



8 November 2023

Reserve Bank of New Zealand
Wellington 6143

insurancesolvency@rbnz.govt.nz

ICNZ Feedback on the Second Amendment of the Interim Solvency Standard September 2023

The Insurance Council of New Zealand representing General Insurers is pleased to provide the Reserve Bank of New Zealand with feedback on the Second Amendment Interim Solvency Standard

We present the Reserve Bank with the following comments on certain sections of the Interim Solvency Standard.

1. Section 1.1.3: Implementation Date from 1 June 2024. Could earlier optional adoption be considered, such as 31 March 2024 or the first balance date after the Standard is issued by the RBNZ?
2. Standardisation of the Balance Sheet.

There are currently two different valuation methods that can be applied to the Standardised Insurance Items for short term contracts. These two methods lead to materially different results. The changes proposed in this consultation go some way to align them, but also introduce some further points of difference.

The change made in Paragraph 30(i) of the ISS to alter the treatment of Premium not yet due does not appear to be covered in the consultation document. As drafted, future modal premiums will now be included in the premium receivable that needs to be established as part of this approach, and the standardised liability will be increased accordingly (with no net impact on solvency capital). This is more in line with the previous Non-Life Solvency Standard, but less consistent with the valuation result obtained through paragraph 28 (modified GMM).

It should also be noted that the Guidance note on paragraph 30(i) still reflects the ISS before this set of amendments which excludes future modal premiums not yet due over the coverage period.

Section 2.4.7: Paragraph 30 (ii) DAC

It is not clear what outcome is expected from this change. Is the DAC expected?

Does this become part of the standardised insurance items?

Or is it to be held separately (as was done under IFRS4)? An impression which is strengthened due to the existence of paragraph 106(ii). Noting that paragraph 106(ii) has been updated to say "implicit DAC asset" so the suggests the later, but not entirely clear.

Section 2.5.4: Paragraph 30 (iii) PAA Allowing Diversification Benefit in the RA

The use of paragraph 30 (modified PAA approach) is optional for short term business. If the change to allow RA at all business level is made here, it needs to be allowable for short term business under paragraph 28 for consistency. Some of our members have long-term general insurance business and would also consider that the longstanding practice of allowing for diversification benefits within risk adjustments for those products should also be provided for.

We support the New Zealand Society of Actuaries approach to this as outlined in their submission.

3. Section 2.24: Paragraph 28 (v). Contract Boundary definition We understand the intention that cancellation clauses should not impact on the determination of contract boundary or coverage period for solvency purposes. However, we do not think the proposed change to paragraph 28(v) will necessarily achieve the required clarity on this point for all contracts, especially where cancellation clauses impact on the contract boundary and coverage period determined under IFRS 17.

Any changes to paragraph 28 are independent of paragraph 30, and therefore the interpretation of contract boundary for those contracts where the PAA method is applied is not impacted by the change proposed. Reliance on the coverage period definition from IFRS 17 for short term contracts remains problematic where cancellation clauses are interpreted as determining contract boundary/coverage period under IFRS 17.

If the intention is that cancellation clauses should be ignored in determining contract boundary and coverage period for solvency purposes, perhaps a more specific statement to this effect, applying to both paragraph 28 and paragraph 30 (and any other relevant parts of the standard such as those parts pertaining to the determination of insurance risk capital charges) should be made. This may best be achieved by including a specific definition of coverage period within the ISS (which would override any IFRS 17 interpretation of coverage period) and making further changes to the definition of contract boundary to make the intention clearer.

4. Section 2.3.2 Modified PAA valuation – tax adjustments

The specified tax treatment for non-life insurance still does not make sense and we seek further clarification of what is intended by RBNZ.

- I. Paragraph 30 (PAA) now refers to the “standardisation of related tax items” and in paragraph 30.iii that “the profit margin must be net of tax”. It is not clear whether this is consistent with GMM where a straightforward interpretation of paragraph 28.iii.c is that the entire standardised liability will be netted down for tax (all general insurance prospective cashflows are subject to tax).
- II. A full netting down of the standardised liability may have some unintended consequences for related capital charges, especially the run-off risk capital charge which will be applied to a net of tax standardised liability. This outcome is also inconsistent with Appendix 8 2.i of ISS which outlines that a gross amount of capital charge should be accounted for.

- III. There are other possible interpretations of the wording that could be made including one where the “taxation effect” only considers future tax and offsets tax that has already been paid. The outcome under paragraph 28 would be that the standardised liability would include a tax item related to the difference between the gross standardised liability and the accounting liability. This is a similar result to paragraph 30 PAA as drafted where only the profit margin adjustment to the liability is tax effected. Related capital charges would be materially the same as under the previous NLSS. Technically, however, the amount of capital charge would still not be a pure gross of tax amount for the purposes of Appendix 8.

- IV. We wonder, therefore, whether the ISS doesn’t properly take into account the tax differences between life insurance and general insurance? Nil taxation adjustment to standardised liabilities may be a more appropriate treatment for non-life insurance?

- V. Given the possible interpretation differences among professionals we believe it is essential that a final version of the ISS spells out clearly the intended tax treatment and has definitions which are consistent with what is intended. For example, the current definition “*Taxation Expense means tax paid plus the increase in tax liabilities over the period*” doesn’t make it clear how the current tax deduction (in some cases relating to future insurance cashflows included in the standardised insurance items) that has already been made on the accounting liability should be treated (if at all) in the context of the standardisation process.

5. Section 2.6.7: Paragraph 38 (iv) Deductions from capital

The suggestion seems sensible but is a specific deduction from capital rather than part of the standardisation of asset values. Consequently, it will be necessary to modify paragraph 113 so that any deduction in paragraph 38 appropriately adjusted included in the Distressed Wind-Up charge (noting only economic value of the item will become part of the Wind-Up Capital Charge)

For items written down to economic value in paragraph 38 iii) should paragraph 113 now be requiring write off of the economic value (rather than no contribution to the capital charge)?

While this seems like pragmatic response to concerns raised through previous consultation in practice, this will be difficult to apply as there are established methods to value these assets and taking a different view will be difficult to substantiate.

6. Section 2.8.3 Paragraph 56 UWRCC

Paragraph 56 as drafted the number is a central estimate of outstanding claims with no risk adjustment.

The consultation document talks about this charge being to allow for pricing risk, but there are significant parts of the pricing that have not been included:

- Reinsurance, Maintenance, and overhead costs
- taxation

We have concerns that to the extent that this number is different from the SLRC on the Standardised Balance sheet there is an element that is being missed or double counted for other solvency charges.

7. Section 3.1.3 Taxation Expense

The definition would appear to capture all past tax paid, not just the taxation in relation to timing differences that needs to be brought forward into the SII.

In the marked-up copy definitions, 'Taxation Expense' should be a new line.

Should Past Paid tax go back into the calculation?

8. Paragraph 101

There is now a charge on deferred reinsurance assets (101.i.c.) and expected portfolio reinsurance recoveries (101.i.f.) in standardised liability for remaining coverage. There is potential for double counting as a result of this (although this currently depends on the standardisation approach adopted).

9. Suggest changing paragraph 101.i.f. to be "any outwards reinsurance component of the standardised liability for remaining coverage in respect of portfolio reinsurance, where this is an asset to the solvency entity and the risk is not captured by other charges"

10. Section 2.10.4: Paragraph 106 reintroduce the Credit Risk Capital Charges for Fixed Interest Assets

We agree that it is sensible to be reintroducing this.

11. Section 2.11.3 Run Off Expenses

The Objective seems sensible.

Sub paragraph 126 b) should the inflation adjustment be to reflect actual inflation from Jan 2024.

Is there a need to specify what index will be applied when allowing for inflation.

12. Section 3.3.: LTIRCC

Paragraph 58(i) of the ISS should state that the assumption set is in Appendix 5

13. Section 3.4.3 Run Off

Is it possible that the RBNZ may restrict ability to sell new business and not want to apply the run-off condition.

It would be more flexible to leave this requirement unchanged. In the instance where restricting new business should result in a Run-Off capital charge then could be to the modification of the license conditions.

14. Section 3.7.4 Definition of Subsectors of Insurance

We agree with this proposal.

15. Not Publishing Annual Solvency on Website

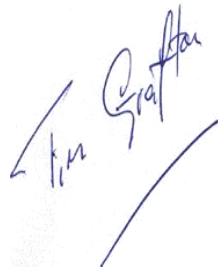
For a short period of time (less than 1 month), the Annual result in the Financial Statements will not align with the results for the same period on the insurers website. *A website disclosure/explanation could be required.*

As the AIR is due 4 months after balance date. The next IR is due 2mths after end of quarter.

Thank you again for the opportunity provide feedback on the Interim Solvency Standard.

If you have any questions, please contact John Lucas on john@icnz.org.nz or 0274411283

Yours sincerely,

A handwritten signature in blue ink that reads "Tim Grafton". The signature is written in a cursive style with a long horizontal stroke at the bottom.

Tim Grafton
Chief Executive

A handwritten signature in black ink that reads "John Lucas". The signature is written in a cursive style with several loops and a long horizontal stroke at the bottom.

John Lucas
Insurance Manager