Reserve Bank
of New Zealand
Te Pūtea Matua

Interim Solvency Standard 2023.

1 October 2022

This document consolidates the following amendment standards to the principal standard:

(1) **Title:** Interim Solvency Standard Amendment Standard 2023, issued on 6 June 2023 and taking effect on 1 August 2023.

(2) **Title:** Interim Solvency Standard Amendment Standard 2024, issued on 5 December 2024 and taking effect on 1 March 2025.

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Introduction

Title, effect, and commencement

1. This is the Interim Solvency Standard 2023.

2. This solvency standard is issued under section 55 of the *Act*.

3. This solvency standard comes into force on 1 January 2023, except that Appendix 4 comes into force on 1 January 2024 for business other than *life insurance*.

Application

4. Exemptions granted under section 59(1) of the *Act* may exempt overseas *licensed insurers* from compliance with part or all of this solvency standard.

5. Except as provided in paragraph 4, this solvency standard applies to:

    i. every *licensed insurer* that carries on insurance business in New Zealand, and that is required by a *condition of licence* to maintain a solvency margin in accordance with this solvency standard; and

    ii. each statutory fund of every *licensed insurer* that carries on insurance business in New Zealand, and for which the *licensed insurer* is required by a *condition of licence* to maintain a solvency margin in accordance with this solvency standard.

6. Where a *licensed insurer* or a *statutory fund* to which this solvency standard applies holds investments in prudentially regulated insurance subsidiaries, either in New Zealand or overseas, this standard must be applied to the *solvency entity* both on:

    i. a solo basis, with all investments in all subsidiaries being treated according to the appropriate class of asset under this standard; and

    ii. a group basis, with prudentially regulated insurance subsidiaries being consolidated into the parent *solvency entity*, and investments in other subsidiaries being treated according to the appropriate class of asset under this standard.

Purpose

7. The *Reserve Bank* uses a combination of measures to increase the likelihood that *licensed insurers* will, in adversity, be able to meet their obligations to *policyholders*. With the exception of seismic risk, this standard aims to broadly calibrate 'adversity' as an event expected to happen once in every 200 years. Adversity in respect of seismic risk is defined as an event expected to happen once in every 1,000 years.

8. Regulatory capital is an important part of this framework, alongside matters such as risk-management programmes, board oversight and *Reserve Bank* supervisory activity. In this sense, this standard supports the purposes of the *Act*, which are to promote the maintenance of a sound and efficient insurance sector and to promote public confidence in the insurance sector (see section 3(1) of the *Act*).

9. One of the purposes of the Reserve Bank of New Zealand Act 2021 is to promote the prosperity and wellbeing of New Zealanders and contribute to a sustainable and productive economy (see section 3(b) of that Act). Appropriately calibrated regulatory capital has a specific role in helping *licensed insurers* to meet the challenge of supporting this purpose.

10. The presence of capital in excess of regulatory requirements does not, however, guarantee that a *licensed insurer* will never fail, and members of the public remain responsible for their own decisions relating to insurance (a principle to be taken into account by the *Reserve Bank*, under section 4(d)(ii) of the *Act*, in meeting the purposes of the *Act*).

General provisions

Interpretation

11. [Deleted]

Paragraph 11 has been modified by the Interim Solvency Standard Amendment Standard 2024.

General requirements

12. Any *solvency margin* required to be determined in accordance with this standard must be prepared on the basis of any appropriate *NZ GAAP* financial statements that are available to the *licensed insurer* unless this solvency standard specifies otherwise. If no appropriate *NZ GAAP* financial statements are available for this purpose, then the a*lternative financial information* must be used, and the *solvency margin* must be prepared on a basis as close to *NZ GAAP* as possible.

13. The *licensed insurer* must ensure that its *appointed actuary* is responsible to the board of the *licensed insurer* for performing or reviewing all aspects of the *solvency margin* calculations to ensure the calculations are complete and accurate.

14. All assets and liabilities of the *licensed insurer* must be considered in determining the required *solvency margin*, except where a *condition of licence* limits the *solvency margin* requirements to a specified pool of assets and liabilities.

Related party exposures

15. An *asset* or *contingent liability* that represents an exposure to a *related party* may be treated as if it were not a *related party* exposure for the purposes of this standard if:

    i. the obligation arises as the result of an exposure to a bank that is a related party of the *licensed insurer* and that bank is subject to prudential regulation and supervision by the *Reserve Bank* or its international equivalent;

    ii. the asset:

        a. is a *related party* trade credit in respect of which payments are not overdue;

        b. does not, in substance, represent permanent funding; and

        c. is provided on not more than 90-day terms in the ordinary course of business on an arm's length commercial basis; or

iii. in relation to a captive insurer that is a *licensed insurer*, the obligation is an obligation of the *licensed insurer's* parent, or of a subsidiary of that parent.

Simplifying assumptions and methodologies

16. This standard represents the minimum requirements for determining a *licensed insurer's solvency margin*. Accordingly, if any simplifying assumptions are made or simplifying methodologies are used in calculating the *licensed insurer's solvency margin*, the *appointed actuary* must:

    i. ensure that such simplifying assumptions or methodologies result in a more conservative assessment of the *licensed insurer's solvency margin*, or have no *material* effects on the result, compared to the case without the simplification; and

    ii. within the *financial condition report*, disclose such simplifying assumptions or methodologies and justify them on the grounds of *materiality* or on the grounds that they provide a more conservative outcome than would be the case without the simplification.

Definitions

17. Unless stated otherwise, terms defined in the *Act*, *the Regulations* or in *NZ IFRS* have the same meanings in this solvency standard. Terms defined below, in the *Act*, *the Regulations* or in *NZ IFRS* are italicised when used in this solvency standard. Where there are conflicting definitions, terms defined in the *Act* and the *Regulations* prevail, followed by terms defined in this solvency standard.

Act means the Insurance (Prudential Supervision) Act 2010.

Acquisition costs mean the costs of selling, underwriting and starting *insurance contracts*. Costs must be directly attributable to the *product class* to which the contracts belong.

Adjusted minimum capital requirement (AMCR) has the meaning given in paragraph 133.

Adjusted prescribed capital requirement (APCR) has the meaning given in paragraphs 127 to 129.

Adjusted solvency margin has the meaning given in paragraph 130.

Adjusted solvency ratio has the meaning given in paragraph 131.

Adjustment for non-financial risk means an adjustment to provide compensation to a potential purchaser of *insurance items* in respect of risks (other than those observable in financial markets) that they would have to bear on purchase. The adjustment is determined according to paragraph 28(iv).

Adjustment to insurance items means an adjustment to change the value of *insurance items* from an *NZ GAAP* basis to a *standardised* basis. It is determined according to paragraph 25.

Alternative financial information means any financial information other than *NZ GAAP* financial statements that is used to determine a *solvency margin*.

Annual solvency return has the meaning given in paragraph 135.

Balance sheet means the Statement of Financial Position required under *NZ IAS 1*.

Benefit term means the term over which contractual benefits or claims could be payable under an *insurance contract*, excluding cases where benefits are delayed by force majeure, litigation or other extraordinary contingencies. Any *guaranteed renewability* feature extends the benefit term across policy years.

Best estimate means the expected value of the full range of possible outcomes, determined using professional judgement, training and experience. *Best estimate assumption* has a corresponding meaning.

Business run-off capital charge means a *capital charge* determined in accordance with paragraph 125.

Capital has the meaning given in paragraph 20.

Capital charge means an amount of *capital* required to be set aside to support an adverse outcome for a risk category or a specific risk.

Capital charge for reinsurance disputes has the meaning given in paragraphs 103 to 104.

Capital factor has the meaning given in paragraphs 86 and 107.

Catastrophe risk capital charge has the meaning given in paragraphs 61 to 63.

Collective investment vehicle means a managed investment fund and includes, for example, unit trusts and group investment funds.

Contract boundary means the point in time beyond which cash-flows arising from rights and obligations under an *insurance contract* are not to be taken into account in its valuation for the purposes of this standard. The *contract boundary* must be set to the end of the *benefit term* and may differ from that used for accounting purposes. Where *outwards reinsurance* or *retrocession* cash-flows are incorporated into a *primary insurance* or *inwards reinsurance* contract, the *contract boundary* is determined as that for the *primary insurance* or *inwards reinsurance* contract.

Counterparty grade has the meaning given in paragraphs 97 to 99.

Coverage period means the period during which the *licensed insurer* provides coverage for an *insured event*. This period includes coverage that relates to all premiums within the *contract boundary*.

Credit risk capital charge has the meaning given in paragraph 95.

Current termination value means the termination value of a policy at the *solvency determination date* and must:

i. be determined as the greater of the amounts that would be paid on the basis of current practice in the event of:

   a. voluntary termination of the policy; or

   b. *wind-up*;

ii. be not less than zero;

iii. be determined as the present value of the future payments using assumptions consistent with Appendix 5 of this solvency standard if:

   a. the amount payable on termination is deferred;

   b. the amount payable is in the form of a series of payments over time; or

   c. an accrued liability will exist on *wind-up* (either legally or in the opinion of the *appointed actuary*) that ought to be paid to the policyholder; and

iv. if applicable, include an allowance for unsettled lump-sum insurance claims on a life policy (net of potential *reinsurance* recoveries), and any claim-settlement costs such as those for obtaining medical evidence and the potential legal costs of disputed claims.

Default catastrophe risk capital charge has the meaning given in paragraph 74.

Deferred acquisition cost assets (DAC assets) means assets established to offset acquisition expenses incurred, such that those expenses can be gradually recognised over time.

Delta factor means the factor implied after the application of the appropriate *equity risk capital charge* factors or *other credit risk capital charge* factors, the shock in foreign currency exchange rates specified in paragraphs 89 to 92 and the shock in interest rates specified in paragraph 83.

Discretions means allowances for management actions and other mitigation, in accordance with Appendix 7.

Direct credit substitute means an exposure that has a risk of loss to the *licensed insurer* that is equivalent to a direct extension of credit by the *licensed insurer* and includes, for example, letters of credit, guarantees and similar covenants.

Expected inflation means the *best estimate* of future increases in the Consumers Price Index published by Stats NZ.

Extreme event means one or more events, including, for example, earthquake, flood, storm or pandemic, that results in unexpected large or extreme losses as a result of claims on more than one *insurance contract*.

Extreme event exposure means the total of all insurance losses that a *licensed insurer* will incur as a result of an *extreme event*, determined in accordance with paragraph 62.

Financial condition report means a report referred to in paragraph 143 and prepared in accordance with paragraphs 161 to 164.

Financial institution means a *financial institution* as defined in section 2(1) of the Banking (Prudential Supervision) Act 1989.

Fixed capital amount means a minimum amount of *capital*, determined in accordance with paragraph 52.

Freely available means, in respect of a portion of the *capital* of an overseas branch, that there is no regulatory or legislative requirement to maintain that portion in the overseas branch, that no regulatory approval is required to remit that portion to a New Zealand bank account controlled by the New Zealand management of the *licensed insurer*, and that there are no other constraints on the use of that portion by the New Zealand *licensed insurer*.

General insurance is insurance that is neither *life insurance* nor *health insurance*.

General measurement model means the valuation method set out in *NZ IFRS 17* paragraphs 29 to 52 (and paragraphs 62 to 68 in respect of *reinsurance*).

Guaranteed renewability means the right of a policyholder to, at the end of the current contract term, renew their cover with no new underwriting (medical or otherwise) and on terms (premium rates, benefit limits, contract wording etc.) that are set from time to time for the sub-class to which their *insurance contract* belongs. A sub-class is a subset of a product class having common product design, for example premium pattern (level vs stepped), benefits provided and risks insured, whether the policyholder is a natural or legal person etc.

Health insurance has the meaning given in section 6 of the *Act*.

Hypothecated portfolio means a portfolio that meets the criteria listed in paragraph 80.

Immaterial has the meaning given in Appendix 3.

Immaterial reinsurance agreement has the meaning given in clause 2 of Appendix 2.

Individual claim means the total of claims filed by a single policyholder relating to a single *insured event*, under *insurance contracts* or supplementary contracts.

Insurance contract has the same meaning as 'Contract of Insurance' in section 7(1) of the *Act*.

Insurance items has the meaning given in paragraphs 22 and 23.

Insurance revenue has the meaning given in *NZ IFRS 17*, provided that the *licensed insurer* has determined insurance revenue for two or more annual reporting periods under *NZ IFRS 17*. Otherwise, *insurance revenue* means *premium revenue*.

Insurance risk capital charge has the meaning given in paragraphs 54 and 55.

Insured event:

i. means an event that initiates claim assessment and payment processes; but

ii. does not include continuation in a certain state (for example, disablement).

Interest rate risk capital charge has the meaning given in paragraphs 82 and 83.

Interim solvency return means a report in a form specified by the *Reserve Bank* and required under paragraph 137.

Investment management costs means the fixed and variable costs of managing a *licensed insurer's* investment funds.

Inwards reinsurance means *reinsurance* under which a *licensed insurer* accepts risk from another insurer.

IPSA means the Insurance (Prudential Supervision) Act 2010.

IPSR means the Insurance (Prudential Supervision) Regulations 2010.

Item means an asset, liability, contingent asset or *contingent liability*.

Liability for incurred claims (LIC) has the same meaning as in *NZ IFRS 17*, unless otherwise specified. The *standardised liability for incurred claims* (SLIC) is the *liability for incurred claims* modified in accordance with paragraph 28.

Liability for remaining coverage (LRC) has the same meaning as in *NZ IFRS 17*, unless otherwise specified. The *standardised liability for remaining coverage* (SLRC) is the *liability for remaining coverage* modified in accordance with paragraphs 28 to 31, depending on the valuation method employed.

Life insurance means insurance of the kind described in section 84(1)(a) to (f) of the *Act*.

Local authority has the same meaning as in section 5(1) of the Local Government Act 2002.

Long-term forward rate means an interest rate determined as the average of the forward rates implied by the yields of the two longest-dated nominal bonds published on the *Reserve Bank* website at the *solvency determination date* and at dates three months, six months, nine months and 12 months prior to the *solvency determination date*. The rates used should be those published as at 11.10am each business day.

Long-term insurance contract means an *insurance contract* that is not a *short-term insurance contract*.

Long-term insurance risk capital charge has the meaning given in paragraphs 58-60.

Maintenance costs means the fixed and variable costs of administering *insurance contracts* subsequent to the sale and recording of the policies and the fixed and variable costs of administering the general operations of the *solvency entity*. *Maintenance costs* include all operating costs and expenses other than *taxation expense*, transitory levies and recoverable transaction taxes, *acquisition costs* and *investment management costs*.

Market risk capital charge has the meaning given in paragraph 81.

Material and materiality have the meanings given in Appendix 3.

Minimum capital requirement (MCR) has the meaning given in paragraph 132.

Natural Hazards Commission–

i. means the Earthquake Commission under section 4 of the Earthquake Commission Act 1993 continued with the name Toka Tū Ake – Natural Hazards Commission under section 125 of the Natural Hazards Insurance Act 2023; and

ii. includes any legal successor to that organisation.

Net insurance losses has the meaning given in paragraph 65.

Non-insurance activity means any business activity undertaken for third party customers that does not involve the bearing of risk under an *insurance contract*.

Non-participating means a product class offering only non-participating benefits (as defined in *IPSR* 21(1)).

NZ GAAP means New Zealand Generally Accepted Accounting Practice. Terms with names that incorporate *NZ GAAP* are defined according to *NZ GAAP*, while other quantities are defined according to this standard or the Act.

NZ IAS 1 relates to the presentation of financial statements and means the in-force version of the following accounting standard issued by the External Reporting Board:

i. NZ IAS 1, where the *licensed insurer* is for-profit.

i. PBE IPSAS 1, where the *licensed insurer* is not-for-profit.

NZ IAS 37 relates to provisions, contingent liabilities and contingent assets and means the in-force version of the following accounting standard issued by the External Reporting Board:

i. NZ IAS 37, where the *licensed insurer* is for-profit.

ii. PBE IPSAS 19, where the *licensed insurer* is not-for-profit.

NZ IFRS means for-profit and not-for-profit versions of accounting standards issued by the External Reporting Board that are in force, taken as a set.

NZ IFRS 4 relates to *insurance contracts* and means the last version of the following accounting standard issued by the External Reporting Board:

i. NZ IFRS 4, where the *licensed insurer* is for-profit.

ii. PBE IFRS 4, where the *licensed insurer* is not-for-profit.

NZ IFRS 9 relates to financial instruments and means the in-force version of the following accounting standard issued by the External Reporting Board:

i. NZ IFRS 9, where the *licensed insurer* is for-profit.

ii. PBE IPSAS 28 and PBE IPSAS 29, where the *licensed insurer* is not-for-profit.

NZ IFRS 16 relates to leases and means the in-force version of the following accounting standard issued by the External Reporting Board:

i. NZ IFRS 16, where the *licensed insurer* is for-profit.

ii. PBE IPSAS 13, where the *licensed insurer* is not-for-profit.

NZ IFRS 17 relates to *insurance contracts* and means the in-force version of the following accounting standard issued by the External Reporting Board:

iii. NZ IFRS 17, where the *licensed insurer* is for-profit.

iv. PBE IFRS 17, where the *licensed insurer* is not-for-profit.

Occurrence exceedance probability means the probability that the largest loss from an *insured event* in a year across a *licensed insurer*'s portfolio will exceed a certain amount.

Operational risk capital charge has the meaning given in paragraph 109.

Other capital charges has the meaning given in paragraph 110.

Other credit risk capital charge has the meaning given in paragraph 107.

Other event capital charge has the meaning given in paragraph 73.

Outwards reinsurance means *reinsurance* under which the *licensed insurer* cedes risk to another insurer.

Pandemic risk capital charge has the meaning given in paragraph 68.

Participating means a product class offering participating benefits (as defined in *IPSR* 21(1)).

Portfolio reinsurance means *outwards reinsurance* that cannot be incorporated with *primary insurance* contracts for the purposes of paragraphs 26 to 30.

Premium Allocation Approach means the valuation method set out in *NZ IFRS 17* paragraphs 53 to 59 (and paragraphs 69 to 70A in respect of *reinsurance*).

Premium revenue has the meaning given in sections 4.1.1 to 4.1.3 of Appendix D of *NZ IFRS 4.*

Premiums not yet due means *premiums* that the *policyholder* is obliged to pay to the *licenced insurer* under an *insurance contract* between the *solvency determination date* and the next anniversary of the commencement of the *insurance contract*. These premiums form part of the paragraph 27(vi) receivable.

Prescribed capital requirement (PCR) means the requirement determined under paragraphs 48 to 50.

Prescribed solvency assumptions means the assumptions set out in Appendix 5.

Primary insurance means insurance that is not *inwards reinsurance* or *portfolio reinsurance*.

Product class refers to groups of *insurance contracts* according to the following list. *Insurance contracts* should first be allocated to subsectors (*general insurance*, *life insurance* and *health insurance*). Next, an *insurance contract* should be included in the first *product class* within the subsector to which it refers, based on the main benefit or object of insurance.

i. General insurance

   a. **Inwards general reinsurance**: Insurance in any of classes (i)(b) to (i)(l) where the policyholder is another insurer.

   b. **Credit**: Insurance issued on a personal or household basis with a benefit amount partly or fully defined by an outstanding balance of a connected loan, debt or mortgage.

   c. **Commercial property**: Insurance issued to organisations with cover for buildings, contents and other physical assets with generally fixed locations; and cover for associated losses and expenses (i.e. including material damage, business interruption and consequential loss).

   d. **Commercial motor**: Insurance issued to organisations with cover for vehicles (whether or not motorised), or cover for their cargo, but excluding *marine and aviation*.

   e. **Marine and aviation**: Insurance issued to organisations with cover for airborne or water-borne vehicles and associated equipment, or cover for their cargo. Insurance is issued on a household or personal basis with cover for pleasure craft.

   f. **Liability**: Insurance issued to organisations with cover for liability to third parties.

   g. **Other commercial**: Insurance issued to organisations that is not *life insurance* or *health insurance* and is not elsewhere classified.

   h. **Domestic property**: Insurance issued on an individual or household basis, with cover for buildings, contents and other physical assets with generally fixed locations.

   i. **Domestic motor**: Insurance issued on an individual or household basis, with cover for vehicles including trailers and caravans.

   j. **Personal accident**: Insurance issued to organisations with cover for accidents involving injury to self, but excluding class (i)(b).

   k. **Travel**: Insurance issued on an individual or household basis, with cover for travel-related costs including some or all of medical, accident, cancellation and baggage loss.

   l. **Other personal lines**: Insurance issued on an individual or household basis that is not *life insurance* or *health insurance* and is not elsewhere classified.

ii. Life insurance

a. Inwards life reinsurance: Insurance in any of classes (ii).(b) to (ii).(k) where the policyholder is another insurer.

b. Group life: Insurance that is *non-participating* and non-investment with lump-sum benefits, and is issued on a group basis, but excluding *credit life insurance*.

c. Group disability income: Insurance that is a *non-participating* non-investment, with income benefits payable on disablement, and is issued on a group basis.

d. Credit life: Insurance that is a *non-participating* non-investment, with the benefit amount partly or fully defined by an outstanding balance of a connected loan, debt or mortgage.

e. Participating: Insurance that is *participating* as defined by *IPSR* r21(1).

f. Investment linked: Insurance that is both *non-participating* as defined by *IPSR* r21(1) and an investment linked as defined in *IPSA* s98(3).

g. Investment account: Insurance that is both *non-participating* as defined by *IPSR* r21(1) and an investment account as defined in *IPSA* s84(5).

h. Term life: Insurance that is a *non-participating* non-investment with lump-sum benefits payable on death, trauma or disablement, and issued on an individual basis.

i. Disability income: Insurance that is a *non-participating* non-investment, with income benefits payable during disability.

j. Annuities: Insurance that provides an income benefit that is contingent on the continuation of life but is not contingent on disability.

k. Other life: *Life insurance* that is not elsewhere classified.

iii. Health insurance

a. Inwards health reinsurance: Insurance in either of classes (iii).(b) or (iii).(c) where the policyholder is another insurer.

b. Group health: Insurance that is issued on a group basis, provided that at least one of the following applies (and is not generally available on an individual basis):

- Premium discount that is *material*.
- Premiums based on experience of the group.
- Premiums guaranteed for any period.
- Underwriting on preferential terms.
- Product tailored for the group.

c. Individual health: *Health insurance* that is not *group health*.

Recognised stock exchange means the NZX or a foreign exchange with a market capitalisation in excess of US$500 million.

Regulations means the Insurance (Prudential Supervision) Regulations 2010.

(Re)insurance incorporates both *primary insurance* and *reinsurance*.

Reinsurance means a contract of insurance under which one insurer indemnifies another in relation to one or more *insurance contracts*.

Reinsurance agreement has the meaning given in Appendix 4.

Reinsurance balance means the present value of the *solvency entity*'s net contractual rights and obligations under a *reinsurance agreement*. The balance is determined as the present value of expected payments to the *reinsurer* minus expected receipts from the *reinsurer* (hence the balance will be more than NZ$0 where there is an expected net outflow of resources from the *licensed insurer* to the *reinsurer*).

Reinsurance credit risk capital charge has the meaning given in paragraph 105.

Reinsurance recovery asset has the meaning given in paragraph 101.

Reinsurance recovery risk capital charge has the meaning given in paragraphs 100 to 102.

Reinsurer means an insurer that indemnifies another insurer in relation to one or more *insurance contracts*.

Remaining coverage period means the part of the *coverage period* that is prospective as at the *solvency determination date*.

Repayable amount has the meaning given in clause 3 of Appendix 2.

Reserve Bank means the Reserve Bank of New Zealand constituted under the Reserve Bank of New Zealand Act 2021.

Retrocession means a *contract of insurance* under which one insurer indemnifies another in relation to one or more *reinsurance contracts*.

Risk-adjusted best estimate liability means a liability for *long-term insurance contracts* that is determined according to paragraphs 26-30. It incorporates components for both incurred claims and remaining coverage, and may be positive or negative.

Run-off means, in respect of a *solvency entity*, that:

i. its board has recorded a decision to cease selling all new *insurance contracts*;

ii. 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*; or

iii. the *premium revenue* received that was referable to new *insurance contracts* sold during the most recent financial year was less than the lesser of one million dollars and 1 percent of the total *premium revenue* received during that year.

Run-off term has the meaning given in paragraph 126.

Servicing costs means the combination of *maintenance costs* and *investment management costs*.

Short-term insurance contract means an *insurance contract* that meets all the following requirements on commencement:

i. The contract is eligible to be measured using the *Premium Allocation Approach* in accordance with the conditions in paragraphs 53 and 54 of NZ IFRS 17.

ii. The *licensed insurer* is not expected to be at risk for any claims that may be incurred more than one year after the commencement date of the *insurance contract*, or more than two years after in respect of the travel insurance *product class* only.

iii. There is no expectation that future renewals of the contract will fund acquisition or insurance expenses in the current policy year.

iv. There is no expectation that the current contract will fund acquisition or insurance expenses under future renewals of the contract.

v. The contract does not have *guaranteed renewability*.

Solvency capital has the meaning given in paragraph 19.

Solvency determination date means the date as at which solvency calculations are being performed under this standard.

Solvency entity means, for the purposes of a solvency determination, any *licensed insurer*, *statutory fund* of a *licensed insurer*, or a consolidated group of *licensed insurers*.

Solvency liability has the meaning given in paragraph 58.

Solvency licence condition means a *condition of licence* imposed under the *Act*, requiring the *licensed insurer* to maintain a minimum *solvency margin* or a minimum *solvency ratio*.

Solvency margin means the excess of *solvency capital* over the PCR.

Solvency ratio means *solvency capital* divided by the PCR.

Specialised risk means a risk inherent in the *licensed insurer*'s business that cannot be suitably allowed for through the use of a margin applied to the underlying *best estimate assumption*.

Standardisation means the process of adjusting *balance sheet items* in accordance with Section 2 of this standard (*solvency capital*), and *standardised* has a corresponding meaning.

Standardised balance sheet means the *balance sheet* after *standardisation*, that is, the *balance sheet* from which *solvency capital* is derived.

State-owned enterprise means a State enterprise named in Schedule 1 or a new State enterprise named in Schedule 2 of the State-Owned Enterprises Act 1986.

Tax and taxation mean income tax payable by the *licensed insurer*. Other taxes and levies should be treated as expenses.

Taxation expense means:

i. Income tax paid

ii. less income tax credits received

iii. plus any increase in income tax liabilities over the period

iv. less any decrease in income tax liabilities over the period.

Underwriting risk capital charge has the meaning given in paragraph 56.

Unpaid premiums means *premiums* that the *policyholder* was obliged to pay to the *licenced insurer* under an *insurance contract* prior to the *solvency determination date*, but which remain unpaid as at that date.

Variable fee approach means the *general measurement model* modified in accordance with *NZ IFRS 17* paragraph 45.

Wind-up means the closure of a *licensed insurer* with all the following characteristics:

i. No new business is written from the *solvency determination date*.

ii. Within one year of the *solvency determination date*, all *insurance contracts* (and associated future tax obligations or benefits) are run off or transferred to other *licensed insurers*.

iii. One year after the *solvency determination date*, no insurance liabilities remain and the *licensed insurer's* licence is revoked. The company is liquidated and removed from the Companies Register (or equivalent processes for *licensed insurers* domiciled outside New Zealand).

iv. Any remaining deferred tax assets are assumed to expire following the processes in (iii), with no possibility of transfer to a continuing registered company.

Paragraph 17 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Paragraph 17 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Solvency capital

18. The determination of *solvency capital* is to be undertaken using *NZ GAAP* financial statements, if available, or *alternative financial information* otherwise.

19. *Solvency capital* means the *capital* of the *solvency entity*, adjusted as follows:

	Capital	(paragraphs 20–21)
Plus	Adjustment to insurance items	(paragraphs 22–31)
Less	Deduction for elections under *NZ IAS 1* (if any)	(paragraphs 33–35)
Plus/less	Adjustment to fair value (if any)	(paragraphs 36-37)
Less	Deductions from capital	(paragraph 38)
Less	Repayable amount adjustment (if any)	(paragraphs 39–40)
Plus	Contingent assets (if fair-valued)	(paragraphs 41–44)
Less	Contingent liabilities	(paragraphs 41–44)
Less	Disallowed instrument deduction	(paragraph 45)
Less	Perpetual instrument deduction	(paragraph 46)
equals	*Solvency capital*	

Paragraph 19 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Capital

20. *Capital* means the total value of the following *items*:

    i. Issued and fully or partly paid-up ordinary shares.

    ii. Issued and fully or partly paid-up perpetual non-cumulative instruments.

    iii. Credit union securities.

    iv. Capital reserves, including the following, but not including reserves that are held aside or otherwise committed on account of any assessed likelihood of loss:

        a. Reserves arising from a revaluation of tangible fixed assets, including owner-occupied property.

        b. Foreign currency translation reserves.

        c. Reserves arising from the revaluation of investments.

        d. Other reserves that are created or increased by appropriations of retained earnings net of *tax* and dividends payable.

    v. Retained earnings.

    vi. Non-controlling interests.

    vii. Head office balances (*overseas licensed insurers* only).

21. In the case of a *licensed insurer* that is a mutual insurer constituted in New Zealand, *capital* may be referred to as reserves, members' funds or such other terms by which they are described in the financial statements or *alternative financial information* of the mutual *licensed insurer*.

Adjustments to insurance items

Insurance items

22. The following *items* on the *NZ GAAP balance sheet* are deemed to be *insurance items*:

    i. All *items* that represent the value of future cash-flows under *(re)insurance contracts*, excluding cash-flows meeting the requirements of 27(iii)(c).

    ii. All *items* that represent accumulated historical cash-flows supporting future outgo under *(re)insurance contracts*.

Paragraph 22, sub-paragraph (i) has been modified by the Interim Solvency Standard Amendment Standard 2024.

23. *Taxation items* that are generated as a consequence of the recognition of *insurance items* are themselves *insurance items*.

Paragraph 23 has been modified by the Interim Solvency Standard Amendment Standard 2024.

24. *Insurance items* must be segregated into insurance assets and insurance liabilities, depending on whether they augment or diminish *capital* respectively.

Determination of adjustment

25. The *adjustment to insurance items* is an addition to *capital*, and is determined as:

    i. insurance liabilities; less

    ii. insurance assets; less

    iii. standardised insurance liabilities; plus

    iv. standardised insurance assets.

Standardised insurance items

26. The *insurance contract* (determined in accordance with section 7 of *the Act*) is the basic unit of account for determining *standardised insurance items* under this standard. However:

    i. *Licensed insurers* may separate perils or benefits to the extent permitted under *NZ IFRS 17*;

    ii. *Portfolio reinsurance* arrangements are *insurance contracts*; and

    iii. *Outwards reinsurance* and *retrocession* arrangements (other than *portfolio reinsurance*) are not standalone *insurance contracts*, being combined with their associated *primary insurance* and *inwards reinsurance* contracts respectively.

Paragraph 26 has been modified by the Interim Solvency Standard Amendment Standard 2024.

27. Except as provided in paragraph 30, *standardised insurance items* (other than tax *items*) must be determined using *NZ IFRS 17* methods, with the following modifications:

    i. Calculations at the *NZ IFRS 17* levels of granularity, such as the portfolio or group of *insurance contracts*, are not required.

    ii. *NZ IFRS 17* paragraph 16 should be applied such that no *insurance contracts* are classified as onerous, and no loss components are recognised or derecognised.

    iii. The following *items* are excluded:

        a. Any asset or liability relating to insurance acquisition cash-flows and recognised in accordance with *NZ IFRS 17*; and

        b. Any other pre-recognition asset or liability under *NZ IFRS 17* relating to future *(re)insurance contracts* beyond the *contract boundary*;

        c. *Outwards reinsurance* or *retrocession* cash-flows beyond the *contract boundary* of associated *primary insurance* or *inwards reinsurance* contracts; and

        d. Any component benefiting shareholders that is otherwise not considered in this subparagraph (iii).

    iv. *Insurance liabilities* and *insurance assets* must be increased or decreased respectively for the amounts of premiums that have fallen due but have not been received. Corresponding premium receivable assets must be established as *standardised* non-insurance *items* contributing to *solvency capital*.

    v. *Portfolio reinsurance* contract liabilities and assets must be decreased or increased respectively for the amounts of *reinsurance* premiums that have fallen due but have not been paid. Corresponding *reinsurance* premium payable liabilities must be established as *standardised* non-insurance *items* contributing to *solvency capital*.

Paragraph 27 has been modified by the Interim Solvency Standard Amendment Standard 2024.

28. Except as provided for in paragraphs 29 and 30, *standardised insurance items* (other than tax *items*) must be determined using the *general measurement model* (or, where appropriate, the *variable fee approach*) of *NZ IFRS 17*, modified by paragraph 27 and further modified as follows:

    i. Any *NZ IFRS 17 Contractual Service Margin* is excluded.

    ii. The following *items* are to be included in fulfilment cash-flows (alongside those incorporated by *NZ IFRS 17* and not excluded by subparagraph 27(iii)), to the extent they are within the *contract boundary*:

        a. *Outwards reinsurance* or *retrocession* relating to the contract.

        b. Non-*reinsurance* recoveries.

        c. A share of all *maintenance costs* and *investment management costs* (other than those associated with future *insurance contracts*) that cannot be directly attributed to the contract's *NZ IFRS 17* portfolio. These costs should fully provide for future costs, taking into account expected economies or diseconomies of scale.

   d. For *participating insurance contracts*, the expected value of future bonuses and the policyholders' share of any unvested surpluses (if not already incorporated by *NZ IFRS 17*).

iii. Discounting should be applied as follows:

   a. Where all of the fulfilment cash-flows relating to an insurance item are expected to be paid within two years of the contract commencement date, discounting of cash-flows is optional.

   b. Discount rates used for the valuation of *participating insurance contracts* should be those used under *NZ IFRS 17*, provided they are consistent with the earning assumptions used to project bonuses and other *direct participation features*.

   c. In all other cases, discount rates must be risk-free and must be derived using appropriate methods from observed New Zealand government nominal bond yields that relate to the nature, structure and term of the future obligations. For terms beyond those where observations are possible the *long-term forward rate* should be used to extend the yield curve. *NZ IFRS 17* discount rates should not be applied unless they are consistent with this approach.

iv. Income benefits currently in payment and triggered by a contingent event must form part of the *liability for incurred claims*.

v. Adjustments for non-financial risk must be included in *standardised insurance items* and must be calibrated to a 75 percent probability of sufficiency for solvency entities open to new business and a 90 percent probability of sufficiency for solvency entities in run-off. Calibrations must relate to the net-of-reinsurance cash-flows and allow for risk diversification as follows:

   a. For *long-term insurance contracts*, within each *product class*.

   b. For *short-term insurance contracts*, within the *solvency entity*.

Paragraph 28 has been modified by the Interim Solvency Standard Amendment Standard 2024.

29. *Standardised liabilities for remaining coverage* under *short-term insurance contracts* may optionally be determined using the *NZ IFRS 17 Premium Allocation Approach* modified by paragraph 27 and further modified as follows:

   i. Add amounts of premiums that have not fallen due yet but are expected to fall due over the *contract boundary*. Corresponding premium receivable assets must be established as *standardised* non-insurance *items* contributing to *solvency capital*.

   ii. Deduct an amount for unamortised *insurance acquisition cash-flows* over the remaining *contract boundary*, to the extent they are not already deducted in the *NZ IFRS 17 liability for remaining coverage*. This deduction must be made regardless of the approach for accounting purposes, including whether paragraph 59(a) of *NZ IFRS 17* has been applied or not.

   iii. Deduct the portion of any *reinsurance* or *retrocession* premiums paid (net of the corresponding portion of *reinsurance* commission received) that relates to the *remaining coverage period*.

iv. Add the expected amount of any *reinsurance* or *retrocession* premiums (net of the corresponding amount of *reinsurance* commission to be received) remaining to be paid in respect of the part of the *coverage period* that has expired.

v. Where, in the opinion of the *appointed actuary*, the result of applying this paragraph 29 and the modifications in sub-paragraphs (i) to (iv) varies by more than five percent or $100,000 (whichever is greater) from the value that would have been obtained by applying paragraph 28, make any necessary adjustment to ensure that the result of applying this paragraph equal to the estimated value that would have been obtained by applying paragraph 28.

Paragraph 29 has been modified by the Interim Solvency Standard Amendment Standard 2024.

30. Investment-linked *life insurance* liabilities may be determined as functions of the fair values of the units, provided that it can be shown that the values are not *materially* different from those that would have been determined if applying the approach in paragraphs 27 and 28.

Paragraph 30 has been modified by the Interim Solvency Standard Amendment Standard 2024.

31. Any *NZ IFRS* current or deferred tax items that are *insurance items* are effectively replaced with *standardised* current or deferred tax items by the operation of paragraph 25. These *standardised* tax items are also *insurance items* and include (non-exclusively):

i. the present value of *taxation expense* to be generated under the *insurance contract* (as determined in paragraphs 27 to 30); and

ii. the present value of future changes in tax reserves under the Income Tax Act 2007 to be generated under the *insurance contract*, to the extent not already included in (i)

Allowance for future tax payable must be made once, and only once, in the *standardised insurance items*.

Paragraph 31 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Adjustments to non-insurance items

32. Some of the *items* to be adjusted in paragraphs 33 to 46 have linked *NZ GAAP taxation items*. These *taxation items* should be modified in line with *NZ GAAP* principles as a result of the adjustments to the underlying *items*.

Elections under *NZ IAS 1*

This heading has been modified by the Interim Solvency Standard Amendment Standard 2024.

33. If a *licensed insurer* intends to liquidate or cease trading, and has prepared its financial statements on that basis in accordance with paragraph 25 of *NZ IAS 1*, a reduction in *capital* may be required.

34. The reduction will be the amount by which *capital* on the reported basis exceeds that which would have been presented assuming a going-concern paradigm (as defined in *NZ IAS 1*).

Paragraph 34 has been modified by the Interim Solvency Standard Amendment Standard 2024.

35. Where *capital* on the reported basis is less than that on the going-concern basis, no reduction is required.

Fair value adjustments

36. For the purposes of this standard, assets backing *insurance items* must be held at fair value through profit and loss. Valuations according to *NZ IFRS 9* are deemed to be fair value. Where assets backing *insurance items* are held at other than fair value, *licensed insurers* must adjust reported *capital* accordingly.

Paragraph 36 has been modified by the Interim Solvency Standard Amendment Standard 2024.

37. Where, in the reasoned opinion of the *appointed actuary*, the value of the items listed in paragraph 113 exceeds their economic value, the *licensed insurer* must reduce reported capital accordingly. For the avoidance of doubt, the *appointed actuary* is under no obligation to form such an opinion.

Paragraph 37 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Deductions from capital

38. The following *items* must be deducted from *capital*:

    i. Unrealised gains and losses on liabilities designated at fair value through profit and loss that arise from changes in the *licensed insurer's* own credit risk.

    ii. Any fair value gain that relates to a financial instrument for which fair value is:

        a. determined in whole or in part using a valuation technique based on assumptions that are not supported by processes from observable current market transactions in the same instrument;

        b. not based on observable market data; or

        c. based on prices in a market that is not active.

    iii. An allowance for any dividend that has been declared or repayment of *capital* that has been made prior to the finalisation of the solvency margin calculations, but that has not been reflected in the financial statements or *alternative financial information*.

Financial reinsurance

39. *Licensed insurers* must inspect all their *reinsurance agreements* in respect of *long-term insurance contracts* in accordance with the requirements of Appendix 2.

40. Any *repayable amount adjustment* determined under Appendix 2 must be deducted from *capital*.

Contingent assets and liabilities

41. *Contingent assets* are as defined by *NZ IAS 37*.

42. *Contingent liabilities* are those that must be disclosed under *NZ IAS 37*, and also include *direct credit substitutes* to the extent that the *direct credit substitutes* have not been fully recognised in the *licensed insurers'* financial statements.

43. Where the fair values of *contingent assets and liabilities* have been disclosed in the notes to the most recent set of audited accounts, they should be included in *solvency capital* at fair value.

Paragraph 43 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Paragraph 43 has been modified by the Interim Solvency Standard Amendment Standard 2024.

44. If paragraph 43 does not apply:

    i. contingent liabilities should be included in *solvency capital* at their likely maximum exposure; and

    ii. contingent assets should not contribute to *solvency capital*.

Quality of capital

Disallowed instruments

45. *Capital* must be reduced by the value of any instruments that do not meet the general and specific requirements set out in Appendix 1.

Perpetual instruments

46. *Capital* must be reduced by the excess of the value of perpetual instruments over the following proportions of the total value of *capital*:

    i. 50 percent where the *licensed insurer* is mutually owned.

    ii. 25 percent in any other case.

Capital requirements

47. This standard establishes several *capital* requirements for each *solvency entity*:

    i. The *prescribed capital requirement (PCR).*

    ii. The *adjusted prescribed capital requirement (APCR)*.

    iii. The *minimum capital requirement (MCR)*.

    iv. The *adjusted minimum capital requirement (AMCR)*.

Prescribed capital requirement

48. The *PCR* is the minimum amount of *capital* that a *licensed insurer* should maintain in normal circumstances.

49. The *PCR* is the sum of *capital charges* for the underlying risks and is subject to a minimum of the *fixed capital amount* appropriate to the nature of the insurance business, determined as follows:

$$PCR = Max\left(FCA, \sum_{i} Max(CC_i, 0)\right)$$

where:

    i. FCA is the *fixed capital amount*;

    ii. CC_i is the *capital charge* for risk category 'i'; and

    iii. i ranges across the following risk categories for which the relevant *capital charges* will be determined:

        a. Insurance.

        b. Market.

        c. Credit.

        d. Operational.

        e. Other

Paragraph 49 has been modified by the Interim Solvency Standard Amendment Standard 2024.

50. In determining *capital charges* under this standard, *licensed insurers* should take into account changes in *tax* position that arise as a consequence of the (gross of *tax*) shock hypothesised in the *capital charge*. In taking account of such *tax* effects, *licensed insurers* should have regard to the treatments set out in Appendix 8.

51. In determining the *tax* effects mentioned in paragraph 50, *licensed insurers* may employ approximate methods, provided that, in the opinion of the *appointed actuary*:

i. employing a precise method would be onerous; and

ii. the values determined are reasonable approximations of the values that would have been determined using precise methods.

52. The *fixed capital amount* is determined as follows:

i. If a *licensed insurer* meets the requirements for the exemptions for small insurers set out in regulations 9 to 13 of the *regulations*, the *fixed capital amount* is NZ$0.

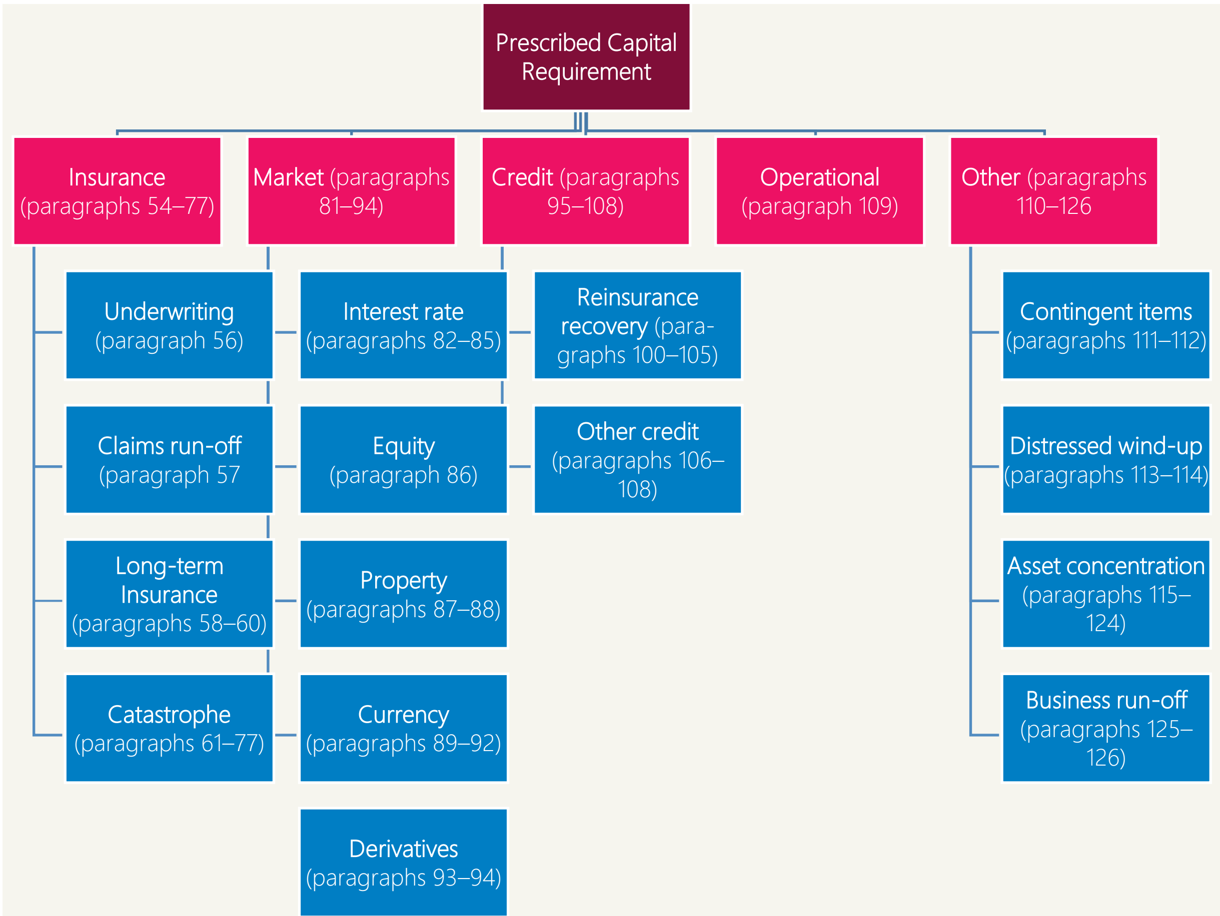
ii. If the *licensed insurer* does not meet the requirements for the exemptions for small *licensed insurers*, then:

a. if the *licensed insurer* is at risk under *long-term insurance contracts*, the FCA is NZ$5 million;

b. if the *licensed insurer* is only at risk under *short-term insurance contracts*, and is a *captive licensed insurer*, the *fixed capital amount* is NZ$1 million; and

c. if the *licenced insurer* is only at risk under *short-term insurance contracts*, and is not a *captive licensed insurer*, the *fixed capital amount* is NZ$3 million.

53. There are three levels of *capital charge* envisaged in this standard – those relating to the *PCR*, to high-level risk categories and to contributory risks. These are set out in the diagram below.



Insurance risk

54. For *captive insurers* that are *licensed insurers*, the *insurance risk capital charge* is an amount equal to 20 percent of the largest per-event retention of the *licensed insurer* plus the cost (if any) of one reinstatement of the relevant *reinsurance* programme. The largest per-event retention is the cost to the *licensed insurer* of the largest *individual claim* or series of claims relating to an event to which it could reasonably be exposed under *insurance contracts* issued, net of *reinsurance* recoveries. If the *licensed insurer* issues policies that do not have a maximum sum insured, or are not protected by excess-of-loss *reinsurance*, then the *licensed insurer* must seek the advice of its *appointed actuary* as to a reasonable approximation of the largest foreseeable per-event retention.

55. For *licensed insurers* other than *captive insurers*, the *insurance risk capital charge* is the sum of the *capital charges* for:

    i. underwriting risk (short-term business);

    ii. claims run-off risk (short-term business);

    iii. insurance risk (long-term business); and

    iv. catastrophe risk.

Underwriting risk (short-term business)

56. The *underwriting risk capital charge* is required in respect of *short-term insurance contracts*. The calculation is to be made by *product class* and summed across all classes. It is determined by multiplying the sum of the following expenses expected to be incurred or amortised over the *remaining coverage period* for *short-term insurance contracts* by the factors in the table below. These expenses may be discounted, consistent with the approach in paragraph 28(iii).

    i. Claims (net of *reinsurance*);

    ii. Cost of *reinsurance* not secured on guaranteed terms by the *solvency determination date*;

    iii. *Maintenance costs* and *investment management costs*; and

    iv. An adjustment for non-financial risk, in accordance with paragraph 28(v).

Factor	Product class
14%	Domestic property, domestic motor, commercial motor, life classes other than disability income, and travel
16%	Commercial property, marine and aviation, credit, personal accident, other commercial, other personal lines, health, disability income and *inwards reinsurance*
22%	Liability

Paragraph 56 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Claims run-off (short-term business)

57. The *claims run-off risk capital charge* is determined by multiplying the *standardised liability for incurred claims* (net of *reinsurance*) for *short-term insurance contracts* at the *solvency determination date* by the factors in the table below. *Solvency entities* in *run-off* should use the factors in the 'closed' column while other *solvency entities* should use the factors in the 'open' column. In each case the calculation must made by *product class* and summed across all classes.

Factor		**Classes**
Open	Closed	
9%	36%	Domestic property, domestic motor, commercial motor, life classes other than disability income, and travel
11%	44%	Commercial property, marine and aviation, credit, personal accident, other commercial, other personal lines, health, disability income, and *inwards reinsurance*
15%	60%	Liability

Paragraph 57 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Long-term insurance risk

58. The *solvency liability* for *long-term insurance contracts* is determined using the methods used to determine the *risk-adjusted best estimate liability*, but:

    i. adopting the *prescribed solvency assumptions* set out in Appendix 5;

    ii. appropriately applying *discretions*; and

    iii. disallowing netting of *reinsurance* if and to the extent that Appendix 4 applies.

Paragraph 58 has been modified by the Interim Solvency Standard Amendment Standard 2024.

59. The *long-term insurance risk capital charge* is subject to a minimum of zero, and is determined for *long-term insurance contracts* in each *product class* by:

    i. calculating the total of the *current termination value*s using the *prescribed solvency assumptions* where applicable;

    ii. determining the *solvency liability* at the balance date;

    iii. taking the greater of the *current termination value*s and *solvency liability*; and

    iv. deducting the *risk-adjusted best estimate liability* from the result in subparagraph (iii).

Paragraph 59 has been modified by the Interim Solvency Standard Amendment Standard 2024.

60. The *long-term insurance risk capital charge* for each *solvency entity* is the total of the amounts determined for each *product class*.

Catastrophe risk

Introduction

61. The calculation of the *catastrophe risk capital charge* is based on the *licensed insurer*'s potential future losses, net of *reinsurance*, under three risk types: seismic risk, pandemic mortality risk and other event risk. Other event risk is any catastrophe risk that may impact the *licensed insurer* other than seismic risk and pandemic mortality risk.

62. The calculation of the *extreme event exposure* under each risk type must include all exposures under all *insurance contracts* issued by the *licensed insurer* that could arise as a result of an *extreme event*. These include exposures under secondary events triggered as a result of a primary event and where losses are aggregated under *reinsurance* treaties with those of the primary event.

63. Any *reinsurance* recoverables taken into account in paragraph 61 must be under arrangements that meet the requirements of Appendix 4 from 1 January 2023 for life and health *product classes* and from 1 January 2024 for non-life *product classes*.

Seismic risk

64. The *seismic risk capital charge* is zero for *licensed insurers* that do not insure against risks arising from earthquakes. For all other *licensed insurers*, the *seismic risk capital charge* is determined in accordance with paragraphs 65 to 67.

65. *Net insurance losses* refers to the insurance losses from a single seismic event. For non-life *product classes* these losses must be calibrated to a 99.9 percent *occurrence exceedance probability*, while for life and health *product classes* the losses should be calibrated to a 99.5 percent *occurrence exceedance probability*. *Net insurance losses* are net of *reinsurance* and include losses from shaking, liquefaction, tsunami, landslide, fire, mortality and morbidity. *Natural Hazards Commission* claims and recoveries do not form part of *net insurance losses*.

Paragraph 65 has been modified by the Interim Solvency Standard Amendment Standard 2024.

66. The *seismic risk capital charge* is determined as:

    i. *net insurance losses*; plus

    ii. the additional cost (if any) of one reinstatement of the full catastrophe *reinsurance* programme (if the *net insurance losses* would cause a termination of or reduction in the programme). The *licensed insurer* is not, however, required to hold this additional cost during the 168-hour period following an initial seismic event that is likely to trigger claims under the catastrophe *reinsurance* programme.

67. The cost of one reinstatement referred to in paragraph 66(ii) must be determined using contractually agreed rates for reinstatement, if available. In other cases *licensed insurers* must estimate the costs based on current *reinsurance* market conditions.

Pandemic mortality risk

68. The *pandemic risk capital charge* is zero for *licensed insurers* that do not insure against mortality risk. For all other *licensed insurers*, the *pandemic risk capital charge* is determined as:

    i. the increase in net mortality strain that would occur should mortality rates be higher than expected by one per thousand over the full year; plus

    ii. the additional cost (if any) of one reinstatement of the full catastrophe *reinsurance* programme for mortality risk (if an increase in mortality rates by one per thousand over the coming year would cause the termination or reduction of the programme).

69. *Net mortality strain* is determined as:

    i. the death benefits expected to be paid in the coming year; less

    ii. the expected *reinsurance* recoveries in respect of the benefits payable in subparagraph (i); less

    iii. the *standardised insurance items* (net of *reinsurance*) that would be released on payment of the benefits in subparagraph (i).

70. The *pandemic risk capital charge* is subject to a minimum of zero.

Other event risk

71. To determine the *other event capital charge*, the *licensed insurer* should identify potential catastrophe events that:

    i. are not seismic or pandemic mortality events;

    ii. are representative of events that could impact the *licensed insurer* in the coming year; and

    iii. have an estimated loss return period of approximately 200 years.

72. Having identified the events in accordance with paragraph 71, the *licensed insurer* must, for each of those events, determine, for each event identified in paragraph 71, the estimated decrease in the *licensed insurer's solvency capital*, taking into account any associated *reinsurance* recoveries and releases of liabilities.

73. The *other event capital charge* is equal to the absolute value of the greatest decrease determined in paragraph 72.

Default risk

74. The *default catastrophe risk capital charge* is two times the largest per-risk retention of the *licensed insurer* plus the cost (if any) of one reinstatement of the catastrophe *reinsurance* programme.

75. The largest per-risk retention is the estimated cost to the *licensed insurer* of the largest *individual claim* to which it could reasonably be exposed under policies issued, net of *reinsurance* recoveries. If the *licensed insurer* issues policies that do not have a maximum sum insured, or are not protected by excess of loss *reinsurance*, then the *licensed insurer* must seek the advice of its *appointed actuary* as to a reasonable approximation of the largest per-risk retention.

Aggregation

76. The *catastrophe risk capital charge* is determined as:

$$\boldsymbol{Max}(\boldsymbol{SR}, \boldsymbol{PR}, \boldsymbol{OE}, \boldsymbol{DC})$$

where

i. SR is the *seismic risk capital charge*;

ii. PR is the *pandemic risk capital charge*;

iii. OE is the *other event capital charge*; and

iv. DC is the *default catastrophe risk capital charge*.

Actuarial review

77. The *licensed insurer* must require its *appointed actuary* to review the basis on which the *catastrophe risk capital charge* has been determined. If the *appointed actuary* has any concerns with respect to the *catastrophe risk capital charge*, the *licensed insurer* must require the *appointed actuary* to report them to the *licensed insurer*'s board as soon as reasonably possible and also to report those matters to the *Reserve Bank* along with the *licensed insurer*'s solvency calculation.

Asset classification

Collective investment vehicles

78. If the *licensed insurer* holds investments in a professionally managed *collective investment vehicle* or in a subsidiary that is primarily used to hold investments for the *licensed insurer*, then the *licensed insurer* must 'look through' the investment vehicle or subsidiary to the underlying investments that represent the assets attributable to the *licensed insurer*. The *licensed insurer* must take account of any special conditions (such as guarantees or redemption restrictions) that the investment vehicle or subsidiary may provide.

79. For the purposes of paragraph 78, a *licensed insurer* must only 'look through' an investment vehicle or subsidiary if it is satisfied with the quality and reliability of the information about the underlying investments. If the *licensed insurer* is not satisfied, or if the look-through approach cannot be applied, then the investment vehicle or subsidiary must be considered to be an indivisible asset or liability of the *licensed insurer*.

Hypothecated portfolios

80. The *market risk capital charge* and the *credit risk capital charge* for *hypothecated portfolios* of assets and liabilities may be separately determined. However, the following criteria must be met for each *hypothecated portfolio*:

i. The specific assets and liabilities must have been hypothecated together, either:

a. because the value of the liabilities is dependent on the value of the assets; or

b. to facilitate the effective financial management of the business.

ii. The hypothecated assets and liabilities must be managed together, and such management must include risk-management practices, management accounting and board reporting.

iii. The hypothecation used must be transparent. In particular, the assets and liabilities that are hypothecated together, as well as how the criteria in subparagraphs (i) and (ii) have been met, must be documented.

iv. A consistent approach must be applied to the identification and management of hypothecated assets and liabilities. Where changes are made to the number, structure or nature of a hypothecated asset or liability portfolio, or where there are significant changes in the financial amount of the hypothecated asset or liability portfolio, the justification for the change and potential impacts must be documented.

v. The *licensed insurer's appointed actuary* must be satisfied that all the above criteria have been met before the treatment set out within this paragraph can be applied within the entity's solvency calculations. If the *appointed actuary* is not satisfied in this respect then both the *market risk capital charge* and the *credit risk capital charge* must be determined without hypothecation.

Market risk

81. The *market risk capital charge* is the sum of the *capital charges* for:

i. interest rate risk;

ii. equity risk;

iii. property risk;

iv. currency risk; and

v. derivative instruments.

Interest rates

82. The *interest rate risk capital charge* is determined by reference to *standardised items* that have value dependent on market interest rates, for example due to discounting. For the purposes of determining the *interest rate capital charge*, these *items* are to be classified as follows:

i. Interest-sensitive investment assets.

ii. Interest-sensitive *insurance items*, excluding any *standardised liability for remaining coverage* in product classes where the *standardised liability for remaining coverage* is negative (i.e. an asset).

iii. Other interest-sensitive items, such as (non-exclusively) lease assets and liabilities, derivative positions and contingent assets and contingent liabilities (as defined by paragraph 10 of *NZ IAS 37*).

83. The *interest rate risk capital charge* is determined by separately revaluing the *items* referred to in paragraphs 82(i) to (iii) under each upwards shock and downwards shock movement in all nominal and real interest rates, as set out in the table below (in which 'bp' means basis point), applied to all interest-sensitive *items*.

	Current interest rate	Up shock (gross of tax)	Down shock (gross of tax)
Nominal interest rate instruments	≥ 1%	Increase of 175 bp	Decrease of 175 bp
	≤ 1% and > 0%	Increase of 150 bp	Decrease of 150 bp
	≤ 0% and > -1%	Increase of 125 bp	Decrease of 125 bp
	≤ -1%	Increase of 100 bp	Decrease of 100 bp
Real interest rate instruments	≥ 1%	Increase of 60 bp	Decrease of 60 bp
	≤ 1% and > 0%	Increase of 50 bp	Decrease of 50 bp
	≤ 0% and > -1%	Increase of 40 bp	Decrease of 40 bp
	≤ -1%	Increase of 30 bp	Decrease of 30 bp

84. The current interest rate referred to in the table is the nominal interest rate used to value each cash-flow for the *items* referred to in paragraphs 82(i) to (iii).

85. The net revaluation impact must be determined for each upwards shock and each downwards shock, and that impact is the change in the value of *solvency capital* resulting from the relevant shock (summed over both the nominal and the real interest rate instruments). The *interest rate risk capital charge* is equal to whichever of the net revaluation impacts under either the upwards shock or the downwards shock has the greatest adverse impact on the *licensed insurer's solvency capital*.

Equity

86. The *equity risk capital charge* is determined by:

i. multiplying the standardised value of the asset types in the table below by the corresponding *capital factor*;

ii. summing across those types; and

iii. deducting any consequent decrease, or adding any consequent increase, in the standardised value of *insurance items*, after an allowance for appropriate discretion in accordance with Appendix 7.

Type	Capital factor
Equities listed on a *recognised stock exchange*	25%
Listed trusts (unless looked through in accordance with paragraphs 78 and 79, excluding listed property trusts)	25%
Unlisted equities	35%
Unlisted trusts (unless looked through in accordance with paragraphs 78 and 79, excluding unlisted property trusts)	35%

Paragraph 86 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Paragraph 86 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Property

87. The *property risk capital charge* is determined by:

  i. multiplying the standardised value of the asset types in the table below by the corresponding *capital factor*;

  ii. summing across those types; and

  iii. deducting any consequent decrease ,or adding any consequent increase, in the standardised value of insurance items, after an allowance for appropriate *discretions* in accordance with Appendix 7.

Type	Capital factor
Listed property trusts	25%
Direct property holdings	25%
Owner-occupied property	25%
Property, plant and equipment	25%
Unlisted property trusts	35%

Paragraph 87 has been modified by the Interim Solvency Standard Amendment Standard 2024.

88. [Deleted]

Paragraph 88 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Foreign currency

89. The *foreign currency risk capital charge* is determined by:

    i. multiplying by 22 percent the net open foreign exchange position in each currency other than New Zealand dollars, regardless of whether the position is long or short;

    ii. summing across currencies; and

    iii. deducting any consequent decrease, or adding any consequent increase, in the standardised value of *insurance items*, after allowance for appropriate *discretions* in accordance with Appendix 7.

90. The net open foreign exchange position is the absolute value of the difference between the value of assets and the value of liabilities (taking into account applicable derivative positions and including any *contingent liabilities*) that are denominated in the relevant currency.

Paragraph 90 has been modified by the Interim Solvency Standard Amendment Standard 2023.

91. If a *licensed insurer*'s asset is denominated in a foreign currency and has been guaranteed, the underlying asset is included in the net open foreign exchange position, but the guarantee is not.

92. If a *licensed insurer*'s New Zealand-dollar asset is subject to a guarantee that is:

    i. denominated in a foreign currency; and

    ii. limited to a particular foreign currency value,

    then the amount of the guarantee recognised in the calculation of the *credit risk capital charge* must be included in the calculation of the net open foreign exchange position for the relevant foreign currency.

Derivative instruments

93. The *derivative instruments capital charge* is the sum of the following:

    i. For equity and bond derivatives, the product of the asset or liability net position and the relevant *equity risk capital charge* factors or *credit risk capital charge* factors.

    ii. For options, the delta weighted position, determined by multiplying the face value by the *delta factor*.

    iii. For mark-to-market gains on any derivatives, the product of the mark-to-market gains and the appropriate *equity risk capital charge* factors or *credit risk capital charge* factors.

94. The interest rate or foreign currency position arising from derivative transactions is excluded from the calculation of the *derivative instruments capital charge*.

Credit risk

95. The *credit risk capital charge* is the sum of:

    i. the *reinsurance recovery risk capital charge*; and

    ii. the *other credit risk capital charge*.

Guidance: Allowances for yield spreads (that is, illiquidity premia and spread risk *capital charges*) will be considered in the preparation of the *final solvency standard*.

96. [Deleted]

Paragraph 96 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Counterparty grades

97. The *credit risk capital charge* depends on the *counterparty grade* of *reinsurers*, other counterparties or the issue rating of an asset. The *counterparty grade* is determined with reference to ratings issued by recognised rating agencies, namely:

    i. the credit rating of an asset in respect of investment assets (issue ratings) or, in some cases, the rating of the counterparty (issuer rating); and

    ii. the insurer financial strength rating in respect of *reinsurance* assets.

98. Each *licensed insurer* must adopt a policy that states the rating agency that it will use as a first preference and other agencies (in order of preference) that it will use if the preferred agency does not publish ratings for a particular counterparty or asset.

Guidance: Because rating agencies do not always agree, it is necessary to have a consistent method of determining the *counterparty grade* to use.

99. The *counterparty grades* are determined by reference to the table below. Where an asset does not have a public rating but the issuer does have a public rating, the rating of the issuer, determined by reference to rows 8 to 10, may be used. 'Short-term issues' are assets that mature in less than 12 months, and 'long-term issues' mature in 12 months or more.

Counterparty grade		1	2	3	4	5
Short-term issues	Standard & Poors	A1+	A1	A2	A3	Other
	Moody's		P1	P2	P3	Other
	Fitch	F1+	F1	F2	F3	Other
	AM Best	AMB-1+	AMB-1	AMB-2	AMB-3	Other
Long-term issues	Standard & Poors, Fitch	AAA	AA+ AA AA-	A+ A A-	BBB+ BBB BBB-	Below / unrated
	Moody's	Aaa	Aa1 Aa2 Aa3	A1 A2 A3	Baa1 Baa2 Baa3	Below / unrated
	AM Best	Aaa	aa+ aa aa-	a+ a a-	bbb+ bbb bbb-	Below / unrated
Reinsurers and issuers	Standard & Poors, Fitch	AAA	AA+ AA AA-	A+ A A-	BBB+ BBB BBB-	Below / unrated
	Moody's	Aaa	Aa1 Aa2 Aa3	A1 A2 A3	Baa1 Baa2 Baa3	Below / unrated

Counterparty grade	1	2	3	4	5
AM Best	A++	A+	A A-	B++ B+	Below / unrated

Reinsurance recovery

100. The *reinsurance recovery risk capital charge* is the sum of the *capital charge for reinsurance disputes* and the *reinsurance credit risk capital charge*.

101. For the purposes of the *reinsurance recovery risk capital charge*, the *reinsurance recovery asset* is determined as follows:

   i. The sum of:

      a. any *outwards reinsurance* component of the *standardised liability for remaining coverage* in respect of *long-term insurance contracts*, where this is an asset to the entity;

      b. *reinsurance* recoverable in respect of the *standardised liability for incurred claims*;

      c. deferred *reinsurance* expense assets, (whether recognised as an *insurance item* or not under paragraph 22) less any unearned exchange commission;

      d. amounts due from *reinsurers* in respect of paid claims;

      e. amounts due from co-insurers, including the *Natural Hazards Commission*, in respect of the recovery of claim amounts previously paid by the *licensed insurer* in respect of the co-insurer's share of the loss; and

      f. any *outwards reinsurance* component of the *standardised liability for remaining coverage* in respect of *portfolio reinsurance*, where this is an asset to the *solvency entity*, other than a deferred *reinsurance* expense asset included in sub-paragraph (c).

   ii. less

      a. any allowance in subparagraphs (i)(a) to (f) for non-fulfilment of obligations by the *reinsurer*; and

      b. any liability component that meets the requirements of paragraph 102.

Paragraph 101 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Paragraph 101 has been modified by the Interim Solvency Standard Amendment Standard 2024.

102. The *reinsurance recovery asset* does not include recoveries that are not *reinsurance* (for example, salvage and subrogation). Where arrangements with a *reinsurer* involve both liability and asset components, these may be taken as a single net exposure to the extent that they are subject to a legally enforceable right of offset.

Capital charge for reinsurance disputes

103. A component of the *reinsurance recovery asset* is in dispute if one or more of the following conditions applies:

i. There is litigation between the reinsurer and the *licensed insurer* in respect of the existence or valuation of the asset.

ii. An arbitration process is underway between the reinsurer and the *licensed insurer* in respect of the existence or valuation of the asset.

iii. There has been written communication between the parties evidencing a disagreement in respect of the existence or valuation of the asset, and the disagreement has remained unresolved for more than 180 days since the date of the communication.

iv. A payment by the reinsurer to the *licensed insurer* in respect of the asset is past due by more than 365 calendar days.

v. More than 180 calendar days have elapsed since the *licensed insurer* requested a payment in respect of the asset.

Paragraph 103 has been modified by the Interim Solvency Standard Amendment Standard 2023.

104. The *capital charge for reinsurance disputes* is

$$50\% \times \sum_i Max(V_i^S - V_i^R, 0)$$

where: i includes all *reinsurance* assets in dispute;

V^S_i refers to the *standardised* value of the asset; and

V^R_i refers to the value of the asset agreed by the *reinsurer*, or zero if no *reinsurer* valuation is available.

Paragraph 104 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Reinsurance credit risk capital charge

105. The *reinsurance credit risk capital charge* is the sum across all *reinsurers* of the *reinsurance recovery assets* in respect of each *reinsurer*, multiplied by the factor determined according to the table below.

Counterparty grade	**1**	**2**	**3**	**4**	**5**
Factor	2%	2%	4%	10%, up to a 20% proportion of the total *reinsurance recovery asset*, and 20% above that limit	20%, up to a 10% proportion of the total *reinsurance recovery asset*, and 40% above that limit

Other credit risk

106. The following *items* do not contribute to the *other credit risk capital charge:*

i. Items contributing to the *reinsurance recovery risk capital charge*, *the equity risk capital charge* and the *property risk capital charge*.

ii. Any amount for unamortised insurance acquisition cash-flows mentioned in paragraph 29(i).

Paragraph 106 has been modified by the Interim Solvency Standard Amendment Standard 2024.

107. The *other credit risk capital charge* is determined by:

i. multiplying the *standardised value* (or, in the case of *unpaid premiums* and *premiums not yet due*, the value as defined in paragraph 17) of the asset types in the table below by the corresponding *capital factors*;

ii. summing across the types; and

iii. deducting any consequent decrease from, or adding any consequent increase to, the standardised value of *insurance items*, after an allowance for appropriate *discretions* in accordance with Appendix 7.

Exposure class	Definition	Capital factor
Secured unpaid premium and loans	• *Unpaid premiums* (excluding *reinsurance* premiums or *policyholder* loan debt due to the *licensed insurer)* to the extent that those *premiums* or debts do not exceed the termination value of the contract	0.0%
Cash and sovereign debt	• Notes and coins • Cash at bank on call • Debt or other obligations issued by, or guaranteed irrevocably by, the New Zealand government, or a government with *counterparty grade* 1 or a supra-national agency with *counterparty grade* 1	0.5%
AA-rated fixed interest < 1 year	• Any debt obligation (excluding subordinated debt) maturing or redeemable in less than one year with *counterparty grade* 1 or 2 • Cash-management trusts with *counterparty grade* 1 or 2	1%
AA-rated fixed interest ≥ 1 year	• Any debt obligation (excluding subordinated debt) maturing or redeemable in one year or more with *counterparty grade* 1 or 2 • Positive *tax* balances with Internal Revenue or *tax* pooling agents	2%
Residential mortgage loans	• Direct first ranking residential mortgage loans with loan-to-valuation ratios not exceeding 80% and not in arrears	2.75%
A-rated fixed interest	• Any debt obligation (excluding subordinated debt) with *counterparty grade* 3 • Cash-management trusts with *counterparty grade* 3	4%
Unsecured unpaid premiums not yet due or less than six months past due	• Unsecured *unpaid premiums* (including premium funding receivables but excluding *premiums* payable to *licensed insurers* that are *captive insurers*) that are less than six months past the contractual due date for payment to the *licensed insurer* • *Premiums not yet due*	4%
BBB-rated fixed interest	• Any debt obligation (excluding subordinated debt) or cash-management trust with *counterparty grade* 4	6%

Exposure class	Definition	Capital factor
Short-term-related party debt	• Credit provided to a *related party* on not more than 90-day terms: o in the ordinary course of business; o on an arm's length commercial basis; o where payment is not overdue; and o that does not automatically roll over	6%
Unrated *local authority* debt, and third-party claim recoveries	• Any debt obligation with a *local authority* that is unrated • Claim recoveries collectable from third parties (excluding *reinsurance* recoveries and co-insurance recoveries from the *Natural Hazards Commission*)	8%
Other direct lending	• Other direct loans, whether secured or not	10%
Other fixed-interest and short-term unsecured unpaid premiums	• Any debt obligation or cash-management trust that has a *counterparty grade* 5 or is unrated • Subordinated debt of a counterparty with *counterparty grade* 1, 2 or 3 • Unsecured *unpaid premiums* (including premium funding receivables and amounts included in *insurance items*, but excluding *premiums* payable to captive *licensed insurers*) that are more than six months but less than 12 months past the contractual due date for payment to the *licensed insurer*.	15%
Transactions between a *licensed insurer* that is a *captive insurer* and its parent owner or a subsidiary of its parent owner	• Any debt, obligation or other balance of any nature between a *licensed insurer* that is a *captive insurer* and its parent owner or a subsidiary of its parent owner	15%
Other on-*balance-sheet* assets not covered elsewhere	• Any other on-*balance-sheet* assets not described in this table, including assets associated with *non-insurance activities* that are not dealt with elsewhere, but excluding *reinsurance* assets contributing to the *reinsurance recovery risk capital charge*, any co-insurance amounts recoverable from *the Earthquake Commission* and right-of-use assets under leases	40%
Assets incurring a full *capital charge*	• Loans to directors or associated parties of the *licensed insurer* • Unsecured loans to employees or agents of the *licensed insurer* in excess of NZ$1,000 • Assets under a charge (as defined in section 3 of the Insolvency Act 2006) • Right-of-use assets, to the extent that they exceed the corresponding lease liabilities recognised under *NZ IFRS 16* • Obligations of a *related party* (except short-term *related party* debt) • Unsecured *unpaid premiums* (including premium funding receivables) that are 12 months or more past the contractual due date for payment to the *licensed insurer*	100%

Paragraph 107 has been modified by the Interim Solvency Standard Amendment Standard 2024.

108. If, in the preceding table, an *item* can be attributed to multiple exposure classes, that *item* should be attributed to the exposure class with the highest *capital factor*.

Operational risk

109. The *operational risk capital charge* is determined as follows:

$$ORCC\% \times \left[Max\left(IR, STL + \frac{LTL}{10}\right) + Max(IR - 1.2 \times IRP, 0)\right]$$

where:

ORCC% is the *operational risk capital charge* percentage, determined according to the following table;

Year in which ***solvency determination date*** falls	2023	2024	2025	2026 and beyond
ORCC%	0%	1%	2%	3%

LTL is the sum of the absolute values for each *product class* of *standardised insurance items* in respect of *long-term insurance contracts*;

IR is the *NZ IFRS 17 insurance revenue* in the most recent financial year (including the *insurance revenue* of any *solvency entity* that has been absorbed by the continuing *solvency entity*);

IRP is the *NZ IFRS 17 insurance revenue* in the preceding year (including the *insurance revenue* of any *solvency entity* that has been absorbed by the continuing *solvency entity*); and

STL is the sum of the absolute values for each *product class* of *standardised insurance items* for *short-term insurance contracts*.

Other capital charges

110. *Other capital charges* is the sum of the following *capital charges*:

i. *Contingent items*.

ii. *Distressed wind-up*.

iii. *Asset concentration*.

iv. *Business run-off*.

Contingent items

111. The *capital charge* for contingent *items* is the sum across all contingent *items* of the absolute values of the following:

i. The stressed value of each contingent item; less

ii. The standardised value of each contingent item (i.e. the value at which the item contributes to *solvency capital*).

112. The stressed value of a contingent *item* must be determined by considering the range of possible *capital* outcomes (excluding market risk effects) for the present value of the cash-flows referable to the *item*, and estimating the outcome at the 99.5th percentile after one year, where the 100th percentile is the worst outcome of all. The basis of estimation must be described in the *licensed insurer's financial condition report*. Where such estimation is not feasible, the stressed value of each contingent asset may be set to zero and the stressed value of each contingent liability set to its likely maximum exposure.

Paragraph 112 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Paragraph 112 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Distressed wind-up

113. The *capital charge* for a reduction in asset values on the distressed *wind-up* of an *entity* is subject to a minimum of zero and is the total of the *standardised* values of the following *items*, less any amount that has been deducted from *capital* under paragraph 38 in respect of each asset:

i. Goodwill, net of any associated deferred tax liability.

ii. Capitalised computer software costs to the extent that they exceed the resale value of that software (if known) or zero (if not known).

iii. Any other non-insurance asset defined as intangible under *NZ GAAP*.

iv. The shareholder portion of deferred tax assets determined in accordance with Appendix 8, on the assumption that the *licensed insurer* is wound up and the net *taxation* position on *wind-up* is a deferred tax asset.

v. Equity investments in, and subordinated loans to, *related parties*.

vi. Equity investments in, and subordinated loans to, other *financial institutions* or holding companies of other *financial institutions* (whether held directly or indirectly) with *counterparty grades* 1, 2 or 3, to the extent that the total of such equity investments or subordinated loans exceeds 15 percent of *solvency capital*, determined excluding investments and loans treated by this sub-paragraph.

vii. Equity investments in, and subordinated loans to, other *financial institutions* or holding companies of other *financial institutions* (whether held directly or indirectly) with *counterparty grades* 4 or 5.

viii. Any surplus, net of any associated deferred tax liabilities, in any defined benefit superannuation fund sponsored by the *licensed insurer*, or another group entity, as employer.

ix. Any portion of the *licensed insurer*'s *solvency capital* relating to its overseas branches not *freely available* to meet the losses of the *licensed insurer* outside those branches.

Paragraph 113 has been modified by the Interim Solvency Standard Amendment Standard 2024.

114. To the extent that an asset contributes to the *distressed wind-up capital charge*, it does not contribute to market, credit or asset concentration *capital charges*.

Asset concentration

Exposures

115. In order to determine an *asset concentration capital charge*, a *licensed insurer* must first determine the total value of its exposures to each single party or group of *related parties* (the counterparty). The exposures must include:

    i. assets (excluding right-of-use assets arising from lease contracts recognised under *NZ IFRS 16*);

    ii. the absolute value of contingent liabilities included in the *market risk capital charge* or the *credit risk capital charge*; and

    iii. the gross *balance sheet* asset in respect of derivative instruments with that counterparty ('asset derivative position') or, where there is a legally binding netting agreement with that counterparty, the net asset derivative position with that counterparty.

116. For *solvency entities* with total assets of less than NZ$10 million, bank bills issued by or deposits (including term deposits and cash on call) with registered New Zealand banks do not need to be included in the calculation of the *asset concentration capital charge*.

117. Where an asset is guaranteed and the guarantee requirements of clause 5 of Appendix 6 are met, then the *licensed insurer* may substitute the guarantor for the direct counterparty in respect of the guaranteed portion of the asset for the purposes of the *asset concentration capital charge*. The guarantor may be substituted to the full value of the guarantee whether or not clause 4 of Appendix 6 applies.

118. Where the *licensed insurer* has 'looked through' a *collective investment vehicle* or subsidiary in accordance with paragraph 78, the same look-through basis must be used in calculating the *asset concentration capital charge*.

Calculation

119. The excess exposure must be determined for each counterparty and each obligation category as the exposure determined in paragraphs 115 to 118 less the limit specified in the table below.

Obligation category	Limit (% of total assets of the entity excluding any reinsurance recovery assets)	Multiple
1. Issued by the New Zealand government or by a national government or supra-national agency of *counterparty grade* 1	100%	1
2. For *captive insurers* only, exposures to the parents of the *captive insurers* or subsidiaries of those parents	66%	1

Obligation category	Limit (% of total assets of the entity excluding any reinsurance recovery assets)	Multiple
3. Issued by a New Zealand *local authority* or *State-owned enterprise*	50% (or NZ$5m if greater)	1
4. Bank bills issued by or deposits (including term deposits and cash on call) with a specific New Zealand-registered bank	25% (or NZ$5m if greater)	1
5. Any other asset or counterparty exposure	10% (or NZ$2m if greater)	2

120. The excess exposures must then be allocated to market and credit risk subcategories such that a unique *capital factor* can be identified for each allocated excess exposure. For interest rate risk, the implied *capital factor* must be determined by dividing the *interest rate risk capital charge* by the *standardised* value of assets subject to the charge. Where an exposure can be allocated to multiple subcategories, the one with the highest capital factor must be employed.

Paragraph 120 has been modified by the Interim Solvency Standard Amendment Standard 2023.

121. The preliminary *asset concentration capital charge* in respect of each counterparty is determined as the sum of the products of:

   i. the allocated excess exposures for each obligation category;

   ii. the multiple for that obligation category in the table above; and

   iii. the applicable market risk or credit risk *capital factors*.

122. The amounts determined in paragraph 121 must be totalled across counterparties to determine the preliminary *asset concentration capital charge*.

123. A deduction may be made in respect of any *item* to the extent that the total of the *market risk*, *credit risk* and *asset concentration capital charges* exceeds the *standardised* value of the *item*.

124. The *asset concentration capital charge* is the preliminary *asset concentration capital charge* less all deductions permitted under paragraph 123.

Business run-off

125. The *business run-off capital charge* is determined as follows:

   i. For *licensed insurers* with *long-term insurance contracts* in *run-off*, NZ$100,000, increased with actual inflation and *expected inflation* from 1 January 2023 as appropriate, multiplied by the run-off term.

   ii. For all other entities, NZ$0.

Paragraph 125 has been modified by the Interim Solvency Standard Amendment Standard 2024.

126. The *run-off term* is subject to a minimum of zero years and is the time in years between:

i. the later of:

a. the *solvency determination date*; and

b. the start of the financial year in which *premium revenue* received is expected to fall below NZ$4,000,000, increased with actual inflation and *expected inflation* from 1 January 2023 as appropriate; and

ii. two years after the end of the financial year in which the *licensed insurer's* last *insurance contract* is expected to terminate.

Paragraph 126 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Other capital requirements

Adjusted prescribed capital requirement

127. Where a *solvency licence condition* is expressed as a minimum *solvency margin*, the *Adjusted Prescribed Capital Requirement (APCR)* is determined by adding the dollar minimum amount to the *PCR*.

128. Where a *solvency licence condition* is expressed as a minimum *solvency ratio*, the *APCR* is determined by multiplying the *Prescribed Capital Requirement (PCR)* by that ratio.

129. Where a *solvency licence condition* is expressed in any other way, the *condition of licence* will provide the method for determining the *APCR*.

130. The *adjusted solvency margin* is *solvency capital* less the *APCR*.

131. The *adjusted solvency ratio* is *solvency capital* divided by the *APCR*.

Minimum capital requirements

132. The *minimum capital requirement (MCR)* is 80 percent of the *PCR*.

133. The *adjusted minimum capital requirement* (*AMCR)* is 80 percent of the *APCR*.

Reporting and accountability

Obligations of the licensed insurer

Reporting to the Reserve Bank

134. Section 56(d) of the *Act* allows the *Reserve Bank* to include within a solvency standard requirements relating to reports on the financial condition or solvency of a *licensed insurer*. Section 56(g) of the *Act* allows the *Reserve Bank* to include within a solvency standard requirements relating to the disclosure of information about the financial condition or solvency of the *licensed insurer*.

Solvency returns

135. A *licensed insurer* must provide to the *Reserve Bank* an *annual solvency return* in respect of the *solvency entity*, and the accompanying information set out in paragraph 136(i) to (v) (in respect of the *licensed insurer*).

136. The *annual solvency return* and accompanying information must be completed as at the *licensed insurer*'s financial year end and be supplied within the timeframe required under section 81(1) of the *Act* for the provision of financial statements or group financial statements to the *Reserve Bank*. If the *licensed insurer* is exempt from section 81 of the *Act*, the *annual solvency return* and accompanying information must be supplied within the timeframe specified in regulation 12(c) of the *regulations* for the provision of financial information. The *annual solvency return* must be in the form specified by the *Reserve Bank* on its website and be accompanied by:

    i. a certification signed by two directors of the *licensed insurer* or, in the case of an overseas *licensed insurer*, its New Zealand chief executive officer, in the form specified by the *Reserve Bank*;

    ii. a copy of the audited financial statements or group financial statements of the *licensed insurer* or, where *alternative financial information* has been used, a copy of that information;

    iii. a report by the auditor of the *licensed insurer* on the audit of the *annual solvency return(s)*;

    iv. a *financial condition report* prepared by the appointed actuary of the licensed insurer; and

    v. a report from the *appointed actuary* that meets the requirements of section 78 of the Act.

137. A *licensed insurer* must provide *interim solvency returns* in respect of the *solvency entity* to the *Reserve Bank* in accordance with the conditions of licence issued to the *licensed insurer*.

138. *Interim solvency returns* must be:

    i. supplied within the timeframes specified in the conditions of licence issued to the *licensed insurer;*

    ii. presented in the form specified by the *Reserve Bank* on its website; and

    iii. certified in the manner specified in the conditions of licence issued to the *licensed insurer*.

Paragraph 138 has been modified by the Interim Solvency Standard Amendment Standard 2023.

139. *Annual and interim solvency returns* may form a constituent part of other reporting required by the *Reserve Bank*.

Audit of annual solvency return

140. A *licensed insurer* must engage its auditor to undertake a reasonable assurance-level audit of the *annual solvency return(s)* and must do everything necessary to allow the auditor to undertake this function. The audit may exclude the *catastrophe risk capital charge* and any forward-looking projections required in the *annual solvency return*.

141. The auditor's report on the *annual solvency return* must address the matters prescribed in this solvency standard and must be signed by the auditor.

142. The *Reserve Bank* may, at its discretion, require an independent review of the audit and the auditor's report.

Financial condition report

143. A *licensed insurer* must engage its *appointed actuary* to prepare a *financial condition report*, in accordance with paragraph 161, for the *licensed insurer*, and must do everything necessary to enable the *appointed actuary* to undertake this function.

Disclosure of solvency measures

144. A *licensed insurer* must disclose the information in respect of the *solvency entity* set out in paragraph 147 in its *financial statements* or group *financial statements*. This disclosure must be as at the balance date to which the *financial statements* or group *financial statements* relate, and include comparative information for the immediately preceding financial year.

Paragraph 144 has been modified by the Interim Solvency Standard Amendment Standard 2023.

145. For an overseas *licensed insurer* subject to this solvency standard, the disclosure under paragraph 144 need only be made within the *financial statements* or group *financial statements* prepared for the New Zealand branch.

146. A *licensed insurer* must disclose the information set out in paragraph 147 on its website (if any). This disclosure must be updated within 10 working days following the required date for the submission of each of the *interim solvency returns* to the *Reserve Bank* to reflect the information in those returns.

Paragraph 146 has been modified by the Interim Solvency Standard Amendment Standard 2024.

147. The information to be disclosed is the outputs of the calculations for the following items, for the *licensed insurer* and, if applicable, each *statutory fund*. If this standard is being applied on both a solo and a group basis under paragraph 6, then both sets of information must be disclosed.

    i. *Solvency capital*.

    ii. *Adjusted prescribed capital requirement*.

    iii. *Adjusted solvency margin*.

    iv. *Adjusted solvency ratio*.

Advice to the Reserve Bank on a likely failure to maintain solvency margin

148. Section 24 of the *Act* requires that, if a *licensed insurer* has reasonable grounds to believe that a failure to maintain a *solvency margin* in respect of the *solvency entity* is likely to occur at any time within the next three years, the *licensed insurer* must report the likely failure to the *Reserve Bank* as soon as is reasonably practicable.

149. The method of determining whether, and the extent to which, the *solvency entity's solvency margin* is being maintained during the three-year period referred to in paragraph 148, and whether a reporting obligation arises, is as follows:

   i. The *licensed insurer* must consider a forward-looking assessment of its compliance with the solvency standard in respect of the *solvency entity* in addition to the calculations at the *solvency determination date*. This forward-looking assessment should:

      a. extend for at least three years from the *solvency determination date*;

      b. take into account known aspects of the *licensed insurer*'s business plan, its enterprise risk management practices and the external environment; and

      c. be undertaken on a basis that allows for *capital* movements and on a basis that allows for no *capital* movements.

   ii. The *licensed insurer* must also, under section 24, put in place procedures, including reporting to the *appointed actuary*, that allow for the identification and escalation of circumstances that may give rise to a reporting obligation in respect of the *solvency entity*.

Activities of the appointed actuary

Financial statements

150. Section 77 of the *Act* requires the *licensed insurer* to ensure that actuarial information contained in, or used in the preparation of, the *financial statements* or group *financial statements* is reviewed by the *appointed actuary*. Section 77(4)(c) allows the *Reserve Bank* to specify, within a solvency standard, information that is actuarial information, which is in addition to that specified in section 77(4)(a) and (b).

151. The specified actuarial information for the purposes of section 77(4)(c) of the *Act* relates to the *licensed insurer* and is as follows (to the extent that such information is required to be determined under *NZ IFRS*):

   i. The *liability for remaining coverage*:

      a. Central estimate of expected claims and recoveries.

      b. Allowance for policy administration and claim-handling expenses.

      c. The contractual service margin.

      d. A risk adjustment.

      e. Discounting as required.

ii. The *liability for incurred claims*:

a. Central estimate of expected claims and recoveries.

b. Allowance for claim-handling expenses.

c. A risk adjustment.

d. Discounting as required.

iii. The *reinsurance liability for remaining coverage*.

iv. The *reinsurance liability for incurred claims*.

v. Any *DAC* or deferred fee revenue relevant to the *liability for remaining coverage*.

vi. The policyholder share of the estate for *participating* life business.

vii. Results of any tests for onerousness, as detailed in *NZ IFRS 17*.

152. If it is the *licensed insurer*'s established policy to seek the advice of the *appointed actuary* in respect of part or all of this actuarial information, and to always adopt that advice in its *financial statements* or group *financial statements*, then the advice from the *appointed actuary* to the *licensed insurer* satisfies the review requirements.

153. In other circumstances the *licensed insurer* must require the *appointed actuary* to undertake whatever additional work is necessary in order to complete the review.

154. In completing the review, the *appointed actuary* may need to utilise the skills and experience of other experts in accordance with paragraph 164.

155. The results of the *appointed actuary*'s review must be documented in a report that meets the requirements of section 78 of the *Act*.

156. Any adjustments arising as a result of the review of the *appointed actuary* must be incorporated into the solvency calculations.

157. The *licensed insurer* must require the *appointed actuary* to use professional judgement to determine the extent of work required regarding the tests for onerousness, considering the nature and size of the *licensed insurer*'s business and the *materiality* of the risks involved.

158. Any adjustments arising as a result of this assessment must be incorporated into the *liability for remaining coverage*.

Solvency calculations and reporting

159. The *licensed insurer* must require its *appointed actuary* to either undertake or review all aspects of all solvency calculations in respect of the *solvency entity*, at whatever date and in whatever form they are reported to the management or board of the *licensed insurer* or the *Reserve Bank*. The results of the year-end calculation or review must be documented in the *financial condition report*.

160. The *licensed insurer* must require its *appointed actuary* to include specific comment in the *financial condition report* on:

i. the basis for determining the *solvency entity*'s *catastrophe risk capital charge*;

ii. the adjustment of various items for *taxation*; and

iii. any other *material* issues arising from the solvency calculations.

Financial condition report

161. The *licensed insurer* must require the *financial condition report* prepared by the *appointed actuary* to:

i. identify and describe the *material* risks (of which it is reasonable to expect the *appointed actuary* to be aware) facing the *solvency entity*, that in the *appointed actuary's* opinion pose a threat to the *solvency entity*'s ability to maintain the required solvency margin now or in the future, and where practicable, quantify such risks;

ii. comment on the steps taken or proposed to be taken by the *licensed insurer* to address the risks identified in subparagraph i;

iii. identify and describe any contingent liabilities that have not been disclosed in the financial statements, comment on the potential size and probability of occurrence of those contingent liabilities and the level of uncertainty around these estimates, and describe any steps taken by the *licensed insurer* to manage the risks associated with those contingent liabilities;

iv. explain any differences between capital and the value of net assets in the *licensed insurer's* financial statements;

v. comment on whether, in the *appointed actuary*'s opinion, the *liability for incurred claims* established by the *licensed insurer* is substantially different from that which would be determined in accordance with *NZ IFRS*, and if so, on the relevant figures by *product class*;

vi. advise the *licensed insurer* on the appropriate treatment, for solvency purposes, of any product, activity or insurance business with risk characteristics not adequately covered by the solvency standard;

vii. advise the *licensed insurer*, if relevant, on the treatment of derivative instruments and the approximate impacts on the derivatives capital charge over the course of the year and at the date of calculation of the *solvency margin*;

viii. comment on the risks involved in mismatching assets and liabilities, and how such mismatches have been accounted for in any relevant capital charge (including the market and credit risk *capital charges*);

ix. detail all assumptions used in the determination of the *solvency entity*'s solvency margin; and

    a. identify those assumptions to which the *solvency entity's solvency margin* is most sensitive ('key sensitivities') and quantify the impacts on the *solvency margin* of those key sensitivities;

b. disclose and justify the use of any simplifying assumptions or methodologies (see paragraph 16) used in the calculation of the *solvency margin*, separately distinguishing (for *long-term insurance contracts*) assumptions made on the following bases:

    (A) *Best estimate*.

    (B) Solvency assumptions made to arrive at the *insurance risk capital charge*, both prescribed assumptions and other assumptions, including *discretions*; and

c. detail the basis for the estimation of the value of any *contingent asset or liability* included in *solvency capital*, if such an estimate has been made;

x. advise the *licensed insurer* on whether, in the *appointed actuary's* opinion, the *licensed insurer* needs to consider reporting to the *Reserve Bank* under section 24 of the Act, taking account of the *licensed insurer's* forward-looking assessment of the solvency margin and the *appointed actuary's* assessment of the *licensed insurer's* business plans and enterprise risk management practices, and the external environment;

xi. provide commentary on outsourcing arrangements, including:

a. the risks arising from outsourcing;

b. the board's outsourcing policy;

c. the strength of contractual arrangements relating to outsourcing (including *inwards and outwards reinsurance agreements*); and

d. how significant outsourcing arrangements are monitored by the *licensed insurer*;

xii. provide commentary on conduct issues, including:

a. conduct risks facing the *licensed insurer*;

b. board policies for dealing with conduct risk; and

c. how *material* conduct issues are monitored by the *licensed insurer*;

xiii. comment on the adequacy of premium rates for each on-sale *product class*; and

xiv. provide financial projections for the *solvency entity* aligned with the *licensed insurer's* business plan for the three years following the *solvency determination date*, including, as a minimum:

a. *insurance revenue*;

b. profit after *tax*;

c. dividends and *capital* injections

d. total assets

e. *solvency capital*;

f. *APCR*;

g. *adjusted solvency margin*; and

h. *adjusted solvency ratio*.

162. In addition to the requirements of paragraph 161, a *licensed insurer* with *long-term insurance contracts* must require its *appointed actuary* to:

i. detail all assumptions made to arrive at the market and credit-risk capital charges, including *discretions* assumed;

ii. describe how all the principles supporting the market and credit risk *capital charges* have been met; and

iii. provide a *reinsurance* statement that includes all the information set out in paragraph 163.

163. The information referred to in paragraph 162(iii) is:

i. a list of all *reinsurance* agreements currently in place, including the name of the *reinsurer*, the starting and expiry dates of the agreement, the form of the agreement (for example, quota share, excess of loss, facultative) and whether any *reinsurance* agreement has been treated as an *immaterial reinsurance agreement* under Appendix 4;

ii. the retention of the *licensed insurer* and cession to *reinsurers* (minimum and maximum, if applicable), the capacity provided by each *reinsurance* agreement, and whether the *licensed insurer* retains any exposure other than the retention that is not reinsured;

iii. the methods for calculating *reinsurance* commissions, selection rebates and selection discounts, and the maximum commission, selection rebate or selection discount payable (if applicable) for the reporting year;

iv. an assessment of whether any *reinsurance* agreement gives rise to a *repayable amount* and, if so, the value of the *repayable amount* adjustment and an explanation of how that value was determined (including, where relevant, how any *repayable amounts* have been apportioned to *product classes* and any differences between the *repayable amount* adjustment and the total of the *repayable amounts*);

v. if the *licensed insurer* is required, by subparagraph (vi), the report the results of testing undertaken under Appendix 2:

a. a description of the portfolio tested and any new business assumptions made;

b. the combination of parameters that would result in the *reinsurer* failing the likelihood test (or a statement that no such scenario exists) in accordance with Appendix 2; and

c. a comment on the likelihood of the parameter combination in (b) occurring, based on quantitative evidence where possible; and

vi. any testing of *reinsurance* agreements in accordance with Appendix 2 must be included in the *reinsurance* statement on the following basis:

   a. The information in subparagraph (v) must be included in the *financial condition report* that relates to the financial year in which the agreement was incepted. For testing of these agreements, modelling is undertaken from the point of inception of the *reinsurance agreement*.

   b. The *reinsurance agreement* should be re-tested, with the testing result included in the *financial condition report* that relates to the year in which the change or exercise of discretion occurred if, following the inclusion of the results of a test of a *reinsurance agreement* in a *reinsurance* statement:

      (A) there are significant changes to any of the following: (i) the agreement; (ii) the assumptions made in respect of the agreement; and (iii) the mix or size of the business reinsured by that agreement; or
      (B) a party exercises any significant *discretion* under the agreement (including a *discretion* to substantially increase *reinsurance* premiums); and

   c. at any time where a test is being undertaken after the inception of the *reinsurance* agreement, any changes to the agreement or mix or size of business or exercise of *discretion* is modelled from the time of the change or exercise of discretion, and all significant changes in assumptions from the previous *reinsurance* statement must be clearly disclosed, to the extent they are known.

164. The *appointed actuary* may rely on other relevant experts, provided that reliance is appropriate and adequate disclosure is included on the nature of that reliance.

New Zealand Society of Actuaries' Professional Standards

165. The *licensed insurer* must require its *appointed actuary* to ensure that all actuarial work carried out for the purposes of, or supporting, this solvency standard is carried out in accordance with the New Zealand Society of Actuaries' Professional Standards.

Appendix 1: Capital instruments

General requirements

1. To ensure that every *capital* instrument included within a *licensed insurer's capital* is of high quality, each *capital* instrument must:

    i. provide a permanent and unrestricted commitment of funds ('permanence');

    ii. be freely available to absorb losses ('loss absorption');

    iii. not impose any unavoidable servicing charge against earnings ('servicing charge)';

    iv. rank behind the claims of policyholders and other creditors in the event of a winding up of the *licensed insurer* ('ranking on winding up'); and

    v. have other features or treatments appropriate to the capital instrument ('other appropriate features').

2. In addition to the requirements in clause 1, each *capital* instrument included within a *licensed insurer's capital* must:

    i. in its entirety, meet the qualifying criteria for the appropriate constituent of capital, as set out under Specific Requirements in clauses 3 to 40 of this Appendix;

    ii. irrespective of its name, satisfy the substance as well as the legal form of the qualifying criteria for the appropriate capital instrument; and

    iii. not contain any terms, covenants or restrictions that could:

        a. hinder the recapitalisation of the *licensed insurer*;

        b. inhibit the sound and prudent management of the *licensed insurer*; or

        c. restrict the *Reserve Bank*'s, or a statutory manager's, ability to use its powers under the *Act* in respect of the resolution of any actual or potential issues relating to the solvency or any other prudential matter experienced by the *licensed insurer*.

Specific requirements

Ordinary shares

Permanence

3. The principal amount of the ordinary shares must be perpetual and must not be repayable outside of liquidation (that is, the ordinary shares must not be redeemable). However, nothing in this clause prevents a *licensed insurer* acquiring its own shares in accordance with section 58 of the Companies Act 1993.

4. In this Appendix:

    perpetual means having no maturity date; and

    redeemable has the meaning given in section 68 of the Companies Act 1993; and

    wind-up refers to the closure of the *licensed insurer* and does not have the meaning set out in the definition at paragraph 17 of this standard.

Clause 4 has been modified by the Interim Solvency Standard Amendment Standard 2024.

5. Neither the *licensed insurer* nor any *related party* of the *licensed insurer* may do anything to create an expectation at issuance that the ordinary shares will be repaid or cancelled, and the contractual terms of the ordinary shares (wherever set out) must not contain any feature that may give rise to such an expectation.

6. The ordinary shares may only be included within *capital* to the extent that the ordinary shares are paid up and the paid-up amount has been irrevocably received by the *licensed insurer*.

Loss absorption

7. After retained earnings and revenue and other reserves, the issued ordinary shares must incur the first and proportionately greatest share of any losses as they occur in all circumstances, including on a going-concern basis and upon wind-up of the *licensed insurer*.

Servicing charge

8. Distributions must meet the following requirements:

    i. The level of distributions must not be linked in any way to the amount paid at issuance and must not be subject to a contractual cap (except for any restrictions imposed by the Companies Act 1993 or this standard).

    ii. There must be no circumstances under which the distributions are obligatory, and in all circumstances the *licensed insurer* must be able to waive any distribution.

    iii. Any waived distributions must be non-cumulative.

    iv. A non-payment of distributions must not be an event constituting a default of the *licensed insurer* or any *related party* of the *licensed insurer*.

    v. Distributions may only be paid by the *licensed insurer* after all other legal and contractual obligations have been met.

    vi. The *licensed insurer* must not be required to make any distribution if it would result in the *licensed insurer* breaching the *solvency margin* requirements of the conditions of licence of the *licensed insurer*.

Ranking on winding up

9. The ordinary shares must represent the most subordinated claim in the event of the liquidation of the *licensed insurer*.

10. Ordinary shareholders are entitled to a claim on the residual assets of the *licensed insurer* that is proportional to their share of issued *capital*, after all senior claims have been repaid in liquidation.

11. The paid-up amount, and any future payments related to the ordinary shares, must not be secured or covered by a guarantee of the *licensed insurer* or any *related party* of the *licensed insurer* or be subject to any other arrangement that legally or economically enhances the seniority of the holder's claim. The ordinary shares must not be subject to netting or offset claims on behalf of the holder of the ordinary shares.

12. The paid-up amount must be classified as equity.

Other appropriate features

13. The ordinary shares must be directly issued by the *licensed insurer* and neither the *licensed insurer* nor any *related party* of the *licensed insurer* over which the *licensed insurer* exercises control or significant influence can have purchased the ordinary shares or directly or indirectly funded their purchase.

14. Holders of the ordinary shares must have full voting rights arising from the ownership of the shares.

15. The amount of ordinary shares must be clearly and separately disclosed in the *licensed insurer's financial statements* or *alternative financial information*.

Perpetual instruments ('perpetuals'): qualifying criteria

Permanence

16. The principal amount of the perpetuals must be perpetual (that is, they must have no maturity dates).

17. Neither the *licensed insurer* nor any *related party* of the *licensed insurer* may do anything to create an expectation at issuance that the perpetuals will be repaid or cancelled (except as provided for in clauses 19 and 20 of this Appendix), and the contractual terms of the perpetuals (wherever set out) must not contain any feature that may give rise to such an expectation.

18. The perpetuals may only be included within *capital* to the extent that the perpetuals are paid up and the paid-up amount has been irrevocably received by the *licensed insurer*.

19. The perpetuals may only be callable, or redeemable (as defined in section 68 of the Companies Act 1993);

    i. at the initiative of the *licensed insurer*; and

    ii. only after a minimum of five years from the date on which the *licensed insurer* irrevocably receives the proceeds of payment for the perpetuals.

20. However, despite clause 19, a perpetual instrument may provide for a call within the first five years of issuance as a result of a *tax* or regulatory event. However, an event will not meet the definition of a *tax* or regulatory event if it is an event that the *licensed insurer* was in a position to anticipate at the time of the issue of the instrument or if the event is minor or insignificant.

Loss absorption

21. The perpetuals must have the potential to absorb losses on a going-concern basis (for example, through cancellation of distributions and upon the wind-up of the *licensed insurer*).

Servicing charge

22. Distributions must meet the following requirements:

    i. The *licensed insurer* must have full discretion at all times to waive distributions on the perpetuals. Any waived distributions must be non-cumulative.

    ii. A cancellation of distributions must not be an event constituting a default of the *licensed insurer* or any *related party* of the *licensed insurer*, and holders of the perpetuals must have no right to do either of the following on the grounds that the licensed insurer fails to make, or may become unable to make, a distribution on the perpetuals:

        a. To apply for the liquidation or voluntary administration of the *licensed insurer* or any *related party* of the *licensed insurer*.

        b. To appoint a receiver of the property of the *licensed insurer* or any *related party* of the *licensed insurer*.

    iii. A cancellation of distributions must not impose restrictions on the *licensed insurer*, or any *related party* of the licensed insurer, except in relation to:

        a. the acquisition, repurchase or redemption of ordinary shares, perpetuals or other instruments; or

        b. dividend stopper arrangements that stop distributions on ordinary shares, other perpetuals or other instruments.

    iv. The *licensed insurer* must have full access to cancelled distributions to enable the licensed insurer to meet obligations as they fall due.

    v. The perpetuals must not have a credit-sensitive distribution feature.

    vi. The perpetuals must not have any step-ups or incentives to redeem, and the terms of the perpetuals must:

        a. provide for the distribution rate to be fixed for the entire term of the instrument; and

        b. must not provide for the rate to be altered or reviewed except in any of the following circumstances:

            (A) A distribution may be cancelled, in whole or in part.

            (B) Where there is a variable rate and where the formula for setting the rate is fixed at the outset.

(C) Where there is a conversion from a fixed rate to a floating rate (or vice versa) in combination with a call option without any increase in credit spread. This will not in itself be viewed as an incentive to redeem. However, the *licensed insurer* or any *related party* of the *licensed insurer* must not do anything that creates an expectation that the call will be exercised. A change in the margin will be considered to be an incentive to redeem.

vii. The *licensed insurer* must not be required to make any distribution if it would result in the *licensed insurer* being insolvent (as defined in section 239C of the Companies Act 1993) or breaching the *solvency margin* requirements of the conditions of licence of the *licensed insurer*.

Ranking on winding up

23. The perpetuals must represent the most subordinated claim after ordinary shares in the event of the liquidation of the *licensed insurer*.

24. The paid-up amount of the perpetuals, or any future payments related to the perpetuals, must not be secured or covered by a guarantee of the *licensed insurer* or any *related party* of the *licensed insurer* or be subject to any other arrangement that legally or economically enhances the seniority of the holder's claim.

25. The perpetuals must not be subject to netting or offset claims on behalf of the holder of the perpetuals.

Other appropriate features

26. The perpetuals must be directly issued by the *licensed insurer* and neither the *licensed insurer* nor any *related party* of the *licensed insurer* over which the *licensed insurer* exercises control or significant influence can have purchased the perpetuals nor directly or indirectly funded their purchase.

27. However, despite clause 26, the *licensed insurer* may issue a perpetual instrument to a special purpose vehicle (SPV) in conjunction with a perpetuals *capital* instrument issued by the SPV to third party investors at the same time and, in that case, the perpetuals *capital* instrument issued by the SPV to third party investors will qualify as *capital* provided that each of the following criteria are fully satisfied:

i. The SPV must be controlled by the *licensed insurer*.

ii. The perpetual instrument issued by the *licensed insurer* to the SPV must meet the qualifying criteria for classification as a perpetual instrument (except that it may be purchased by a *related party* SPV).

iii. The perpetual capital instrument issued by the SPV to third party investors would, if issued by the *licensed insurer*, meet the qualifying criteria for classification as a perpetual instrument.

iv. The terms and conditions of the perpetual instrument issued by the *licensed insurer* to the SPV must match, in all *material* respects, the terms and conditions of the perpetual capital instruments issued at the same time by the SPV to third-party investors.

v. The proceeds from the issue of the perpetual capital instruments by the SPV to third-party investors must be immediately and directly invested in the perpetual capital instrument issued to the SPV by the *licensed insurer* and be available, without limitation to, the *licensed insurer*.

28. The amount of the perpetuals must be clearly and separately disclosed within the *licensed insurer's financial statements* or *alternative financial information*.

Credit union securities: qualifying criteria

29. Credit union securities (Securities) are a *capital* instrument that may only be issued by credit unions under the Friendly Societies and Credit Unions Act 1982.

Guidance: See section 58A(2) of the Friendly Societies and Credit Unions Act 1982, which provides that such securities are transferable only between members and confer no voting rights on holders.

Permanence

30. The principal amount of the Securities must be perpetual (that is, they must have no maturity date) and must not be repaid outside liquidation.

31. The Securities may only be included within *capital* to the extent that the Securities are paid up and the paid-up amount has been irrevocably received by the *licensed insurer*.

Loss absorption

32. After retained earnings and revenue and other reserves, the Securities must incur the first and proportionately greatest share of any losses as they occur in all circumstances, including on a going-concern basis and on the wind-up of the *licensed insurer*.

33. The Securities must be issued in accordance with the requirements and provisions of the Friendly Societies and Credit Unions Act 1982.

Servicing charge

34. Distributions must meet the following requirements:

    i. The level of distributions must not be linked in any way to the amount paid at issuance and must not be subject to a contractual cap (except for restrictions imposed by the Companies Act 1993, the Friendly Societies and Credit Unions Act 1982 or this standard).

    ii. There must be no circumstances under which the distributions are obligatory, and in all circumstances the *licensed insurer* must be able to waive any distribution.

    iii. Any waived distributions must be non-cumulative.

    iv. Non-payment of distributions must not be an event constituting a default of the *licensed insurer* or any *related party* of the *licensed insurer*.

    v. Distributions may only be paid by the *licensed insurer* after all other legal and contractual obligations have been met.

    vi. The *licensed insurer* must not be required to make any distribution if it would result in the *licensed insurer* becoming insolvent or breaching the *solvency margin* requirements of the conditions of licence of the *licensed insurer*.

Ranking on winding up

35. The Securities must represent the most subordinated claim in the event of the liquidation of the *licensed insurer*.

36. The paid-up amount, or any future payments related to the Securities, must not:

    i. be secured or covered by a guarantee of the *licensed insurer* or any *related party* of the *licensed insurer*; or

    ii. be subject to any other arrangement that legally or economically enhances the seniority of the holder's claim.

Clause 36 has been modified by the Interim Solvency Standard Amendment Standard 2024.

37. The Securities must not be subject to netting or offset claims on behalf of the holder(s) of the Securities.

38. The paid-up amount must be classified as equity.

Other appropriate features

39. The Securities must have been directly issued by the *licensed insurer* and neither the *licensed insurer* nor any *related party* of the *licensed insurer* over which the *licensed insurer* exercises control or significant influence may have purchased the Securities or directly or indirectly funded their purchase.

40. The amount of the Securities must be clearly and separately disclosed within the *licensed insurer's financial statements* or *alternative financial information*.

Appendix 2: Financial reinsurance

Overview

1. This Appendix defines when a *repayable amount* exists in respect of a *reinsurance agreement*, and how the value of a *repayable amount* is determined.

2. The requirements of this Appendix apply to all *licensed insurers' reinsurance agreements*, except for *immaterial reinsurance agreements*. In this Appendix, an *immaterial reinsurance agreement* is an agreement that may be considered *immaterial* under the *materiality* requirements in Appendix 3.

3. A *repayable amount* will exist if there are obligations that are in substance a liability of the *licensed insurer* but have been treated as *reinsurance* for financial reporting purposes. The intent in this case is to provide a treatment that differs from that under financial reporting standards, ensuring that such obligations have broadly the same impacts on the *licensed insurer's solvency margin* as would be the case had the obligation been included in other liabilities.

4. In this Appendix any reference to an amount received includes a reference to an amount accounted for as received or receivable, and any reference to an amount paid, payable or to pay includes an amount accounted for as paid or payable or to pay. The treatment of receivables is as modified by paragraphs 27(iv) and 27(v) of this standard. All discounting should be at the risk-free rates used in paragraph 28(iii) to determine *standardised reinsurance items*, unless otherwise specified.

Clause 4 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Clause 4 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Testing of reinsurance agreements

5. Every new *reinsurance* agreement must be tested to determine whether a *repayable amount* exists. Annexes to existing agreements that change the terms of the agreements or introduce new blocks of business are considered to be new *reinsurance agreements*.

6. Testing must be carried on the first *solvency determination date* following the commencement of each *reinsurance agreement*. A valuation of any *repayable amount* must be carried out at each *solvency determination date*.

7. Subject to clause 8, a *repayable amount* exists if the *reinsurance agreement* fails any one of the likelihood test, the specified event test and the embedded obligations test, as set out in clauses 9 to 27. *Reinsurance agreements* fail the tests if they do not pass them.

8. Neither an amount that has been included in other liabilities nor an amount less than zero is a *repayable amount.*

Likelihood test

Testing process

9. A *reinsurance agreement* will pass the likelihood test if it can be shown that there is a plausible scenario in which the *licensed insurer's net reinsurance liability* under the agreement could experience a significant reduction, taking into account the time value of money.

Net reinsurance liability

10. To determine the *net reinsurance liability* under the agreement, cash-flows must be projected from the commencement of the agreement up to the point where the *reinsurer* can unilaterally terminate or reprice as:

    i. future outgo from the *licensed insurer* to the *reinsurer*; less

    ii. future income to the *licensed insurer* from the *reinsurer*.

11. Cash-flows should include future new business expected under the *reinsurance* arrangement.

12. Net *reinsurer* cash-flows must be discounted by adding a 4 percent per annum equity risk premium to the risk-free discount rates used to discount *standardised insurance items* under this standard.

Test criteria

13. A plausible scenario is one based on a projected lapse and/or insurance experience that has a probability of occurrence of 10 percent or greater (when ranked against other scenarios). Reasonable assumptions should be made as to the exercise of *discretions* in the plausible scenario, such as increases in *reinsurance* premiums.

14. A significant reduction is one that exceeds 1 percent of the present value of future *reinsurance* premiums and other insurer outgo under the *reinsurance agreement*.

Repayable amount for this test

15. The *reinsurer* profit multiple is determined as at the commencement of the *reinsurance agreement* as:

    i. the present value of expected future outgo from the *licensed insurer* to the *reinsurer*; divided by:

    ii. the present value of expected future income to the *licensed insurer* from the *reinsurer*.

16. Future income and outgo must:

    i. be projected up to the *contract boundary*, considering the *reinsurance* treaty as a stand-alone contract that is not offset against *primary insurance*; and

    ii. be discounted at the risk-free rates indicated in paragraph 28(iii).

Clause 16 has been modified by the Interim Solvency Standard Amendment Standard 2024.

17. The *repayable amount* is determined at each *solvency determination date* as the greater of zero and:

    i. the present value of expected future outgo from the *licensed insurer* to the *reinsurer*, less

    ii. the present value of expected future income to the *licensed insurer* from the *reinsurer*, multiplied by the reinsurer profit multiple.

Specified event test

Testing process

18. Subject to clause 20, an amount will be a *repayable amount* if the *licensed insurer* will, on the occurrence of an event specified in the *reinsurance agreement*, be under an obligation to pay that amount to the *reinsurer* otherwise than from out of the future profits arising from the reinsured portfolio. The circumstances of the occurrence of the specified event include, but are not limited to, the following:

    i. The financial deterioration, insolvency or administration of the *licensed insurer*.

    ii. A poor experience of the underlying portfolio, such as a higher-than-expected rate of claims or higher-than-expected lapse rate.

    iii. The termination of the agreement or withdrawal of the portfolio.

Clause 18 has been modified by the Interim Solvency Standard Amendment Standard 2023.

19. Clause 18 applies whether or not the obligation on the *licensed insurer* is subordinated to policyholders and other creditors.

20. The following circumstances do not give rise to a *repayable amount* under clause 18 of this Appendix, but may, to avoid doubt, give rise to a *repayable amount* as a result of another specified event in the *reinsurance agreement*:

    i. The amount becomes payable on the lapse of an underlying *insurance contract* and the *licensed insurer* is entitled to receive a broadly equivalent amount from a third party in respect of that amount (a claw-back commission).

    ii. The amount is payable to adjust for an error in calculation.

    iii. The *licensed insurer* is subject to a claim for contractual damages, as determined by a court (or similar forum, for example arbitration), for losses incurred by the *reinsurer* due to non-performance of an obligation or breach of contract (including amounts payable due to the rescission of the agreement by a court); or

    iv. The amount is an increase in *reinsurance* premium and the *licensed insurer* will or would be reasonably able to increase premiums on the underlying *insurance contracts* by a similar amount; or

    v. The specified event is the termination of the *reinsurance* agreement or withdrawal of the portfolio and either sub-clause (a) or (b) applies.

        a. Both parties agree to such termination or withdrawal at the point of termination or withdrawal and the amount that will become payable is to be determined at the point of termination or withdrawal as an amount no greater than the arm's-length commercial value of the portfolio at that point in time and is not related to amounts paid in the past by the *reinsurer* to the *licensed insurer*.

        b. Termination may be effected by either or both parties as a result, or substantially as a result, of any of:

(A) substantial fraud, misrepresentation or non-disclosure of a *material* fact in relation to the agreement, by a party other than the *reinsurer*, at or before the time the *reinsurance agreement* is entered into, the effect of which is to reduce substantially the anticipated value of the portfolio;

(B) the agreement or the performance of the agreement, or an important part of the agreement, is rendered illegal or prohibited or is otherwise impossible;

(C) war, civil unrest or a similar event that *materially* affects the performance of the obligations under the agreement by the *licensed insurer* or *reinsurer*;

(D) an un-remediated *material* default by a party other than the *reinsurer* under the agreement, provided that any amount payable in such an event is the loss of future profits to the *reinsurer* as assessed by an independent third party; or

(E) the *licensed insurer* takes steps that result in the *reinsurer* no longer receiving amounts under the agreement in respect of policies reinsured, such that the value of the portfolio to the *reinsurer* is substantially reduced, provided that any amount payable in such an event is the loss of future profits to the *reinsurer* as assessed by an independent third party.

Clause 20 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Repayable amount for this test

21. If clause 18 or clause 20 of this Appendix applies, 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.

Embedded obligations test

Testing process

22. The *licensed insurer* must consider whether any individual cash-flows, or group of cash-flows, under the *reinsurance agreement* give rise to a *repayable amount* under clause 23.

23. Subject to clause 24, an amount received from the *reinsurer* will give rise to a *repayable amount* under the embedded obligations test if the *licensed insurer* must repay that amount otherwise than from out of the future profits arising from the reinsured portfolio.

24. A *repayable amount* does not arise in the following circumstances:

    i. The termination of the *reinsurance* agreement or withdrawal of the portfolio (termination events must be considered under the specified event test); or

    ii. Any event specified in sub-clauses 20(i) to (iv) of this Appendix.

25. At a minimum, the *licensed insurer* must consider whether amounts received as *reinsurance* commission give rise to a *repayable amount* under clause 23.

26. For the purposes of clause 25, a *reinsurance* commission includes all payments made to the *licensed insurer* by the *reinsurer*, of which the purpose or effect is to fund some portion of the *licensed insurer's acquisition costs*, including selection rebates, selection discounts and any other similar amounts.

Repayable amount for this test

27. Where an amount repayable to the *reinsurer* is assessed as a *repayable amount* under clause 23 of this Appendix, the *licensed insurer* may value that amount as the greater of:

    i. the portion of the *reinsurance* balance attributable to the repayment of that amount, less any related amount that the *licensed insurer* expects to receive from third parties that offsets the *repayable amount*; or

    ii. the value of the initial amount received from the *reinsurer*, less any related amount the *licensed insurer* expects to receive from third parties that offsets the *repayable amount* and less any amount that has already been repaid.

Clause 27 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Repayable amount to be deducted from solvency capital

28. The *repayable amount adjustment* for *a solvency entity* is the total value of the *repayable amounts* for that *solvency entity*, determined in accordance with this Appendix, less any portion of those amounts that the *licensed insurer* can demonstrate have otherwise been accounted for in the *licensed insurer's solvency capital*.

29. [Deleted]

Clause 29 has been modified by the Interim Solvency Standard Amendment Standard 2024.

30. If a *repayable amount* exists under more than one of the tests in this Appendix in respect of a *reinsurance agreement*, the *repayable amount* in respect of that agreement must be determined by:

    i. summing all the *repayable amounts*; and

    ii. adjusting the sum downwards to ensure that no element is captured more than once, but subject to the proviso that the net balance must not be less than the largest *repayable amount* determined under any one of the tests.

Appendix 3: Materiality

1. All calculations required under this standard are subject to the following *materiality* requirements:

   i. Particular values or components are to be considered *material t*o the overall result of a calculation if their misstatement or omission would cause that result to be misleading to the users of the information.

   ii. *Materiality* tests must assess the significance of the particular value or component by relating it to the amount of the overall result to which it contributes.

   iii. The base amount for *materiality* purposes is the *solvency margin*.

   iv. The *licensed insurer* must require the *appointed actuary* to consider *materiality* relative to the amount of both:

      a. the major individual components of the calculation; and

      b. the overall cumulative effect of those individual components.

   v. Values or components generating variations in amounts of 10 percent or more of the *solvency margin* must be presumed *material*, while those generating variations in amounts of 5 percent or less of the *solvency margin* may be presumed *immaterial*. The *materiality* of values and components generating variations between 5 percent and 10 percent will be a matter for professional judgement.

2. *Materiality* applies to all aspects of the determination of the *solvency margin* and covers the acceptability of grouped data, modelled projections and approximate valuation methods and, in applying the *materiality* standards described in this Appendix:

   i. it is appropriate to use as the base amount for *materiality* purposes a rolling average of the *solvency margin*, provided that the average is a function of not less than three and not more than five years' experience and reflects the current and anticipated future experience; and

   ii. it is appropriate, as the *solvency margin* approaches zero, for alternative key indicators to be used in establishing *materiality*.

Appendix 4: Quality of reinsurance

1. This Appendix applies to *life insurance* business with effect from 1 January 2023, and to all other *insurance* business with effect from 1 January 2024.

2. In applying the requirements relating to the *reinsurance* of *insurance contracts*, attention must be directed to the economic substance of the *reinsurance agreement* rather than the legal form.

3. In this Appendix, the terms *reinsurance agreement* and *agreement* include any side letters, correspondence or other agreements that alter the obligations of the parties under a *reinsurance agreement* or that are so interconnected with the *reinsurance agreement* that in substance they form part of the agreement.

4. The benefits of a *reinsurance agreement* must not be netted from *standardised* or stressed *insurance items* or used to reduce any *current termination value* if:

    i. the *reinsurance balance* in respect of that agreement is less than zero (net inflow); and

    ii. one or more of the following circumstances applies:

        a. The *licensed insurer* has reason to believe, having made reasonable enquiries, that the *reinsurance agreement* is not legally binding.

        b. The *reinsurance agreement* is not in writing or has not been signed by authorised persons (in respect of each counterparty to the agreement).

        c. The *licensed insurer* is not a party that has a right to the receipt (whether directly or indirectly) of *reinsurance* payments under the agreement.

        d. Subject to clause 5:

            (A) the *reinsurance agreement* may, before its expiry date and without the consent of the *licensed insurer*, be unilaterally terminated, or may terminate on the occurrence of an event specified in the *reinsurance agreement*; or

            (B) the *reinsurer* may unilaterally be released from an obligation to pay amounts that would, without the release and in the event of the *licensed insurer*'s insolvency, be due under the *reinsurance agreement*.

5. Clause 4(ii)(d) does not apply where the contractual right to terminate or to be released from payment is substantially the result of any of the following events:

    i. Fraud, misrepresentation or non-payment of monies due in relation to the agreement, in each case by a party other than the *reinsurer*.

    ii. An un-remediated *material* default of a party other than the *reinsurer* under the agreement, including a failure of the *licensed insurer* to abide by specified prudent underwriting practices or other policies stipulated in the *reinsurance* agreement.

    iii. The agreement or performance of the agreement, or an important part of the agreement, is rendered illegal or prohibited or is otherwise impossible for reasons for which the *reinsurer* is not responsible.

iv. The *reinsurer* is prevented at law from making a payment.

v. The *licensed insurer* transfers all or part of the portfolio reinsured without the consent of the *reinsurer*, including by way of substantive change of control, internal corporate restructure or change of ownership of the *licensed insurer*.

vi. War, civil unrest or a similar event affects the performance of the obligations under the agreement by the *licensed insurer* or *reinsurer*.

vii. All the *insurance contracts* to which the *reinsurance* relates have expired or been terminated and there is no outstanding insurance liability in respect of those contracts, provided that the *licensed insurer* confirms that this is the case.

viii. Provided that the *reinsurer* remains liable for all obligations incurred prior to termination or release:

    a. The insolvency of one of the parties.

    b. The reduction of the *licensed insurer*'s paid-up *capital* or a call-up of issued *capital* by the *licensed insurer*.

    c. The downgrading of the *licensed insurer*'s financial strength rating.

    d. The withdrawal or suspension of the *licensed insurer*'s authorisation, licence or registration in respect of any business covered.

    e. Termination or cancellation that takes effect on the anniversary of the *reinsurance* agreement.

Appendix 5: Prescribed solvency assumptions

1. The *prescribed solvency assumptions* in this Appendix must be used in the determination of the *solvency liability* for *long-term insurance contracts*.

2. To the extent that the use of *prescribed solvency assumptions* implies a *material* change (for example, between the *risk-adjusted best estimate liability* and the *solvency liability*) to the shape of or a variance to the distribution of outcomes, the *adjustment for non-financial risk* should be re-determined.

Clause 2 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Discount rates

3. The *prescribed solvency assumption(s)* for gross investment yield and liability discount rate will be those established in paragraph 28(iii) of this standard for *standardised insurance items*.

Clause 3 has been modified by the Interim Solvency Standard Amendment Standard 2024.

Servicing costs

4. The *prescribed solvency assumption* for *maintenance costs* (excluding claim handling expenses) must include a margin of 7.5 percent above the greater of the unit costs required to cover:

   i. actual *maintenance costs* (excluding claim handling expenses) in the 12 months prior to the *solvency determination date*; and

   ii. expected *maintenance costs* (excluding claim handling expenses) in the 12 months subsequent to the *solvency determination date*.

Clause 4 has been modified by the Interim Solvency Standard Amendment Standard 2024.

5. The *prescribed solvency assumption* for *investment management costs* must:

   i. be based on an asset profile that, under the adverse circumstances of the *solvency liability*, would be expected to yield a return equal to the prescribed solvency assumption for gross investment yield;

   ii. include a margin of 7.5 percent above this base requirement; and

   iii. if the *licensed insurer* has contractually agreed to pay a higher investment management cost regardless of the asset profile adopted, assume that higher expense.

6. When determining *servicing costs* for each *insurance contract*, the *appointed actuary* must be satisfied that direct and indirect expenses have been allocated to individual policies in an appropriate manner.

7. The *servicing cost* assumptions may be adjusted to allow for one-off expenses (both actual and expected), but must:

   i. exclude costs that would not be incurred if the *licensed insurer* ceased to write new business, provided this adjustment does not reduce the cost below *best estimate*; and

   ii. not be used to sanction the exclusion of operational expenses relating to the servicing of policies.

8. The *prescribed solvency assumptions* for *servicing costs* must not be applied to any components of those expenses that have been contractually agreed to for the life of the policy.

Inflation rates

9. Except where elsewhere defined, the *prescribed solvency assumptions* for inflation in respect of *maintenance costs* and other cash-flows that are subject to inflation must:

   i. be non-negative;

   ii. be consistent with the prescribed solvency assumption for gross investment yield; and

   iii. be determined as *best estimates*, appropriate to the relevant cash-flow type.

Taxation

10. The *taxation* treatment of the *long-term insurance risk capital charge* in respect of these *prescribed solvency assumptions* is covered in Appendix 8.

Insurance claims

11. The *prescribed solvency assumptions* for probabilities of contingent events on which the payments of insurance claims are to be based are shown in the table below:

Insured risk	Calculation base	Prescribed assumption
Long-term *general insurance* underwriting risk	*Standardised liability for remaining coverage*	Increase claims and claims handling expense assumptions used to determine the SLRC by the percentage prescribed in paragraph 56
Long-term *general insurance* claims *run-off* risk	*Standardised liability for incurred claims*	Increase the SLIC by the percentage prescribed in paragraph 57
Insured lives (Individual and group)		110% of *best estimate assumptions* for mortality
Annuitants	Base	90% of *best estimate assumptions* for mortality
	Improvements	2% per annum in addition to the *best estimate assumptions*
Trauma (Individual and group)		130% of *best estimate assumptions* for morbidity
Total permanent disability (Individual and group)		120% of *best estimate assumptions* for morbidity

Insured risk	Calculation base	Prescribed assumption
Disability income: (Individual and group)	Active lives	150% of *best estimate assumptions* for claim costs
	Claims in payment (projection method)	Reduction of 25% in *best estimate assumptions* for termination rates
	Claims in payment (case estimate) Claims that have been incurred but not reported are to be treated consistently with claims in payment	125% of *best estimate assumptions* for case estimate, adjusted to allow for the prescribed investment earnings assumption. Limited to the case estimate determined using the maximum benefit period of the individual policy
Health	*Standardised liability for incurred claims,*	111% of *standardised liability for incurred claims*
	Standardised liability for remaining coverage, claims incidence	115% of *best estimate assumptions* in year 1, 105% thereafter
	Standardised liability for remaining coverage, claims inflation	1% per annum in addition to the *best estimate assumptions* for medical expense inflation
Other *insured events*: (Individual and Group)		130% of *best estimate assumptions* for claim costs

Clause 11 has been modified by the Interim Solvency Standard Amendment Standard 2023.
Clause 11 has been modified by the Interim Solvency Standard Amendment Standard 2024.

12. Appropriate assumptions must be applied (on bases consistent with clause 11) for claims that have been incurred but not reported and claims that have been reported but not admitted.

13. The *appointed actuary* must make an appropriate and specific allowance for *material specialised risks*. These *specialised risks* may be allowed for through the determination of specific additional reserves, consistent with the risk criterion underlying this standard.

Voluntary discontinuances

14. The *prescribed solvency assumptions* for the following must reflect an adverse change in experience of 40 percent of the *best estimate assumptions*:

    i. The rates of voluntary discontinuance (including partial surrender).

    ii. The rates of premium dormancy and conversion of policies to paid-up status.

15. An adverse change in experience may be an increase or a decrease in the rate of discontinuances. The adverse change must be that which increases the *long-term insurance risk capital charge* at the *product class* level utilised for *best estimate assumptions*.

Options provided to policyholders

16. The *prescribed solvency assumption* in relation to experience after the exercise of an option must allow for appropriate risk margins that have been applied to *best estimate assumptions*.

17. The *prescribed solvency assumption* for the take-up rate of the option must reflect an adverse change of 10 percent of the *best estimate assumption*.

Investment-linked policies

18. A *prescribed solvency assumption* must include a margin to reflect the additional risks that may be borne by the entity in conducting investment-linked business.

19. For the purposes of clause 18, the prescribed margin is 0.25 percent, and must be applied to:

    i. the *solvency liability* as determined immediately prior to the inclusion of this margin; and

    ii. the *current termination value* as determined immediately prior to the inclusion of this margin.

Appendix 6: Guarantees

1. In this Appendix:

   maturity (a) in respect of a **guarantee** includes a maturity date and any date on which the guarantor has the capacity to terminate, otherwise end or increase the effective cost of the guarantee; and (b) in respect of the underlying asset means the longest possible remaining time that the asset may remain an asset of the *licensed insurer* (irrespective of any potential rights to call).

   maturity matched guarantee means a guarantee that exists when the *residual maturity* of the guarantee is the same as or greater than the *residual maturity* of the underlying asset. A guarantee of a demand loan where the initial maturity of the guarantee is three years or greater is considered to be a *maturity matched guarantee*.

   maturity mismatched guarantee means a guarantee that exists if the *residual maturity* of the guarantee is less than the *residual maturity* of the underlying asset.

   principal counterparty means the counterparty to the transaction with the *licensed insurer* that gave rise to the underlying asset.

   residual maturity means the time remaining until maturity. For a demand loan the *residual maturity* of the loan is deemed to be three years and the *residual maturity* of a guarantee of a demand loan is deemed to be the initial maturity.

2. The portion of an asset covered by a guarantee that meets the requirements of clause 5 may be assigned the *credit risk capital factor* that would be applicable were the guarantor the *principal counterparty*, plus an additional *capital factor* of 2 percent.

3. In determining the *credit risk capital factor* for a guaranteed asset, the *counterparty grade* in the credit risk factor table in paragraph 105 should be interpreted as an issuer rating of the guarantor (determined by reference to the table in paragraph 99).

4. The portion of an asset considered to be covered by a guarantee is that portion of the asset equal to the value of the guarantee determined in accordance with clauses 7 to 12. Any portion of the asset in excess of the value of the guarantee must be assigned the *credit risk capital factor* applicable absent the guarantee.

5. The guarantee must meet all the following requirements:

   i. It must be provided by a guarantor with an issuer *counterparty grade* (or for governments, the long-term foreign currency credit rating) of 1, 2 or 3 (see the table in paragraph 99).

   ii. It must be provided by a party that is not a parent entity of the *licensed insurer* and is not a *related party* of the *licensed insurer*.

   iii. It must be legally enforceable, clearly documented in writing and, if exercised, represent a direct claim on the guarantor that may be pursued without legal action being taken against the principal counterparty.

iv. It must be explicitly referenced to a specific asset or pool of assets.

v. It must cover all types of payments the principal counterparty is required to make under the documentation (including interest).

vi. It must be irrevocable by the guarantor prior to maturity (that is, the guarantor must not have the right to unilaterally terminate the guarantee prior to any specified date on which the guarantee will mature or may otherwise terminate).

vii. It must be unconditional (that is, there must be no conditions that need to be fulfilled prior to the guarantor being liable on default of the principal counterparty).

6. If an asset, or pool of assets, of a *licensed insurer* is subject to more than one guarantee, but those guarantees are limited to the extent of common collateral, the guarantees must only be recognised up to the value of that collateral.

7. For the purposes of clauses 2 to 4, the value of a *maturity matched guarantee* is the guaranteed amount.

8. For the purposes of clauses 2 to 4, the value of a *maturity mismatched guarantee* must be determined in accordance with clauses 9 to 11 of this Appendix.

9. Subject to clause 10, the value of a *maturity mismatched guarantee* where the *residual maturity* of the guarantee is equal to or less than 12 months is zero.

10. However, if a *maturity mismatched guarantee* of *residual maturity* equal to 12 months provides that it will be renewed automatically unless a notice of termination is given, and the *licensed insurer* has no reason to believe that the guarantee will not be renewed, the guarantee may be recognised in the 12 months prior to renewal, provided that:

    i. the value of the guarantee is determined in accordance with the formula in clause 11 of this Appendix; and

    ii. the residual maturity of the guarantee is considered to be six months for the entirety of that 12 months for the purposes of that formula.

11. The value of a guarantee that is *maturity mismatched* and referred to in either clause 9 or clause 10 must be adjusted, for the purposes of clauses 2 to 4, in accordance with the following formula:

$$\text{Value of guarantee} = \text{guarantee amount} \times \frac{\min(\text{T}, \text{residual maturity guarantee})}{\min(5, \text{residual maturity asset})}$$

    Where

    i. residual maturity is measured in years or part years; and

    ii. T is the lesser of 5 and the residual maturity of the asset.

12. A *licensed insurer* must assume that a guarantee applies to the asset with the longest *residual maturity* first for the purposes of clause 8 if:

i. there is a single guarantee;

ii. that guarantee is limited in sum;

iii. that guarantee applies to a pool of assets; and

iv. the residual maturity of the assets in that pool differ. Where there is a single guarantee, limited in sum, that applies to a pool of assets where the residual maturity of the assets in the pool differ, the *licensed insurer* must assume that the guarantee applies to the asset with the longest residual maturity first for the purposes of clause 10.

Appendix 7: Discretions

1. A *licensed insurer* may apply *discretions*, in accordance with this Appendix, in the process of calculating the following charges:

    i. *Insurance risk capital charge*.

    ii. *Market risk capital charge*.

    iii. *Credit risk capital charge*.

2. In all three calculations, the valuation is performed under an assumed scenario of adverse experience: in the former case under the *prescribed solvency assumptions* and in the latter two cases under the adverse impact implied by the additional application of the *market* and *credit risk capital charge* calculations.

3. The *discretions* assumed to be applied should be consistent with these scenarios of adverse experience, and realistic and consistent as a set.

4. *Discretions* can mitigate losses from adverse experiences that arise from the dates the *discretions* are enacted. However, *discretions* should not be used to recover losses that would be incurred under solvency stresses from the *solvency determination date* through to the date of the enactment of the *discretion*.

5. The *discretions* assumed to be applied must be applied consistently within each calculation of an *entity's prescribed capital requirement* (*PCR*).

Termination value

6. When applying termination value *discretions*, the *appointed actuary* must consider the impacts of those *discretions* on future discontinuance rates, the impacts on the *insurance risk capital charge* and the impacts (if any) on the market and credit *risk capital charges*.

7. The *appointed actuary* must not assume the application of *discretions* in the calculation of the *current termination values* used in calculating the *insurance risk capital charge*.

Reduction in discretionary benefits

8. This *discretion* applies where a *licensed insurer* is able to reduce or discontinue discretionary benefits. In determining the *PCR*, where it is likely that discretionary benefits would be reduced or discontinued under the above scenarios of adverse experience, it is appropriate to allow for that reduction.

9. When applying such *discretions*, the *appointed actuary* must also consider their impacts on future discontinuance rates and the impacts on the *insurance risk capital charge* and the market and credit *risk capital charges*. In carrying out the calculations in this standard, the *licensed insurer* may modify the value of the policyholder share of the unvested estate, to the extent that is justified under the relevant scenario of adverse experience.

10. The amount and timing of the reduction in discretionary benefits assumed in the calculation of the *PCR* must be consistent with a *licensed insurer*'s ability to reduce discretionary benefits in practice.

11. Approximate methods, consistently applied, may be used to determine levels of future discretionary benefits under the above scenarios of adverse experience assumed.

Increases to expense charges – inflation linked

12. If a *licensed insurer* has discretion to increase *insurance contract* expense charges in line with changes in an inflation index, and where the *licensed insurer* has consistently utilised such *discretions* in the previous five years, it is appropriate to allow for inflation-linked increases to charges. The amount and timing of the indexation of charges assumed in the projection must be consistent with the *licensed insurer*'s normal practice. The underlying inflation rate should be the same as the rate determined under the *prescribed solvency assumptions*.

13. If there is insufficient experience to prove a consistent utilisation of such *discretions* in the previous five years, the amount and timing of the indexation of charges assumed in the projection must be realistic in the circumstances.

Quantum (one-off) increase to expense charges

14. If a *licensed insurer* has discretion to increase *insurance contract* expense charges, other than in line with the changes in an inflation index, and it is likely that the *discretion* would be exercised under the scenarios of adverse experience used for assessing the *PCR*, then it is appropriate to allow for the exercise of the *discretion*.

Premium rate increase

15. Premium rates may be increased to reflect changes in loss experience if:

    i. it is likely that discretion would be exercised under the above scenarios of adverse experience; and

    ii. the timing and extent of the discretion applied is consistent with normal practice or, in the absence of sufficient past experience to prove normal practice, is realistic in the circumstances.

16. In determining the *insurance risk capital charge*, the *market risk capital charge* and the *credit risk capital charge*, the *appointed actuary* must consider all appropriate factors, including the unexpired risks, any guaranteed renewal options, the effects of anti-selection exercised by discontinuing policy owners, the delays in claim reporting and the time lags involved in assessing experience and making the subsequent changes to premium rates.

17. Premium rate increases for *health insurance* business must not exceed *best estimate* inflation assumptions by 10 percent on a one-off basis and by more than 5 percent annually.

Claw-back of acquisition commission

18. If acquisition commission paid may be recovered and it is likely that this *discretion* would be exercised under the above scenarios of adverse experience, it is appropriate to allow for the exercise of this *discretion*. The timing and extent of the *discretion* applied should be consistent with the established practice of the *licensed insurer* and a realistic assessment of what is achievable given potential delays in recoverability and the possible risk of adviser/broker default.

Reduction in health insurance benefits

19. *Health insurance* benefits may not be reduced by more than 5 percent annually. The base amount of benefits prior to such reductions should incorporate *prescribed solvency assumptions* for inflation.

Appendix 8: Taxation and the prescribed capital requirement

1. In considering the appropriate adjustment for *taxation*, the *appointed actuary* must consider:

   i. the *taxation* status of the *licensed insurer* in respect of New Zealand *taxation* laws;

   ii. the *taxation* status of other organisations within the *licensed insurer's taxation* group (if any), against applicable *taxation* laws; and

   iii. whether any requirements or aspects of the *taxation* laws need to be taken into account.

2. *Taxation* must be applied to the calculation of the *PCR* in the following manner:

   i. Capital charges should be determined with an allowance for the tax effects expected under the prescribed solvency shock. The gross amount of these capital charges and the *taxation* on these capital charges, if any, must be clearly identified. Where such tax effect calculations are onerous, *licensed insurers* may elect to use approximate methods to determine tax on capital charges. *Immaterial* tax effects do not need to be determined.

   ii. Additional current or deferred *taxation* liabilities or assets that arise as a result of the capital charge calculations in sub-clause 2(i) must be clearly identified and arrived at using a prudent assessment of the *taxation* rate and any other relevant *taxation* assumptions. For any current or deferred *taxation* assets to be included within the *taxation* effect of the capital charge calculations in sub-clause 2(i), the potential recovery of such *taxation* assets must be highly likely in all of the following paradigms:

      a. Going-concern open to new business.

      b. Going-concern in *run-off*.

      c. *Wind-up*.

   iii. Using the results of the calculations in sub-clauses 2(i) and 2(ii) and any other necessary information, the *licensed insurer* must determine its net *taxation* position in the event that the *licensed insurer* were wound-up ('net *taxation* position on *wind-up*') by adjusting, as appropriate, the net *taxation* position reported in the *licensed insurer's* financial statements or *alternative financial information* for the *taxation* effect of *standardisation* and of all relevant capital charges. In arriving at the net *taxation* position on *wind-up*, *taxation* liability and *taxation* asset balances may be netted off where this treatment is legally certain.

   iv. If the net *taxation* position on *wind-up* results in a deferred *taxation* asset of the *licensed insurer*, then the net *taxation* position on *wind-up* must be included in the *distressed wind-up capital charge*.

   v. All numeric *capital factors*, the up-shock, down-shock and shock to foreign currency exchange rates used within the *capital* charge calculations are stated gross of *taxation* (that is, before any allowance for *taxation*)

Clause 2 has been modified by the Interim Solvency Standard Amendment Standard 2024.