of the solvency entity to cease selling all new insurance contracts".

3.4.2 It is also possible for the Reserve Bank to impose a condition of licence under section 21 of the IPSA, with the effect that a licensed insurer must cease selling new insurance contracts or will be significantly restricted in doing so.

3.4.3 We propose we amend sub-paragraph (ii) to: "the Reserve Bank has issued a direction to, or imposed a *condition of licence* on, the *licensed insurer* in respect of the *solvency entity* that prohibits or significantly restricts the issuance of new insurance contracts"

[2] Solvency Standard for Life Insurance Business 2014
[3] Solvency Standard for Non-life Insurance Business 2014 (incorporating amendments to November 2018)

3.5 Prescribed assumptions for long-term non-life contracts

3.5.1 Appendix 5 shows prescribed solvency assumptions for non-life claims as numbers only. These assumptions should only apply to general insurance business (as health insurance has its own assumptions). They should also refer to the use of factors in the UWRCC, applying these as an increase in long-term claim assumptions.

3.5.2 We propose limiting these assumptions to general insurance, correctly identifying source of the capital factors and stating that they are to be applied to long-term claim assumptions.

General Matters

3.6 Transfer of guidance to separate document

3.6.1 Guidance is currently contained in shaded boxes throughout the ISS. We think that we can improve clarity and align better with international practice by moving all guidance to a separate document (the Guide).

3.6.2 This guidance will be augmented by new explanatory material.

3.6.3 We propose that we move all guidance, previously contained in shaded boxes within the standard, to a separate document (the Guide).

3.7 Life, health and general insurance

3.7.1 With respect to the product class definition, the ISS states that "Insurance contracts should first be allocated to subsectors (general, life and health insurance) according to the provisions of the Insurance (Prudential Supervision) Act 2010 (IPSA)."

3.7.2 Stakeholders queried this definition, noting that IPSA does not distinguish between general life and health insurance, having only a definition for life insurance and non-life insurance.

3.7.3 IPSA contains definitions for life insurance (in section 84 of IPSA) and health insurance (in section 6 of IPSA), with general insurance being the residual. However, we do agree that we can improve the clarity of this definition.

3.7.4 We propose we introduce IPSA-related definitions of the three subsectors in Paragraph 17 to improve clarity.

3.8 Disclosure of the annual solvency return

3.8.1 The ISS requires the disclosure of solvency information on insurers' websites. Paragraph 146 states that "A licensed insurer must disclose the information set out in paragraph 147 on its website (if any). The disclosure must be updated within 10 working days following the required date for the submission of each of the annual and interim solvency returns to the Reserve Bank to reflect the information in those returns."

3.8.2 We do not consider the requirement for insurers to publish annual solvency return figures on their websites necessary as these figures would only prevail for a month. Interim returns by themselves provide users with regularly updated series. Publication of annual return figures alongside interim return figures may also create confusion for users.

3.8.3 We propose that we remove the requirement for insurers to publish annual solvency return figures on their websites.

3.9 Minor changes

3.9.1 Paragraph reference: We propose we amend the incorrect paragraph reference in paragraph 106(ii) which relates to other credit risk charges from paragraph 30(iii) to paragraph 30(ii).

3.9.2 Italicisation: We propose we italicise the term 'related party' which is defined in IPSA throughout Appendix 1.

3.9.3 Italicisation: We propose we italicise the defined term 'reinsurance balance' in Appendix 4, paragraph 4(i).

3.9.4 Capitalisation: We propose we remove the capitalisation in the term 'risk-adjusted best estimate liability' in Appendix 5, paragraph 2.

3.9.5 Italicisation: We propose we italicise the term 'related party' which is defined in IPSA in Appendix 6, paragraph 5(ii).

3.9.6 Paragraph reference: We propose we amend the guidance note referencing paragraph 68(ii), which relates to the reinstatement of reinsurance programmes, to 66(ii).

3.9.7 Redundant guidance: We propose we amend the guidance relates to the reinstatement of reinsurance programmes (as discussed in 3.10.6 above) by deleting the sentence relating to the term 'full original cost' as this term is not referenced in the main text.

3.9.8 Redundant guidance: We propose we delete the guidance relating to the use of capital factors below paragraph 108. Paragraph 108 has the same effect as the guidance note since the last row has the highest capital factor.

4 Other Issues Raised by Stakeholders

Solvency Capital

4.1 Non-insurance Deferred Tax Assets

4.1.1 Some stakeholders raised concerns that the modification of taxation items in line with NZ GAAP principles as set out in paragraph 32 is ambiguous. Possibly there is a concern that tax items on the standardised balance sheet cannot be treated using NZ GAAP principles as the standardised balance sheet is not an NZ GAAP balance sheet.

4.1.2 Paragraphs 33-46 deal with the standardisation of non-insurance items (i.e., their revaluation to economic value, if required). Tax payables and receivables will have a different value when taking such an economic view. Paragraph 32 therefore requires that these tax items are revalued in consequence to any revaluation of insurance items. Rather than establishing a standard valuation basis for the tax items, it relies on NZ GAAP valuation, taking into account the standardised value of the underlying items.

4.1.3 We propose we do not make any change to the standard but address this further in the Guide.

4.2 Ambiguity in financial reinsurance wording

4.2.1 Some stakeholders raised questions about Appendix 2 – Financial Reinsurance, which contains tests for assessing whether a repayable amount exists, as well as methods for valuing the repayable amount.

4.2.2 For specified event test, stakeholders wanted to understand how the events or circumstances listed under paragraphs 18 and 20 were determined.

4.2.3 It is for the appointed actuary and other signatories of solvency returns to determine whether the events and circumstances in clauses 18 and 20 of Appendix 2 have taken place.

4.2.4 Stakeholders also noted that, under the prior standard, repayable amount under paragraph 21 would only apply for paragraph 18 under this test. However, in the ISS, the repayable amount is applicable for both paragraphs 18 and 20.

4.2.5 Clause 20 was included because it may give rise to a repayable amount independent of clause 18. Note that we will revisit financial reinsurance in stage 2 of the Solvency Review.

4.2.6 Lastly, for the embedded obligation test, stakeholders wanted to understand how it differs from the likelihood test and specified event tests.

4.2.7 The difference between the embedded obligations test and the specified event test is that the repayment of the obligation is programmed rather than triggered by an event.

4.2.8 We propose no changes to the ISS to address these points.

4.3 Modified PAA valuation – risk adjustments

4.3.1 Some stakeholders requested that we clarify that the profit margin calculation for PAA should include an allowance for a risk margin as outlined in paragraph 28 (iv) for calculations using GMM.

4.3.2 This issue existed in the May 2022 "review version" of the ISS but was addressed in sub-paragraph 30(iii) of the issued version in October 2022.

4.4 Minor issues

4.4.1 Expenses associated with future generations of policyholders need definition.

4.4.2 We propose we provide guidance to help clarify sub-paragraph 28(iii)(d).

4.4.3 One-off expenses: A stakeholder asked for definition of the term 'one-off expenses'. This term was used in the May 2022 "Review Version" of the ISS but has not been used in issued versions of the standard.

4.4.4 We propose no change to the ISS.

4.4.5 Incorrect reference: If paragraphs 18 or 20 of Appendix 2 apply, the value of the *repayable amount* is the maximum value of the obligation at the date of the assessment that the *licensed insurer* may be subject to on the occurrence of the specified event.

4.4.6 We propose no change to the ISS, but plan to review the appendix in Stage 2 of the Review.

Capital Requirements

4.5 Insurance linked securities

4.5.1 Paragraph 61 discusses the calculation of the catastrophe risk capital charge. The calculation is based on the licensed insurer's potential losses, net of reinsurance, under seismic, pandemic mortality and other event risks. There is currently no allowance for netting off other forms of risk transfer, such as insurance-linked securities (e.g., catastrophe bonds).

4.5.2 We propose no changes in this review, but we intend to address the potential inclusion of insurance linked securities as part of Stage 2 of the Review.

4.6 Seismic risk – 168 hour grace period

4.6.1 Some stakeholders have raised concerns that the 168 hour requirement for the reinstatement of full catastrophe reinsurance is too short following a major seismic event.

4.6.2 The 168 hours is a relaxation relative to the old non-life standard, which allowed for no lag at all.

4.6.3 We propose no change at this time, but we intend to consider this grace period as part of Stage 2 of the Review.

4.7 Seismic risk – application to whole portfolio

4.7.1 Some stakeholders raised concerns that the catastrophe risk charge applies to insurers' whole portfolios rather than particular product classes (e.g. domestic and commercial property). In their view, this increases reinsurance costs and hence premiums for the end consumer.

4.7.2 This application of the charge to product classes does not differ from the previous non-life solvency standard. Furthermore, this treatment is aligned with the 'total balance sheet approach' promoted by ICP17.1.

4.7.3 We propose no change in this amendment, but we intend to consider whether the settings of the catastrophe risk charge are appropriate as part of Stage 2 of the Review. In the meantime, insurers can apply paragraph 16 to simplify calculation approaches.

4.8 Discretions on derivatives

4.8.1 Paragraph 93 of the ISS sets out the derivative instruments' capital charge. Theoretically we should allow any discretions to be applied against the derivatives charge, however, discretions can already be offset against other market risk charges and the diversification framework is not yet in place to ensure that various post-discretion charges can be combined appropriately.

4.8.2 We intend to consider discretions on derivatives in Stage 2 of the Review.

4.9 Minor issue

4.9.1 A concern was raised that right-of-use-assets under lease arrangements might be capital charged for credit risk, notwithstanding their linkage to lease liabilities. This may have been an issue in the May 2022 "review version" of the ISS, however in the issued version of the ISS, right-of-use assets under leases were specifically excluded from capture as "other on-balance-sheet assets not covered elsewhere."

4.9.2 We therefore propose no change to credit risk on right-of-use leases.

5 Have Your Say

5.1.1 Stakeholders are welcome to provide comment and information to us aimed at correcting errors and improving the operation of the standard within the scope of the Stage 1 changes, i.e., the transition to NZ IFRS 17 and the structural changes in the regime put in place through the ISS.

5.1.2 Stakeholders are specifically invited to comment on

- the proposals in this consultation paper, shaded in beige;
- the text of the Interim Solvency Standard Amendment Standard 2024; and
- the text of the Guide to the Interim Solvency Standard 2023.

5.1.3 This consultation will not consider Stage 2 issues, including new methodologies and parameterisation.

5.1.4 Use this email – insurancesolvency@rbnz.govt.nz – to provide comments. Please clearly indicate which document and paragraph(s) your comments relate to.

5.1.5 Comments or submissions should be received by 5pm on 8 November 2023. Submissions received after this date will not be considered.

5.1.6 As noted earlier in the paper, it is our practice to publish submissions received unless specifically requested not to. We may also publish an anonymised summary of submission received.