

# **SOLVENCY STANDARD RE-ISSUE 2014**

Reserve Bank of New Zealand Consultation Document

## **SUBMISSION**

From



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**Insurance Council of New Zealand**

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## **1. INTRODUCTION**

The Insurance Council of New Zealand thanks you for the opportunity to provide a submission on this consultation paper on Solvency Standard Re-Issue 2014, by the Reserve Bank of New Zealand (RBNZ).

## **2. INSURANCE COUNCIL OF NEW ZEALAND**

ICNZ is the industry representative for fire and general insurers in New Zealand. We aim to assist our members in the key areas that affect their business through effective advocacy and communication.

ICNZ currently has 30 members who collectively write more than 95 percent of all fire and general insurance in New Zealand. ICNZ members, both insurers and reinsurers, make up a significant part of the New Zealand financial services system. ICNZ members currently protect more than half a trillion dollars' worth of New Zealanders' assets.

ICNZ plays an active role in representing the insurance industry. Our members are licensed under the Insurance (Prudential Supervision) Act 2010 ("IPSA") and are signatories to the Fair Insurance Code, which sets service standards for the industry and encourages professionalism among members. We also perform an important role in informing and educating consumers about key insurance issues and risks.

## **3. HIGH LEVEL COMMENTS**

### **3.1 Consultation process**

The timing of the publication document on 16 September, puts the workload for submissions across quarter end for most insurers and year end for a few. Insurers find it difficult to allocate resources to address the consultation document.

The workshops held by the RBNZ are a good idea however feedback from insurers suggests that these were too short notice and too early in the submission period to allow people to read the paper and consult within their teams. Consultation through the workshops would be more helpful later in the feedback period. A further suggestion for improvement in these workshops would be for more live examples to be given to illustrate the intended changes that are outlined in the consultation document.

### **3.2 Consultation**

Some of the significant changes in the consultation document have been the subject of previous consultation over the past 12 months. These included the areas of quality of capital and regulatory treatment of financial reinsurance, guarantees and off-balance sheet exposures and financial reinsurance. The industry has provided feedback on these documents, however there has been no return feedback from the RBNZ on whether they have considered and understood the insurers comments in arriving at their position in the current consultation document. Providing feedback on submissions is one area that we urge the RBNZ to improve, in order for insurers to better understand the Reserve Bank's reason behind changes.

### **3.3 Catastrophe risk Charge – Extreme event Exposure**

While not a specific part of this consultation document, the requirement for insurers to hold sufficient catastrophe reinsurance to cover insurance losses

for a loss return period of 1 : 1000 years is still very contentious. This is vastly higher than other comparable jurisdictions and will result in insurance in New Zealand being uncompetitive with the rest of the world and will result in higher prices for insurance in the domestic market. Insurers urge RBNZ to consult further on this with the industry.

#### **4. SPECIFIC COMMENTS**

##### **4.1 Contingent liabilities**

The consultation document in paragraph 26 outlines that the range of contingent liabilities is wider than those in the Accounting Standards under NZ GAAP. The Solvency Standard has been revised to require the appointed actuary to identify contingent liabilities not disclosed on the financial statements. The actuary would normally rely on the professional expertise of the accountants to identify and quantify contingent liabilities. If a more extensive review is required by the RBNZ then greater guidance in identifying contingent liabilities will be required.

Insurers are keen to confirm that future lease commitments are not regarded as contingent liabilities. In the draft Off Balance Sheet Exposures Guidelines issued in November 2013 for consultation, there was an example that indicated future lease commitments were not to be regarded as contingent liabilities. At recent workshops on the consultation document, RBNZ staff indicated that these should be included as contingent liabilities. We do not support this position. For some insurers this could result unnecessarily in significantly increased Risk Weighted Exposure Charges. We ask that RBNZ clarifies their intentions around the treatment of leases.

##### **4.2 Related party exemptions**

Paragraph 104 of the current non-Life Solvency Standard defines when an asset is not regarded as a related party asset. This section provided a “carve out” for reinsurance assets (104 b) and captive reinsurers (104 c). In the new standard, section 104 has been removed and a new section 16 defines when a related party asset may be treated as if it were not a related party exposure. However, the “carve outs” for reinsurance assets and captive reinsurers has been omitted. This will not be a problem for insurers who have reinsurance recovery assets from unrelated reinsurers, but a number of ICNZ members have either captive reinsurance relationships or reinsurance that comes through their parent company either directly or on an agency basis. Under the proposed new non-life Solvency Standard those insurers with related party reinsurance assets will not be able to offset their claims liabilities with the reinsurance assets (adjusted for the reinsurance recovery risk capital charge) which will result in insurers needing to keep large amounts of extra capital. This, in the current Canterbury earthquake environment, could be hundreds of millions of dollars of extra capital.

We recommend that an explicit carve-out from the related party rules be retained in the proposed non-Life Solvency Standard along the lines of para 104 of the existing standard, so that it remains clear that all reinsurance assets and Captive reinsurance assets are not subject to the related party rules.

##### **4.3 Tax effecting**

Paragraphs 123 & 124 are welcomed in that they confirm that all capital risk charges and adjustments thereto can be tax effected by the applicable tax rate (currently 28%, but subject to any particular tax rules applying that would alter the standard rate) with the proviso that tax effecting can only be included in the solvency calculation to the extent that a tax asset is not created. The industry is pleased that the Bank have included these confirmation paragraphs.

#### **4.4 Preference Shares**

Paragraph 22(b) of the Solvency Standard states that perpetual non-cumulative preference shares can form part of the capital base. By their nature, perpetual preference shares pay their distributions out of net of tax profits and part of their return is in the form of imputation credits. Imputation credits cannot necessarily be utilised by particular types of investors such as local councils, retirees, off-shore investors and institutional investors. This would therefore mean that an investment in perpetual preference shares is less attractive for potential investors and increases the cost of capital for insurers.

The ICNZ recommend that the RBNZ consider allowing perpetual subordinated bonds as part of the capital base. These instruments involve distributions out of before tax profits and are more attractive to particular types of investors, which will reduce the cost of capital overall for insurers. Furthermore, these instruments are essentially identical to perpetual preference shares and meet the RBNZ requirements in terms of permanence, loss absorption, servicing charge and ranking on winding up.

#### **4.5 Solvency Standard Layout**

In the new Non-Life Solvency standard, it seems unusual that paragraphs 123 and 124 which relate to tax adjustment considerations of the various solvency charges should be located under the section on Obligations of the Appointed Actuary. Because these comments relate to the whole of the Standard, it would make more sense to place these under the General provisions in section 1.5. A replacement paragraph 123 could include a requirement for the Appointed Actuary to comment on the treatment of taxation in the calculations and confirm that an appropriate allowance for deferred tax has been made if any tax deductions have been assumed.

On another note, it would make it easier for users of the Solvency Standard if there was a comprehensive table of contents in the document.

## **5. CONCLUSION**

We appreciate the opportunity to comment on the consultation document. If you need further clarification on points made above, please contact ICNZ.

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