Insurance Council of New Zealand
P.O. Box 474 Wellington 6140
Level 2, 139 The Terrace
Tel 64 4 472 5230
email icnz@icnz.org.nz
Fax 64 4 473 3011
www.icnz.org.nz

12 November 2020

Reserve Bank of New Zealand
2 The Terrace
PO Box 2498
Wellington 6140
New Zealand

Email: insurancesolvency@rbnz.govt.nz

Solvency Standards Principles and Timelines

1. Introduction

Thank you for the opportunity to provide input on the principles that will guide the Solvency Standard Review.

2. High Level Comments

You preface the outline of the principles with the comment that these have been adapted from those used in the Bank Capital Review and that you wish to have a consistent approach between the two sectors. Insurers have on many occasions warned of the dangers of conflating the insurance and banking industries and adopting a 'one size fits all' supervisory approach. There are very different market dynamics underpinning the insurance market which warrant a different approach. A combined approach may, for example, have the effect of exacerbating issues of accessibility to, and affordability of, insurance in the New Zealand market. There is also a fine line between increased consumer protection through increased capital requirements on one hand and decreasing consumer accessibility because of decreased affordability. This overarching feedback applies to all of our comments below.

We also see value in including some detailed and specific context setting before the principles are set out. In particular:

2.1. Clarifying that capital requirements are presumably to be set at a level that promotes the maintenance of a sound and efficient insurance sector (i.e. at a system level) while recognising that there may be individual insurer issues that do not, in and of themselves, constitute system failure.
2.2. Recognising that there may be some possible but unlikely events (e.g. extreme natural disaster events) outside of parties control that could have systemic impacts.
2.3. Identifying what the Solvency Standard is trying to achieve over all (i.e. what is the overall risk appetite), recognising that solvency requirements for private insurers are just one piece of a broader puzzle that New Zealand refers to for maintaining resilience. Credit risk should be considered differently to natural disaster exposures for example.

We note the short timeframe provided between this consultation on principles and the timetable for the solvency review and the initial substantive consultation on the structure of the solvency standards proposed to begin in December. We query the extent to which the feedback in this principles and timetable consultation can be incorporated in the later consultation given the short turnaround.

3. Consideration of Additional Principles

We also note that the principles appear to be more about what the particular Solvency Standard should be rather than principles of review itself. If there is an intention to cover the latter, then principles related to the process together with commitments to engagement / consultation, open-mindedness etc. should be reflected.

Additionally, consideration should be given to adding the following additional explicit principles:

3.1 Protection of customers, and
3.2 Consistent treatment of insurers, noting that the current solvency framework is not particularly transparent. For example circumstances where insurers with similar reported solvency positions have varying credit ratings without any readily identifiable explanation.

4. Specific Comments

In this section we address specific comments on each principle and the timetable

Principle 1

We will have regard to international comparability, particularly LAGIC (Australia), Solvency II (Europe), International Capital Standard (IAIS) and the Insurance Core Principles (IAIS), with the caveat that principle number 2 will take precedence.

We agree, noting in particular that consistency with the Australian jurisdiction is helpful given the number of insurers operating on both sides of the Tasman.

However, it is unclear how this principle interacts with the others. In particular, principle 1 is diminished and overridden:

- explicitly by principle 2, and
- implicitly by principle 6.

The relationship with international solvency requirements could be more clearly articulated, perhaps in a single principle, noting that while it makes sense to bring New Zealand up-to-date with international standards for prudential regulation in general terms, there will be areas where this may not be appropriate due to the unique characteristics of the New Zealand insurance market.

Principle 2

We take a substance over form approach and tailor our requirements to New Zealand. This principle will take precedence over international comparability.

We agree although noting that consistency with the Australian jurisdiction may be helpful in certain circumstances e.g. when an insurer is a branch of an Australian parent, noting that this is available in the current standards.

Principle 3 & 4

(3) Capital must readily absorb losses before losses are imposed on policyholders.

(4) Capital requirements should be set in relation to risks that may impact insurer balance sheets.

While both principles 3 and 4 sound reasonable, as these just describe what Solvency Standards do, they could be omitted.

In respect of principle 4, we believe this should only be in relation to 'material' risks. We note that while in theory all risks impact the balance sheet, some do so more directly than others. We caution against developing a capital requirement framework that attempts to capture all risks possible (e.g. conduct risks, reputation risk, etc.). Management of risks should be undertaken via qualitative measures with RBNZ having the ability, where warranted, to make supervisory adjustments. Careful consideration is required regarding the more 'indirect' impacts on an insurer's balance sheet.

Principle 5

Insurers should be subject to a single method of determining capital requirements and the use of judgement should be limited to the extent possible.

This principle ought to be refined as it is unclear what the 'single method of determining capital requirements' involves.

One possible interpretation of the 'single method' is that one standard is intended to apply across different classes of business or sectors. In our view, dual solvency standards are required for life and general insurance respectively, as we have currently. Creating one approach across both Life and General is likely to have unintended consequences given the differences in the underlying businesses. Also there should be mechanisms for insurers to apply for exemptions and adjustments, should specific circumstances warrant this.

Alternatively, the 'single method' could be interpreted as applying one standard across jurisdictional boundaries where there is an element of overseas ownership. We would be concerned if this was intended as this would drive up costs, with operations in different countries being required to aligned to the 'single method' standard. It would also be challenging to maintain a competitively neutral environment between local and overseas insurers.

Replacing the reference from 'single method' to 'consistent methods' may be more appropriate as this provides flexibility, acknowledging that different methods may appropriately apply.

Principle 6

Capital requirements of New Zealand insurers should be conservative relative to those of international peers, reflecting the Reserve Bank's regulatory approach.

The reference to 'conservative' ought to be expanded upon or modified as it is unclear to us what this means in this context.

On one hand, this principle may constitute no change to RBNZ's current approach as it has already stated that it is increasing resourcing to more actively monitor insurers and given the earlier introduction of the 1 in 1000-year catastrophe event requirement which, in conjunction with better quality data about risks insured (e.g. construction materials, rebuild costs and location) and upgraded catastrophe models, mean insurers are holding significantly higher levels of capital/reinsurance than they were ten years ago.

If this reference is intended to signal a shift to further conservativism, this has the potential to warrant the application of very high capital requirements which are likely to result in negative consequences. To explain:

- Adopting unduly conservative standards will lead to higher capital requirements, necessitating higher returns for investors (and higher premiums for policyholders), to provide a sufficient margin to attract business to New Zealand insurers.
- RBNZ needs to be cautious about developing more conservative standards for insurers in New Zealand relative to other jurisdictions. The general insurance market in New Zealand is serviced by international insurers and New Zealand owned insurers who operate in a competitive environment. In our view, regulation in New Zealand should, wherever possible, be competitively neutral between domestic and overseas insurers and should protect the New Zealand policyholder as a priority.
- Additionally, a more intensive level of supervision paired with a more conservative capital approach has the potential to cause insurance accessibility and affordability issues, such as those being experienced by aspects of the Wellington apartment market. Accordingly, a more conservative approach seems out of line with any concerns about the affordability of insurance that RBNZ may have or the purpose of IPSA to promote public confidence in the insurance sector.
- Raising solvency requirements even further relative to other countries will also make New Zealand less attractive to new entrants with consequential flow on effects to competition and innovation.

In our view, a country's capital standards should be based upon its own independent view of what constitutes an appropriate level of risk, rather than a desire to be stronger than other countries.

Principle 7

The solvency framework should be practical to administer and minimise unnecessary complexity and compliance costs.

We consider that principle 7 should be refined as it could be interpreted in a number of different ways. In our view, this should not be relied upon to justify different standards applying to different insurers even if that is easier for some.

We agree that the solvency framework should be practical to administer and minimise unnecessary complexity and compliance costs. This can be achieved if the capital charges are calibrated against a balance sheet prepared using the appropriate accounting standard with minimal adjustments to it being required.

Principle 8

The solvency framework should be transparent to enable effective market discipline.

Note our comment in 3.2 above.

5. Timetable

Phase 1 (Q4 2020 – Q4 2021)

The timetabling for phase 1 may not be realistic given the progress made by insurers in implementing IFRS 17, particularly those that need to apply the General Measurement Model. Specifically, the planned calibration exercise in late 2021 may be too early or alternatively may need to be undertaken on a best endeavours basis, noting that insurers cannot be expected to apply any new Solvency Standard until IFRS 17 has been applied.

When considering the timing for implementing IFRS17, alignment with other jurisdictions would be desirable where possible, to avoid a period of dual reporting for foreign owned insurers.

Phase 2 (Q1 2022 – Q4 2023)

We are concerned about how phase 2 might impact the management of data and reporting of capital requirements under a new IFRS17 standard, particularly if various detailed matters (e.g. capital charges) have not been finalised.

6. Other comments

It would be helpful to understand what the approach to transitionary reporting will be reflecting on all this change and the finalisation of aspects that will need to be linked together.

Phase 1 of the timetable should also collect feedback on the current standards to ensure any current issues are addressed as part of the review. It's not clear that this is part of the suggested process.

7. Conclusion

Thank you again for the opportunity to provide comments on this topic. Please contact Terry Jordan (terry@icnz.org.nz) if you wish to discuss or require further information or clarification.

Tim Grafton
Chief Executive