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Reserve Bank of New Zealand - Te Pūtea Matua
Financial System Policy and Analysis Department

Dear Sir/Madam,

ICNZ submission on draft interim solvency standard

Thank you for the opportunity to submit on the Reserve Bank of New Zealand - Te Pūtea Matua (**RBNZ's**) Draft Interim Solvency Standard (**Draft ISS**) issued on 22 July 2021.

By way of background, the Insurance Council of New Zealand - Te Kāhui Inihua o Aotearoa (**ICNZ's**) members are general insurers and reinsurers that insure about 95 percent of the New Zealand general insurance market, including about a trillion dollars' worth of New Zealand assets and liabilities. ICNZ members provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, business interruption, professional indemnity, commercial property and directors and officers insurance).

Please contact John Lucas (john@icnz.org.nz) if you have any questions on our submission or require further information.

This submission has two parts:

- overarching and key comments, and
- feedback on specific aspects of the Draft ISS.

1. Overarching and key comments

A. The implementation date and IFRS 17

The implementation date of the new Solvency Standard, from 1 January 2022, would be unworkable for our members. Many insurers will not be sufficiently progressed with their IFRS 17 implementation to allow for implementation from 1 January 2022 and we understand that no insurer in New Zealand is likely to adopt IFRS 17 early. Previously the RBNZ had indicated that the Draft ISS would be 'accounting standard agnostic' which would have made it possible to introduce this solvency standard on a different timeline to IFRS 17. However, this is not how the Draft ISS is presented and IFRS 17 language is embedded throughout this document.[1]

[1] An example of this is the Liability for Remaining Coverage (**LRC**). We understand that if the RBNZ's expectation of the LRC in the standardised balance sheet is akin to the current premium liabilities which does not include future premiums, this would be at odds with the IFRS 17 definition. This results in uncertainty as to what the RBNZ requires in the Solvency Standard. For example, in clause 145 and

It is also problematic that no transitional arrangements are provided for under the Draft ISS. This means, for example, that once the new Solvency Standard is implemented it must be considered and reported on under section 24 of the Insurance (Prudential Supervision) Act 2010 (**IPSA**) even though, consistent with comments made above, IFRS 17 may only be implemented by an insurer at a future date.

Furthermore, in addition to the IFRS 17 related changes, the new Solvency Standard is likely to materially increase the amount of capital that insurers are required to hold (as further expanded upon below). The proposed implementation date allows very little time for insurers to obtain any additional capital required or to communicate these changes to stakeholders.

In more general and practical terms, it appears doubtful that the RBNZ would have sufficient time to thoroughly review and consider feedback provided in this consultation, undertake further engagement and make and test the appropriate changes to the Draft ISS and finalise it before this implementation date.

In light of these concerns, our strong preference is that the effective date of the new Solvency Standard be extended until the effective date of IFRS 17, namely until entities' annual reporting periods on or after 1 January 2023 commence. In practical terms, this means that when this Solvency Standard takes effect would vary by insurer, as and when they implement IFRS 17. This extension would also provide an opportunity for thorough consultation on a second draft of this Solvency Standard, which in light of the numerous issues we raise about this first draft, we would strongly support.

Without resiling from this position, as a fall-back option, we would suggest either that:

- The new Solvency Standard be altered to include transitionary provisions. These would allow the majority of standard to take effect on 1 January 2022 but with the parts that require significant systems development by insurers to implement IFRS 17 to come later once this has occurred.[2]
- The new Solvency Standard be reworked to be accounting standard agnostic as earlier indicated that it would be, so that it could be implemented by entities independent of their implementation of IFRS 17.[3]

B. The single solvency standard and long-term versus short-term treatment under it

As previously indicated by ICNZ and the majority other submitters to the earlier Solvency Standards Structure and IFRS 17 consultation, who are similarly opposed to the consolidation of Life and Non-life insurance Solvency Standards into one Solvency Standard,[4] life insurers and general insurers are each large sectors in their own right and have very different risk profiles, with a single Solvency Standard covering all sectors and subsectors adding significant complexity and introducing a risk of

150 of the Draft ISS, it is unclear whether the actuarial information is contained in the financial statements or the liabilities that form part of the solvency requirements.

[2] These transitionary provisions might apply to, for example, the sections entitled 'Adjustments to insurance items' (clauses 25 to 31 of the Draft ISS) and 'Obligations of the appointed actuary - Financial statements' (clauses 144 to 153 of the Draft ISS).

[3] In a situation where IFRS 17 is yet to be implemented, we would expect solvency projections for an entity to be on the current (IFRS 4) basis for the entirety of the projection horizon. Again, this is because the capital charges required by this Standard may not yet be known by insurers.

[4] See a summary submissions included in the relevant feedback statement, https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Insurers/ISS-review/Solvency-Standards-Review-feedback-statement-Structure-and-IFRS-17.pdf?revision=c521ba3a-5914-4957-9213-bf4cc0cef638&la=en, page 5.

unintended consequences. This has certainly come to pass in the single and consolidated Solvency Standard presented as the Draft ISS.[5]

To achieve the consolidation into this single standard, the Draft ISS includes reconstituted content from the current or previous solvency standards re-characterising this content as 'long-term' contracts or 'short-term' insurance contracts. This approach is intended to apply to both life and general insurance but does not align well with general insurance products and how general insurers conduct their businesses. For example, the Draft ISS does not capture all general insurance products or when it does capture them these are not necessary characterised appropriately.[6] There is a risk that the definition of short-term insurance contracts does not adequately capture non-life insurance products that have long-term characteristics (such as a long-term quota share reinsurance contract, which is not eligible for the Premium Allocation Approach (**PAA**)).[7] Stepping back, it is unclear whether there is any specific rationale for treating particular contracts as long-term and, if so, what this is. We expect these issues will be explored and expanded upon further by insurers bilaterally through the Quantitative Impact Assessment exercise.

As detailed in the next section, there are a number of additional issues associated with the application of 'long-term' concepts (i.e. life insurance specific solvency standard content) to general insurance that would create significant implementation challenges for general insurers and their Appointed Actuaries. We reiterate our and others' previous feedback and strongly recommend that the Life and Non-Life Solvency Standards not be combined into a single Solvency Standard as proposed. In our view, the current Solvency Standard for Non-Life is sufficiently fit for purpose and arrangements should not be made overly complex, and the risk of unintended consequences introduced, by applying concepts and requirements that are only relevant to life insurance to general insurance.

Without resiling from that position, if a single Solvency Standard is to continue to be progressed, we recommend that this does not bifurcate between 'long-term' and 'short-term' insurance contracts as currently drafted and that instead throughout this standard 'Life' and 'Non-life' are treated discretely, with general insurance treatment drawing upon the approach under the current Non-life Solvency Standard. Within each clause, section or appendix (as appropriate) it should be clearly indicated where the requirements apply to 'Life', 'Non-Life' or both.

C. The implications of introducing the operational risk charge

As expanded upon in the next section,[8] the introduction of the operational risk charge would involve a material increase in the level of capital entities are required to hold. This is notwithstanding that insurers will not be subject to any more risk, the RBNZ's previous comments that the they do not believe the level of risk assessment is inappropriate and that the interim standard is not primarily designed to alter capital requirements. We also note that the parameters of an operational risk

[5] We understand that it was the same approach (i.e. combining Life and non-Life industries into a single IFRS 17 accounting standard) taken by the International Accounting Standards Board and that is already causing significant challenges for general insurers.

[6] By way of example, under the definition of 'Product Class' (definitions, clause 20 of the Draft ISS) there is a sub-clause (i) 'General insurance' that is not referred to elsewhere in the Draft ISS. Additionally, as expanded upon below, some product classes are not currently reflected in this definition of 'general insurance' (i.e. Contract Works and General Liability).

[7] Without resiling from our position below, if the 'short-term' / 'long-term' treatment is to remain, we suggest that the short-term insurance contract definition reference the non-life list of products on page 12 of the Draft ISS. This list should also include Professional Indemnity and Directors and Officers; Financial Lines (**PIDO**). If a product does not fall within this list then the existing short-term insurance contract definition should apply.

[8] See comments regarding clause 105 (Operational risk) of the Draft ISS below.

charge were not something specifically raised or consulted on previously and that the RBNZ intends to re-calibrate capital charges in stage 2 of this solvency standard review.

Our strong recommendation is that consideration of the operational charge be deferred until the next stage of this review (where its impact can be considered more holistically, in conjunction with any other re-calibrations of capital charges and the potential introduction of diversification benefits), which is our preference. Alternatively, we recommend that the operational risk charge be gradually introduced over a three-year period or reduced. We also recommend that consideration be given to reflecting an entity's complexity and adjusting the applicable rate to reflect an entity's risk maturity.

*D. The role of the Appointed Actuary and the Financial Condition Report (**FCR**)*

As also expanded upon in the next section,[9] we are concerned about the significant extension of Appointed Actuary responsibilities and the expanded role of the FCR under the Draft ISS. These changes do not align well with the role and purpose of the Appointed Actuary and the FCR which is to identify and describe the material risks facing a licensed insurer. If the RBNZ wishes to gain greater insight into business processes and management of risks that do not meet the material risk threshold, they should do so via mechanisms outside of the FCR. If the tools available under IPSA are insufficient in this regard, this should be addressed as part of the IPSA review rather than expanding the FCR to items outside its intended scope. We are also concerned that these changes may distract Appointed Actuaries from their fundamental responsibility, namely identifying and assessing matters that pose a threat to the insurer's financial condition and solvency.

E. Issues with tax treatment

It is unclear from the Draft ISS whether insurance liabilities and capital charges are intended to be treated as before, or after, tax and we note that aspects of the Draft ISS appear to be inconsistent in this respect.[10] A clear statement of intent would be useful in this regard. Obviously, it would assist if all provisions in the Draft ISS aligned with the chosen approach.

While it appears that the Draft ISS permits tax effecting of all capital charges, subject to the limitation on creating and/or increasing a deferred tax asset, this is unclear and something that should be clarified in this standard and the rationale explained. In many cases, the requirement to tax effect a capital charge will result in the creation of a deferred taxation asset which is then taken as a full capital charge under clause 109 of the Draft ISS.

This generates a significant amount of extra work for the same mathematical result as applying a gross of tax charge initially. To reduce the regulatory burden situations like this should be avoided in our view.

For completeness, in the section below we raise a number of other queries or comments about appropriate tax treatment under this standard.

F. Sequencing with the IPSA review

The Draft ISS is intended to be an interim approach with a further tranche of changes expected to be made, following the completion of the separate IPSA review, to align with the outcomes of that review. In addition to requiring a second series of system/process changes, this approach may result in two disruptions to the reported level of solvency within the insurance sector. For this reason, we

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[9] See comments regarding clause 156 (Financial Condition Report) of the Draft ISS below.

[10] For example, whereas clause 29(iii)(c) of the Draft ISS suggests net, Appendix 8 suggests gross, of tax.

strongly recommend that any changes that have material impacts on insurers' solvency levels be delayed until the relevant parts of the IPSA review have been completed and the approach confirmed.

Without resiling from this position, if the RBNZ is to go ahead with implementing such changes under this standard prior to the completion of other parts of the IPSA review, we consider that it is important for the RBNZ to clearly and publicly communicate that any volatility in reported capital is not symptomatic of concerns about the security of the sector but rather reflects a change in reporting requirements driven by the RBNZ's chosen implementation approach.

G. The treatment of standardised insurance items

The prohibition against using the PAA for solvency purposes under sub-clause 29(i) of the Draft ISS is likely to result in entities incurring increased compliance costs due to dual reporting requirements, i.e. a requirement to complete both financial reporting (using the IFRS 17 PAA approach) and solvency reporting (using the RBNZ's modified General Measurement Model (**GMM**) approach).

The use of a GMM approach to set the standardised premium liability will also create addition work and complexity for entities who have adopted the PAA approach for financial reporting purposes. While some work is required to monitor onerosity of groups of contracts under the Accounting Standard, the approach under the Draft ISS materially differs in this respect.

We note that using the unearned premium component of the PAA methodology, as a simplification for the standardised premium liability, is consistent with the requirements under clause 19 of the Draft ISS and consider that it would be unnecessary and inappropriate to specifically exclude this alternative approach.

For completeness, in the section below we make a number of other comments about clause 29 of the Draft ISS.

2. Specific feedback

Feedback as it relates to specific aspects of the Draft ISS (i.e. clause, section or appendix) is set out below.

Please note that while we have noted a number of material errors and incorrect cross-references below, many other typographical errors identified have not been commented on. We expect that these will be addressed as part of proofing and finalising this standard.

Another area where we consider further work is required from a drafting perspective is the use of definitions throughout the Draft ISS. As expanded upon below, we note that some definitions differ to those included in the relevant accounting standard and it is unclear if this is deliberate. Where the intention is to refer to the same matter(s), the defined term used and description of it, should be the same. Conversely, if the intention is to refer to something different, a different defined term should be used.

Draft ISS reference	Comment
Title, Effect, and Commencement, clause 3	As above, we do not agree with the consolidation of Life and Non-Life Solvency Standards into one Solvency Standard. If one consolidated standard is to be progressed, it would be clearer if it was explicitly stated which product groups each clause, section or appendix applies to (e.g. Life, Health, General, some or all of them).

Draft ISS reference	Comment
	As expanded upon below, there are a number of clauses, sections and appendices taken from the Life Solvency Standard that do not appear applicable to general insurance.
Clause 5	As above, we do not consider that an implementation date of 1 January 2022 is feasible.
Application, clause 6	This clause should be reworded to improve clarity. We query whether it is necessary or appropriate to require both sub-clauses (i) and (ii) to apply before the exemption is triggered.
Purpose, clause 9	We support the inclusion of a purpose statement and confirmation that, other than in respect of seismic risks, the underlying risk appetite is a 1 in 200-year event.
Clause 11	We consider that more broadly framed and comprehensive commentary needs to be included about the role of the insurance sector. This should reflect the role of insurance in: • protecting people and businesses from the risk of financial shocks resulting from major disasters, as well as events associated with everyday life • enabling investment and trade by underwriting losses that can occur, and • signalling risk through underwriting and pricing decisions. We also suggest that commentary be included explaining the critical role reinsurance plays in the provision of insurance, noting the particular importance of this to general insurance in respect of major disasters (such as a large earthquake), where the solvency of an insurer following a major seismic event will not just depend upon the capital position of the insurer, with the size and quality of their reinsurance programme also playing a very important role in this regard. With this in mind, consideration should also be given to, throughout the Draft ISS, explicitly referring to the role of reinsurance (as distinct from capital) with reference to different types of risks and requirements.
Related party exposures, clause 18	The cross reference in clause 18 is incorrect and needs updating. We expect that this is intended to be a reference to clause 103. It would also be useful to confirm whether (and if so, how) this clause preserves the current solvency standard proviso that captive reinsurance related party balances are not treated as related party balances (irrespective of whether they are dedicated related party captive or a group insurance entity). Sub-clause (iii) needs to be clarified in this respect.
Definitions, clause 20	As indicated above, care should be taken with the definitions used in the Draft ISS which have alternate meanings to those included in the accounting standard - it is unclear if this is deliberate. For example, 'acquisition costs' as defined here is different from the definition under IFRS 17. Where the

Draft ISS reference	Comment
	intention is to refer to the same matter(s), the defined term used, and meaning, should be the same. Conversely, if the intention is to refer to something different, a different defined term should be used. Throughout the Draft ISS reference is made to the defined term 'liability for remaining coverage (**LRC**)'. In some cases, this is referring to the IFRS 17 calculation and in other cases the fulfilment cashflow calculations required for the standardised balance sheet. To avoid confusion, a different term should be used to refer to the fulfilment cashflow calculation in our view. The connection with IFRS 17 should be made clearer or separated completely from the definition of 'best estimate liability'. For example, the definition refers to fulfilment cash flows. However, it is unclear whether this includes fulfilment cash flows on both the IFRS 17 LRC and liability for incurred claims (**LIC**). It is also unclear whether the risk adjustment be included or excluded. Additionally, while the guidance for this definition suggests that deferred acquisition costs should be included, it is unclear what the rationale for this is and this should be explained. This approach also seems at odds with the requirement in clause 29(ii)(b). We also note that the defined term 'standardised best estimate liability' is referred to in clause 64(iv) but not defined elsewhere. Please also clarify the definition of 'deferred acquisition costs'. In the table under clause 103 of the 'Other credit risk' section, reference is made to the 'standardised balance sheet' in this regard, which is further defined in clause 29. However, clause 29(ii)(b) appears to exclude insurance acquisition cash flows. For the definition 'current termination value', please clarify the treatment of any recoverable amounts that may be captured within the current termination value, and how any credit risk associated with these should be treated. The identified product classes may present issues. Our main concern is the extra effort required to report at this level for immaterial products, such as credit, personal accident and travel, that generally make up a very small portion of an entity's total premiums. It would be preferable, and reduce compliance costs, in our view if entities could instead combine immaterial products. For example, in respect of the products referred to above, combining these into the 'other personal lines' category. More clarification on combined contracts would also assist. For example, how would one determine what is in line with the main benefit. We also note that IFRS 17 has definitions describing how contracts should be grouped that do not align with the definition of 'Product Class' in the Draft ISS. The definition of 'short-term insurance contract' should be refined as it appears that some general insurance contracts could be interpreted as falling outside of this. For example, in simple economic terms, an insurer may lose money on the first year of an insurance contract due to the acquisition costs

Draft ISS reference	Comment
	but rely on retaining it in the future to be profitable. Accordingly, while one may not expect future renewals of an individual contract to fund acquisition expenses in the current policy year, one could expect that to occur at a portfolio level. We also note that this definition differs from the conditions required to be eligible to use the PAA under IFRS 17. This means there are likely to be instances where an entity is applying the PAA for accounting purposes but is unable to treat the contracts as short-term for solvency purposes. Consistent with comments made in the previous section, the definition of 'general insurance' should be amended to include Contract Works and General Liability product classes. Additionally, our preference would be to: • Use the term 'solvency capital' or 'regulatory capital' rather than 'capital resources'. • Include all relevant definitions within the Solvency Standard so users do not have to cross-refer to IPSA and IFRS materials.
Insurance items, clause 26	The definition of 'insurance item' should be amended to clarify what tax items are included.
Adjustments to insurance items, insurance items, clause 27	Given the description in this clause, it appears that how insurance items are segregated into insurance assets and liabilities for solvency purposes differs materially from how assets and liabilities are defined in accounting standards. If correct, this raises the risk of interpretation differences and would require more adjustments between financial and regulatory reporting than earlier envisaged.
Determination of adjustment, clause 28	The drafting of sub-clauses (i) to (iv) is potentially confusing. It would be clearer if the words 'less' and 'plus' were noted at the beginning, rather than the end, of the relevant sentences.
Standardised insurance items, clause 29	*Overarching comments* As is evident for the large number of comments and queries, we found this clause particularly challenging to work through. We recommend that this clause be completely re-drafted to address our feedback below and in the interests of greater clarity and certainty. Doing so will make it much easier for entities to understand and comply with their obligations under this clause, which as currently drafted are very unclear. Additionally, expanding upon comments made in the previous section about the implications of introducing the proposed operational risk charge: • The prohibition against using the PAA for solvency purposes in sub-clause (i) is likely to result in entities incurring increased compliance costs with dual reporting requirements for financial reporting (using the IFRS 17 PAA approach) and solvency reporting (using the RBNZ's modified General Measurement Model (**GMM**) approach). • Also, the use of a GMM approach to set the standardised premium liability will create additional work and complexity for entities who have

Draft ISS reference	Comment
	adopted the PAA approach for financial reporting purposes. While some work is required to monitor onerosity of groups of contracts under the Accounting Standard, the Draft ISS differs from this in that requires: o cashflows for both the gross contract and reinsurance to be considered together, and o risk adjustments that are not determined for PAA methodology and that differ from the accounting framework, as they need to apply to the net cashflows and do not allow for diversification of risk across different portfolios. We note that using the unearned premium component of the PAA methodology, as a simplification for the standardised premium liability, would be consistent with the requirements under clause 19 of the Draft ISS and we consider it would be unnecessary and inappropriate to specifically exclude this alternative approach. Allowing for this would give insurers the choice of either approach, depending on their preference for reporting a conservative solvency position or undertaking the additional work to release the surplus technical reserves into the capital base. The method of specifying standardised approaches to some items seems reasonable.[11] However, these could be incorporated with the use of the PAA. *Other comments* Below we outline other issues or queries we have identified regarding clause 29: • Sub-clause (ii)(b) prohibits an insurer from adding back any asset or liability relating to insurance acquisition cash-flows as part of the standardised insurance assets and liabilities. This would appear to prevent an insurer from recognising any asset for deferred acquisition costs. This seems to be inconsistent with the table under clause 103(iii), which states that any asset for deferred acquisition costs that remains "*on the standardised balance sheet (and contributing to capital resources)*," will incur a credit risk capital charge of 5%. Please clarify whether the intention is for an insurer to be able to recognise an asset for deferred acquisition costs as part of the standardised balance sheet in some circumstances and (if so, what). • As noted above, sub-clause (iv) requires an insurer to calibrate the Risk Adjustment for Non-financial Risk (**RAfNR**) at a 75% probability of sufficiency, provided this is at a level no greater than the Product Class. This contrasts with the current Solvency Standard which allows an entity to calculate a risk margin across their total net outstanding claims liability, which implicitly allows an adjustment for the benefits of diversification between different product classes. We expect that the requirement to calibrate[12] at a product class level will remove the ability

[11] For example, under sub-clause (iv) calibrating the RAfNR, to a 75% probability of sufficiency, under sub-clause (vi) using non-discounted amounts for cash flows expected to be paid within one year of the solvency determination date and under sub-clause (vii) the approach to deriving discount rates.

[12] See footnote 10.

Draft ISS reference	Comment
	of insurers to make an allowance for diversification of insurance risk between product classes and increase insurance risk capital charges. If this is the case, we recommend that the requirement to calibrate the RAfNR at a Product Class level be deferred until the RBNZ introduces a diversification allowance in the final Solvency Standard. Please clarify how a 13-month cashflow profile should be treated under sub-clause (vi). Specifically, it is unclear whether the intention is to discount all 13 months or just month 13. The former does not appear appropriate, as the regulatory impact would be worse for 13 months compared to 12 months. Please also clarify how valuations would be conducted under this sub-clause. • Additionally, we note that: o The standardised insurance liability appears to represent a best estimate liability plus a risk adjustment, where the best estimate liability and risk adjustment are considered in relation to the specified contract boundary. If this is the intention, this should be explicitly stated. o The definition of the contract boundary for long-term insurance contracts could be made clearer. o It would be helpful if the RBNZ could explain the rationale for discount rates to be specified for swap rates,[13] and why New Zealand Government Bond yields cannot be used. • We would also appreciate it if further clarity could be provided in respect of the following parts of clause 29: o How sub-clause (i) reconciles with sub-clause 25(ii) o Whether sub-clause (ii)(b) is referring to the majority of the Deferred Acquisition Cost (**DAC**) or just the prepaid DAC asset o Sub-clause (iii) including the reference to ‘item’ and whether this sub-clause requires GST to be incorporated o ‘Reinsurance relating to the contract’ under sub-clause (iii)(a) o How tax items are adjusted to avoid double counting under sub-clause (iii)(c) o Whether sub-clause (iii)(d) relates to DAC only because an ‘item’ is defined as an asset, liability, contingent asset or contingent liability o Whether under sub-clause (v) the IFRS 17 definition applies for the ‘contract boundary’ as this is not defined in the Draft ISS (although noting that the language currently used is inconsistent with IFRS 17). This also implies that the LRC and the LIC should be considered as a single item. o The reference to ‘claims in course of payment’ under sub-clause (ix), and o Sub-clause (x). We would also suggest that (viii) be included at the beginning, rather than towards the end, of this clause, noting that under IFRS 17 these items form part of the LRC and are not separate on the balance sheet. This section

[13] Additionally, we note that interest swap products are currently not freely available in the market.

Draft ISS reference	Comment
	requires one to remove them from consideration of the GMM and re-create the separate asset or liability.
Deduction from capital, clause 37(ii)	While the deduction in this clause for fair value gains, determined based on non-observable market data, is carried over from existing Solvency Standards, this appears to conflict with the RBNZ's stated intention to move the valuation of capital resources closer to an economic valuation, and to be driven by a principle of conservatism. While there is an increased level of subjectivity in valuing financial instruments based on non-observable market data, there is clear guidance on how to do this in NZ IFRS. Additionally, any such valuations would be independently audited as part of the audit of an entity's financial statements. Conceptually, we query why these items should be subjected to any stricter standard than is applied elsewhere in the Draft ISS. For example, the derivation of a best estimate liability also relies on applying professional judgement to non-observable market data, yet this is an accepted practice in the Draft ISS. We suggest this deduction be removed. Instead, any fair value gain that would have been deducted under this clause would attract an appropriate capital charge (e.g. if the asset is an equity instrument, it would attract an equity risk capital charge in accordance with clause 83).
Contingent assets and liabilities, clause 43(iii)	This clause requires an entity to include contingent liabilities as a deduction "*at their likely maximum exposure*". By definition, the chance of a contingent liability occurring at all is unlikely, in fact IAS37 uses the wording "*not probable*" to describe it. Accordingly, logically the 'likely' maximum exposure will always be zero. Alternatively, if one considered that the 'likely' maximum exposure was greater than zero, it would no longer be a contingent liability, but an actual liability, noting that a provision is recognised when it is "*probable that an outflow of resources … will be required to settle an obligation*." Notwithstanding the above, if the RBNZ is minded for there to be a deduction here, we consider that this clause needs to be reworded. One option could be to replace the reference to 'likely maximum exposure' with 'probability weighted exposure'.
Prescribed capital requirement, clause 49	It is unclear whether the intention is for the prescribed capital requirement (**PCR**) formula to include a tax effect. This should be clarified and the rationale for the approach explained.
Clause 50	The treatment of short-term and long-term insurance contracts in this clause highlights the issues with adopting an approach that focusses on life insurance contracts, but which potentially catches some general insurance contracts as long-term, due to the definition of short-term.
Insurance risk, clause 51	What is a captive insurer is not clearly defined and the guidance in this clause is very high-level. It is also unclear whether the intention is for this clause to relate to short or long-term business (or both).
Clause 52	It is unclear whether the intention is for these risk charges to be tax effected. Again, this should be clarified and the rationale for the approach explained.

Draft ISS reference	Comment
	Also see our feedback on clause 50 above.
Underwriting risk (short-term business), clause 53	It should be stated that LRC is net of reinsurance. This is consistent with treatment of LIC in clause 54. It is also unclear whether the intention is for this risk capital charge to be tax effected.
Claims run-off (short-term business), clause 54	We note that the term standardised LIC is not clearly defined anywhere, with clause 29 largely drafted to reflect items in the premium liability.
Catastrophe risk (short-term business), Calculation, clause 55	It is unclear whether the intention is for the catastrophe risk charge to be tax effected. Again, this should be clarified and the rationale for the approach explained.
Clause 56	The definition of capital risk charge is ambiguous and should be clarified. Given a number of insurers use third party vendor models, a modelled whole of portfolio approach could be requested. Alternatively, for those with Wellington exposure, the RBNZ could specify an event from the underlying earthquake event catalogue. This clause also needs to be amended to ensure that the catastrophe charge applied is that determined by the class of business, rather than in terms of the insurance contract. As currently drafted, some general insurance products would be treated as long-term insurance contracts and under this clause what was previously the Life Insurance Catastrophe charge would apply to them.
Clause 57	The reference to sub-clause 56(iii) should be removed as for non-earthquake extreme events that clause explicitly refers to a 1 in 250-year loss return period.
Long-term insurance risk, clauses 63 to 65	This section is currently part of the Life Solvency Standard. Accordingly, while this section should apply to life insurance, it should not apply to general insurance. To address the equivalent issues for a general insurance perspective, provisions consistent with clauses 41 to 44 of the current Non-life Solvency Standard should be included in the Draft ISS. Without resiling from the above position, we note that with respect to clause 64, the fixed capital amount defines the minimum PCR. For example, $5m for those with long-term insurance contracts. However, under clause 64 a long-term insurance risk charge is required to equal the difference between the greater of current termination values and solvency liability less the standardised best estimate liability. In this context, the fixed capital amount appears somewhat arbitrary. New Zealand insurers who previously had the $5m charge in determining the minimum solvency capital may not have the minimum charge anymore. It is unclear if this is intended and this matter should be clarified.

Draft ISS reference	Comment
Catastrophe risk (long-term business), clauses 66 to 73	This section is taken from the current Life Solvency Standard. Accordingly, it should apply to life insurance only and not apply to general insurance.
Asset classification, clauses 74 to 76	We believe that the requirements regarding collective investment vehicles, where the look-through approach is unable to be applied, should be clarified (in particular, clause 75). Clause 76 is taken from the current Life Solvency Standard and accordingly we recommend that it be made clear that this only applies to life insurance and is not applicable to general insurance. Without resiling from this position, with respect to hypothecated portfolios, the desired outcome should be clarified. Under clause 76, it is currently unclear what the practical implications for an entity of demonstrating that the portfolio is hypothecated would be.
Interest rates, clauses 79 to 82	It is unclear whether the Draft ISS introduces different stresses based on different levels of interest rates (rather than a uniform stress). How to apply these stresses should be clarified – i.e. if using a yield curve, which of the following applies: • the stresses to spot or forward rates (our recommendation would be the latter), or • a different stress to each forward rate based on the level of that rate and how it compares to the thresholds. In the table of stresses, it is unclear which row applies when the rate is exactly 1% (although potentially this is just a typographical oversight). The interest rate stress on liability appear to apply the stress on the best estimate liability rather than the Current Termination Value (**CTV**). It is unclear if this is intended. If it is, please explain why this is the case, given the long-term insurance risk charge already replaces the best estimate liability with max (CTV, Solvency Liability). Please amend clause 79 to clarify whether one can apply interest rate sensitivities on the standardised liabilities where no discounting is carried out (e.g. liabilities where under clause 29(vi) no discounting applies). If one cannot do this, this would cause a strain as investments are generally hedged to liabilities. We consider that IFRS 16 leased assets and liabilities should be excluded from the interest rate capital charge under sub-clause 79(iii). Please also clarify the position for liabilities that are not discounted in the standardised liabilities but in reality are interest rate sensitive. The table set out under clause 80 appears overly complex. We understand entities rely upon outside valuers to measure these matters based on standing instructions such as the current +/- 175 bp change. However, as proposed, assets would be continually moving between brackets and those instructions would need to become complex and fluid. In our view this table needs to be simplified to be workable.

Draft ISS reference	Comment
Equity, clause 83(iii)	Please clarify the relevance of the standardised value of insurance items to the equity risk charge.
Property, clause 84(ii)	Please clarify the relevance of the standardised value of insurance items to the property risk charge.
Clause 85	Please confirm that the IFRS 16 Right-of-Use (**ROU**) Assets are excluded from this capital charge. This would preserve the status quo as per clause 62A of the current Non-life Solvency Standard.
Foreign currency, clause 86(iii)	As noted below, Appendix 7 appears to be taken from the current Life Solvency Standard. Accordingly, it should be stated that this does not apply to general insurance in our view.
Credit risk, clauses 93 and 94	We understand the rationale for having a higher capital charge for reinsurance recovery assets that are in dispute. However, the nature of disputes could vary widely, which makes a 'one-size-fits-all' adjustment problematic.[14] It would assist if what is in 'dispute' was clarified. In our view, this should make it clear that to be in 'dispute' it is necessary for legal proceedings to have been initiated. It will also be important for the 'amount in dispute' in such circumstances to be clarified. It is unclear whether the intention is for this to be the entire amount or for the reinsurance recovery asset to be split into portions based on the minimum the reinsurer would pay versus the amount claimed by the insurer. There is also a risk of double counting in this context. For example, if the dispute is significant enough to call the valuation of the asset into question, one would be required to provide against it for accounting purposes. It is also unclear whether one would then also have to incur an additional solvency charge on the already written down value. These matters should be clarified.
Derivative instruments, clause 91(ii)	The calculation of the delta weighted position under the derivative instruments charge should be clarified.
Counterparty grades, clause 95	Consideration should be given to the treatment of catastrophe bonds and other forms of non-traditional reinsurance.
Reinsurance recovery, clause 99	Consistent with remarks above, to make the application of the reinsurance recovery risk charge clearer we suggest that subject to 'dispute' by the reinsurer should be defined. This should make it clear that to be in 'dispute' it is necessary for legal proceedings to have been initiated. That is, as opposed to a reinsurer simply querying a payment until such a time as more information is provided. The scope of this definition may be material in the event of a catastrophe.

[14] For example, what is in 'dispute' could cover a wide range of potential areas where there is disagreement, some of which may not have a material impact on the solvency position, such as where there is disagreement about when the recovery should be paid, not how much should be paid. Alternatively, it could be that the reinsurer accepts that they are liable to pay a reinsurance recovery, but disagree with the amount of that recovery, and refuse to pay any part until this quantum issue is resolved.

Draft ISS reference	Comment
	It is also unclear whether the intention is to capture amounts that are both receivable and outstanding. This should be clarified.
Clause 100	It appears that the capital factor on EQC is 2% as that is the lowest factor available. However, it is unclear what the rationale for this would be if sovereign debt is at 0.5% and EQC has a Crown guarantee. This treatment may have substantial impacts if an insurer is managing claims on behalf of the EQC for large events and their capital is strained. Please also clarify sub-clause 100(ii)(a) as it is unclear what 'less' means in this context. We also note that as IFRS 17 already allows for reinsurance default, this may amount to duplication.
Other credit risk, table under clause 103	'Deferred acquisition costs' is defined as "[a]*ny such assets remaining on the standardised balance sheet (and contributing to capital resources)"* and attracts a 5% capital factor. However, it is unclear why there would be deferred acquisition costs on the standardised balance sheet. This should be clarified.
Operational risk, clause 105	While we support the theoretical rationale for introducing a risk charge for operational risk (and doing so using a method such as a percentage of gross written premiums),[15] this is not something that was specifically raised or consulted on previously. Accordingly, there has been no opportunity to consider and provide feedback on the nature and design of such a charge in detail. We also note that in the previous Solvency Standards Structure and IFRS 17 consultation, concern was expressed by submitters (including ICNZ) about whether the operational risk charge could be appropriately calibrated to an individual insurer's profile.[16] The new 3% operational risk charge proposed will materially increase the capital that entities are required to hold and constitute a significant slice of current year net profit after tax (**NPAT**). Independent of other changes in the standard, we understand that this could result in an increase of 20-25% to PCRs, which would be a material change to capital requirements, without entities being subject to any new risks. This approach also appears inconsistent with the RBNZ's previous comments that the current level of capital held by the industry does not need to be increased. We also note that the RBNZ has indicated that the interim standard is not primarily designed to alter capital requirements and that it intends to re-calibrate capital charges in the next stage of this review. Given these concerns and comments, as earlier indicated, we strongly recommend that consideration of the operational risk charge be deferred until the next stage of this review, where its impact can be considered more holistically, in conjunction with any other re-calibrations of capital charges

[15] We note that this appears similar in form of to international comparators, for example, the approach taken by APRA in Australia.

[16] See a summary submissions included in the relevant feedback statement, https://www.rbnz.govt.nz/-/media/ReserveBank/Files/Publications/Policy-development/Insurers/ISS-review/Solvency-Standards-Review-feedback-statement-Structure-and-IFRS-17.pdf?revision=c521ba3a-5914-4957-9213-bf4cc0cef638&la=en, page 15. For this reason, it was suggested by some submitters that this matter should be considered instead as part of general risk management, the insurer's ICAAP process or the Appointed Actuary's review of financial condition.

Draft ISS reference	Comment
	and the potential introduction of diversification benefits, which is our preference. Alternatively, we recommend either that: • this charge be gradually phased in over 3 years, in a similar manner to the transition approach adopted by the RBNZ in implementing the revised bank capital standards,[17] or • a lower percentage rate apply instead. We are also concerned that the single rate approach does not reflect the complexity of an organisation (e.g. multiple systems, products and manual processes), an organisation's risk maturity or encourage entities to improve their operational risk management from a capital perspective. Given that the RBNZ has oversight of risk management improvements, it would be useful if it could provide a risk maturity score that adjusts any base capital charge. We note that the proposed flat percentage rate of gross written premium (**GWP**) structure of the operational risk charge, with an additional loading factor for entities with a fast growth trajectory, is also problematic. The use of GWP (rather than gross earned premium (**GEP**)), will already increase the operational risk charge for a growing business, because GWP is greater than GEP in this situation. Applying a further risk charge in this context amounts to element of double counting. This could be avoided by using GEP in these calculations instead. It is also unclear whether the intention is for this operational risk charge to be tax effected. Again, this should be clarified and the rationale for the approach explained. We also note that it would be useful for the RBNZ to clarify whether the 'absolute value' is to be applied to the Long-Tail Liability (**LTL**) at the Product Class or entity level. Please also clarify how tax should be incorporated in this respect.
Other capital charges, clause 106	Regarding the asset concentration risk charge, it is unclear why the unstressed value is used for contingent liabilities. We query whether the 'stressed value' (as defined in clause 108 under contingent items) should be used for determining the asset concentration risk charge exposure instead. Regarding business run-off, the $0.5m per annum parameter appear arbitrary. Please also explain how management actions are considered in setting this capital charge.
Contingent items, clause 107	It is unclear what 'contingent items' are, specifically whether these are intended to be synonymous with 'contingent liabilities', refer to 'contingent assets', or additionally cover other items. It is also unclear what "*the standardised value of each contingent item"* is and we query whether this is

[17] If the operational risk charge is to be phased in, it will be important to ensure that this occurs in a way that minimises competitive distortion, i.e. by phasing occurring as consistently as possible across insurers, although noting some may have different financial reporting dates.

Draft ISS reference	Comment
	intended to be a cross-reference to clauses 42 and 43. If this is the case, this should be clearly stated. While we can see that the stressed value of a contingent item in this clause aligns with the interim standard's concept of a 1 in 200-year event, this could be problematic when applied to contingent items. For example, if an entity is faced with a 'vexatious' legal claim with very low probability of success, we see this definition as requiring an entity to provide for the full amount of a legal claim. This would require entities to hold significant extra amounts of capital, as they will need to provide for the full amount that is claimed on all contingent liabilities, without having regard to the chances of success. As contingent liabilities, by their nature, can come and go, and vary in amount, this may also introduce significant volatility to an entity's Minimum Capital Requirement (**MCR**). At a minimum, a requirement should be added to make it clear that contingent liabilities that do not meet the test for disclosure under NZ IAS37 will not incur a capital charge. As that standard does not require disclosure of contingent liabilities where the possibility of an outflow of resources is 'remote', this should at least partly reduce the risk of extreme scenarios impacting capital. Further amendments may be possible to improve matters.
Distressed wind-up, clause 109	Please clarify whether this clause applies only on wind-up, or is part of the general calculation (which is our understanding). We recommend that it be made clear that a going concern basis is explicitly presumed under this clause (with 'economic' values to prevail), and for wind-up <u>not</u> to be presumed, unless the entity does not meet the accounting standard requirements for reporting on a going concern basis. If this is not the case, then deductions from capital would attract a 100% capital charge to all items listed, which would be overly conservative in our view. For example, in a genuine going concern scenario, for a deferred tax asset, there should be a degree of capital recognition as if it has met the accounting standard requirements for recognition, in that it is likely that future taxable income will be available that the deferred tax asset can be utilised against. Whilst the solvency margin remains consistent with the existing Solvency Standard, this would reduce the solvency ratio. Given the RBNZ intends to put in place a ladder of intervention based on the solvency ratio, this equates to capital raising by stealth in our view. For example, if the RBNZ targets a 1.2 x Prescribed Capital Amount (**PCA**), this would effectively be a 20% capital strain on an accounting asset that cannot deteriorate further. If wind-up is to be presumed, even though the insurer is a going concern, then in our view RBNZ needs to explicitly confirm these 100% capital charges can be tax effected. In our review, the Deferred Tax Asset (**DTA**) should be admissible as it is a receivable from the Crown in an actual going concern scenario. However, to allow for uncertainty, in a going concern scenario a capital charge of ~30% could be applied to this DTA.

Draft ISS reference	Comment
	We also note that: • Sub-clause (v) uses the term 'assuming', suggesting wind-up is not to be assumed for the rest of this clause. Sub-clause (v) should not refer to 'assumed' in our view. • The 'Distressed wind-up' heading for clauses 109 and 110 may create confusion about the intent of these provisions. We suggest other terminology be used here instead, potentially 'Assets not considered elsewhere'.
Asset calculation, calculation, clause 117	Please include an example in guidance for this clause.
Business run-off, clause 121	It would be clearer if everything related to run-off was contained within this, or another, specific provision, rather than this matter being dealt with across a number of different clauses (e.g. clauses 109-110 and then 121-123).
Adjusted prescribed capital requirement, clauses 124 to 128	While we favour a transparent adjusted prescribed capital requirement (**APCR**), the interim Solvency Standard would be improved if it also contained clear guidelines about when adjustments to the PCR may be applied, including an outline about what consultation would be undertaken by the RBNZ with the insurer in this respect and how these adjustments may develop or be removed in the future.
Minimum capital requirements, clauses 129 and 130	This Solvency Standard should explain the rationale for the quantification of the MCR (i.e., being 80% of the PCR) and if the MCR incorporates some degree of flexibility to accommodate differences between entities (such as in product mix, size and complexity of operations). These differences mean that a 'one-size-fits-all' percentage is not appropriate in our view. As guidelines for the 'ladder of intervention' framework are developed, we would appreciate it if the RBNZ could set out clear expectations about what actions may be taken at each trigger point, along with the nature of any discretions available to it in this regard.
Audit of annual solvency return, clauses 134 to 136	Under the current Solvency Standards, the IFRS 4 balance sheet is used for both financial reporting and as the starting point for the solvency calculation. However, under the Draft ISS, the starting point for the solvency calculation is an accounting IFRS 17 balance sheet, with certain adjustments to insurance items then applied. Where an insurer is still applying IFRS 4 for financial reporting purposes, we expect insurers and auditors will need to commit significant additional time and resource to prepare and audit the solvency return. We also reiterate our comments in the previous section in this regard and note that the issues described directly above would add to the challenge of implementing the new Solvency Standard by the proposed 1 January 2022 date and reinforce the need for this to be delayed.

Draft ISS reference	Comment
Obligations of the appointed actuary, financial statements, clauses 144 to 153	While these clauses are under the heading 'Financial Statements', the guidance under clause 152 suggests that this content may apply equally to the standardised balance sheet of the Solvency Standard. If this is not the intention, the guidance may be better placed under clause 155 instead. As we understand it, this level of disclosure is not suited to the Appointed Actuary's report under Section 78.
Obligation of the appointed actuary, financial statements, clause 145	It is unclear whether the RBNZ intends for this to be on an IFRS 17 basis, standardised basis or both. If on an IFRS 17 basis, we note that this will not be workable until IFRS 17 is implemented.
Clause 150	As per the above, it is unclear whether the intention is for this to be on an IFRS 17 basis, standardised basis, or both. If an entity is eligible to use the PAA approach, then this clause requires the calculation and run-off of contractual services margins (**CSMs**). We understand that many entities will not be calculating or setting up systems to monitor these. If this is the intention (i.e. the RBNZ is wanting entities to use both the GMM and the PAA to estimate insurance liabilities to standardise the balance sheet), this requirement would add an additional regulatory burden and cost, as they will need to set up a balance sheet under both models – one for financial reporting and one for solvency. Sub-clause (i) does not align well with the IFRS 17 definition of the LRC. This appears to only refer to LRC that has been calculated using the GMM under IFRS 17 (i.e., as per clause 41(a)(i) of IFRS 17) and does not refer to the elements of LRC as calculated using the PAA. Additionally, even for LRC calculated using the GMM, some important coverage elements are missed. For example, this clause refers to expected claims and recoveries and some expenses but fails to refer to premiums and other cash flows that would be considered as part of the calculation of the LRC. This clause could be made more comprehensive and clearer by using similar wording to those used IFRS 17, such as replacing the reference in (i)(a) and (i)(b) with "*estimates of the fulfilment cash flows relating to future service*". Sub-clause (ii)(c) appears to have been included in error, as the calculation of the liability for incurred claims prepared in accordance with the requirements of IFRS 17 does not include any element relating to the CSM. Regarding sub-clause (iv), please clarify what is envisaged by the application of any tests for onerousness. In particular, it is unclear whether the intention for this to be under the IFRS 17 level of aggregation or the Solvency Standard Product Class. Under the PAA approach, contracts are not onerous unless facts and circumstances indicate otherwise. It is also unclear whether the intention is for the Appointed Actuary to oversee management or whether they want them to use the Fulfilment Cashflow approach to challenge them. If the latter, then the RBNZ is asking entities to use a GMM approach in addition to the PAA approach, adding additional regulatory burden and cost.

Draft ISS reference	Comment
Clause 152	We note a potential inconsistency between sub-clause 150(iv) and this clause. While sub-clause 150(iv) appears to amount to a review of the IFRS 17 onerousness testing, the guidance under clause 152 refers to a 'full assessment', which we envisage would require something equivalent to the current net liability adequacy test (**LAT**), and these outcomes may differ. In respect of the guidance set out immediately after this clause, we consider that the proposed comparison would better sit within financial statements rather than the Appointed Actuary's report under s 78 of IPSA.
Clause 153	It is unclear what the purpose of this clause is. As we understand it, this matter is already dealt with under clause 28 (termination of adjustment). It is also unclear what is practically required in this respect. In particular, we query whether the expectation is that a net LAT will be performed and increase (net) standardised LRC wherever there is a deficit. If this is the case, it is unclear what level of granularity this net LAT is supposed to operate at (e.g. at the IFRS 17 level or the RBNZ Product Class level). These matters should be clarified.
Financial condition report (FCR), clause 156	A number of elements of this clause amount to a significant increase on top of current requirements, which go well beyond the conventional role and purpose of the Appointed Actuary and FCR to identify and describe material risks. The requirements are not actuarial in nature and should not form part of the Appointed Actuary's obligations in our view. In particular: • With respect to sub-clause (xi), current guidance under PS30 requires the Appointed Actuary to comment on material risks to the financial condition of an entity, the purpose of the FCR being to comment on material risks that may have consequences for the solvency of an entity to its' Board. This clause effectively requires the actuary to peer review the Board's outsourcing decisions, a matter in respect of which they have no skills or experience. We suggest such inquiries be carried out through the supervisory regime the RBNZ has in place not via the FCR. • With respect to sub-clause (xii), as above, the intention of the FCR is to present the material risks to the entity's Board. The projection required under section 24 of IPSA is also to be included in this document. It appears that the intention here is to provide a more prescriptive and detailed view than the entity's Board requires. If that is correct, the RBNZ can deal with this using its powers under section 121 of IPSA or by updating the solvency template, as opposed to requiring this to be included in the FCR in our view. If the tools the RBNZ has available within the context of IPSA do not allow it to achieve these outcomes, these issues should be addressed as part of the separate IPSA review, rather than expanding the FCR to cover items outside it or the Appointed Actuary's remit. We also note that: • Sub-clause (iii) relies on the Appointed Actuary being aware of matters not disclosed in the financial statements.

Draft ISS reference	Comment
	• It is unusual for 'inwards and outwards reinsurance agreements' to be raised in the context of 'outsourcing' under clause (xi)(c). • Please provide further details on the 'adequacy' expectations under sub-clause (xiv). • It would be clearer if sub-clause (xii)(a) was explicit on whether earned premium is net or gross. • The cross references to sub-clauses (m) and (n) in sub-clause (xiii) and (xiv) appear to be in error. • With respect to sub-clause (xiv), it is unclear what the basis and level the RBNZ wants the actuary to comment on regarding the adequacy of premium rates.
Clause 157	We reiterate our comments for clause 50 in this respect.
Clause 158	The cross reference to sub-clause 157(c) should be changed as this does not exist. Presumably this should be a reference to clause 157(iii). We also reiterate our comments for clause 50 in this respect.
Appendix 2 – Financial reinsurance	This appendix appears to be a reproduction of Appendix E from the current Life Solvency Standard. Clause 38 of the Draft ISS makes it clear that Appendix 2 only applies in respect of 'long-term insurance contracts'. This is appropriate in so far as the content in this appendix is tailored to life insurance concepts but it should not be applied to general insurance in our view. However, this is not something that is made clear within this appendix itself, and should be in our view. Without resiling from the above position, we note that the purpose of sub-clause '1A' under clause 2 is unclear and we query whether clause 13(v) should refer to 'sub-clause (i) or (ii) applies' rather than a cross reference to '(a) or (b)'. Additionally, clause 22(iv) specifies that 'highly unlikely' means a probability of less than 10%. However, the Draft ISS does not: • Provide any guidance on how to determine this probability in the context of the stresses specified, which are supposed to have a 1 in 200-year (0.5% probability) calibration. For example, for mortality, the draft standard prescribes a 10% stress to best estimate assumptions. It is unclear whether this implies that, for testing the repayable amount, the stress on mortality used needs to be materially less than 10% or what the position would be if the entity's view is that a 10% probability means a greater than 10% mortality stress. • Address what happens if, on a 10% probability, neither the insurer nor the reinsurer makes a loss. For example, premium rates and reinsurance premium rates being charged are more than sufficient to cover a 1 in 10-year event. It is unclear why a repayable amount should exist in such a scenario. • Provide guidance on how to determine what a 'significant loss' is. This would reduce entities having to resort to subjective exercises of judgement.

Draft ISS reference	Comment
	The issues raised in the first two bullet points directly above may result in some reinsurance contracts being classified as having a repayable amount when this is not consistent with the nature of the reinsurance contract.
Specified event test	The wording associated with the 'value of the repayable amount' should be clarified in our view.
Appendix 3 - Materiality	It is unclear what the 'solvency margin' under clause 1(iii) is. We envisage this should be a reference to the 'adjusted solvency margin' instead. Given that clause 1(iv)(b) ends with '…; and', we query whether '(v)' should refer to '(iv)(c)' instead.
Appendix 4 – Quality of reinsurance	This appendix only applies to long-term insurance contracts. We suggest this appendix be re-worked so as to relate to Life Insurance contracts and not be applicable to general insurance. Without resiling from the above position, we note that clause 3(ii)(d) cross references clause 3 which appears to be incorrect.
Appendix 5 – Prescribed solvency assumptions	This appendix is taken from Appendix A of the current Life Solvency Standard and the content clearly relates to life insurance. Accordingly, we suggest it be made clear that this does not apply to general insurance.
Appendix 6 - Guarantees	This appendix comes from Appendix B of the current Non-life Solvency Standard. We note that clause 12(iv) includes text that was in the old clause 9 of Appendix B, but this content is also recreated as clause 12(i) to (iii) so appears to be duplicate and unnecessary. We query whether the cross reference in sub-clause 5(i) should be to clause 98 rather than clause 112.
Appendix 7 - Discretions	This appendix appears to be taken from the current Life Solvency Standard and the content clearly relates to life insurance. Accordingly, we suggest it be made clear that this does not apply to general insurance.
Appendix 8 - Taxation	This appendix appears to be taken from the old clause 4.2 of the Life Solvency Standard. In general terms, it would be helpful if more clarity was provided on how this applies to general insurance (if that is the intention), noting that this is fundamental to the application of this new Solvency Standard. If the intention is to permit all capital charges to be tax effected (which, as noted above, is unclear and should be clarified), then it would be simpler to state this in each of the relevant sections or make this clear in this appendix. Tax impacts the solvency calculations in a number of ways, and there are specific tax effects of certain charges and capital adjustments, as well as a requirement to consider the impact of tax overall. With that in mind, in general terms, we consider that there would also be benefit in: • expanding the guidance on how the tax principles are applied, and

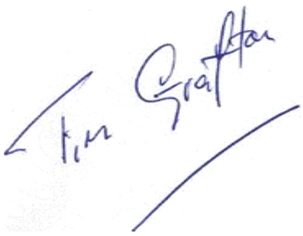
Draft ISS reference	Comment
23	• considering separating tax effects from the various adjustments into separate tax adjustments and charges. Given the current timetable the RBNZ are working to, we envisage that this may need to be deferred until a later date. In many cases, the requirement to tax effect a capital charge will result in the creation of a deferred taxation asset which is then taken as a full capital charge under clause 109 of the Draft ISS. This generates a significant amount of extra work for the same mathematical result as applying a gross of tax charge initially. To reduce the regulatory burden situations like this should be avoided in our view. Additionally, we note that, while deferred tax assets and liabilities for foreign taxes cannot generally be offset against the equivalent for New Zealand tax, foreign tax credits can be offset against New Zealand tax if the appropriate rules are satisfied. Foreign deferred tax, which would be available as foreign tax credits, are unlikely to be material. This is another area where specific guidance would assist. Sub-clause 2(ii) states that "*capital charges must be calculated with an allowance for tax. The gross amount of these capital charges and the taxation on these capital charges, if any, must be clearly identified*." This clause should be clarified as there are at least two ways of interpreting it: • One interpretation is that if one is making an adjustment that has a direct consequential tax impact, one should adjust tax balances. For example, if one has adopted a 100% capital charge on intangible assets, and those intangible assets have a deferred tax balance associated with them (e.g., when these intangible assets have a large DTA associated with them), one should also adjust the deferred tax balance. • Another interpretation of this is that, if one assumes that a capital charge represents a potential write-off, then that write-off would generate a tax benefit and one should adjust their solvency calculation for that. For example, if the 2% Asset Risk Capital Charge (**ARCC**) on fixed rate interest investments represents the potential that an entity may have to write off 2% of the investments in a 1 in 200-year event scenario, one should recognise that 2% ARCC. However, it is unclear whether one should also then make an allowance for the potential tax benefit they would get from writing off that investment (i.e., 28% x 2%). One would still need to be able to confirm that the recovery of such a tax asset would be beyond doubt in a wind-up situation, which may be the case if there was a tax liability that it could be offset against. Sub-clause 2(iii) refers to ""….*were the licensed insurer to be wound up*." It should be made clear in this sub-clause and other provisions in this appendix that a going concern basis is presumed and wind-up is not presumed, unless the entity does not meet the accounting standard requirements for reporting on a going concern basis. We also query whether the cross references to sub-clause (b) in sub-clause 2(iii) should be to (i), (a) and (b) to (i) and (ii) and consider that the phrase

Draft ISS reference	Comment
	'beyond doubt' is inappropriate. If recognition of the tax asset meets IAS12 requirements, as evidenced by audited accounts, then that recognition criteria should suffice in our view. Sub-clause 2(iv) refers to sub-clause (c) which does not exist. The appropriate approach may be to simply state that all capital charges can be tax effected if that is the intention. Under sub-clause 2(vi) again it is unclear whether a going concern basis is presumed. As above, we recommend that this and the fact that wind-up is not presumed (unless the entity does not meet the accounting standard requirements for reporting on a going concern basis), is clearly stated. Please explain how sub-clause 2(vii) works as this appears to be inconsistent with all other provision that appear to permit tax effecting.

3. Conclusion

Thank you again for the opportunity to submit on this matter. If you have any questions, please contact our Insurance Manager by emailing john@icnz.org.nz.

Yours sincerely,



Tim Grafton
Chief Executive

John Lucas
Insurance Manager