



20 March 2009

Director – Accounting Standards  
New Zealand Institute of Chartered Accountants  
PO Box 11 342  
WELLINGTON

Dear Sir,

**ED 115 Omnibus Exposure Draft [2008-2]**

This submission is made in response to the request for comment on ED 115 Omnibus Exposure Draft [2008-2]. The submission is made by the New Zealand Society of Actuaries (the “Society”), the professional body representing Actuaries practicing in New Zealand.

In particular the submission addresses the proposal to amend NZ IFRS 4 Insurance Contracts, Appendix C Life Insurance Entities paragraph 17.10 by inserting (c) as below:

- (c) whether the amount of solvency reserves disclosed in accordance with paragraph 17.8 has been determined in accordance with the standards and guidelines of the New Zealand Society of Actuaries (Inc);

**Background**

The Companies Act 1993 requires that a company remain solvent. One measure of solvency is from the Balance Sheet determined under financial reporting standards. The financial reporting standards are given the force of law by the Financial Reporting Act 1993. The key financial reporting standard for life insurers is NZ IFRS 4.

Current good financial reporting practice is to defer to the New Zealand Society of Actuaries Professional Standard No. 5 “Solvency Reserving for Life Insurance Business” (PS5) to determine an amount of equity that the life insurance company must retain as a contribution to solvency (or “prudential reserve”). Currently there is no legislative requirement for life insurers to do this.

PS5 is mandatory for actuaries giving advice on the Solvency Reserve for an entity governed by NZ IFRS 4 Appendix C. The purpose of PS5 is to guide actuaries in the determination of the minimum margin to recommend to the Board to be set aside out of shareholders equity, under NZ IFRS 4, to meet the solvency test (of the Companies Act 1993).

## Proposal

The Exposure Draft, if accepted, would make it mandatory for life insurance companies to disclose whether they have determined the solvency reserve in accordance with the Society standard (PS5) however it does not require a solvency reserve determined in accordance with PS5 be disclosed. Companies may simply choose not to report or even calculate a PS5 figure.

## Society Position

The Society would like to see PS5 made mandatory to determine the minimum requirement for prudential reserving under the financial reporting standard.

**If however the current proposal goes ahead and compliance with PS5 is not to be made mandatory, we submit a figure determined in accordance with PS5 should nevertheless have to be disclosed.** This will allow users of the accounts to have a comparable measure of differing companies' capital positions.

## Comment

The financial reporting standard is "income statement focussed" as opposed to "balance sheet focussed". By that we mean the income statement is derived preferentially as opposed to being determined from the difference between two balance sheets. The income statement is intended to give a realistic profit result and hence is based on best estimates about future experience. This means a balance sheet derived from the income statement does not have a quantified prudential margin. This is not generally viewed as a prudent way to manage a financial services company and although the policy liabilities in a life insurer's balance sheet may include an allowance for future profits, there is no particular expectation that those policy liabilities would be adequate to ensure solvency in a range of adverse conditions.

This leads to the requirement for a capital adequacy standard or a prudential reserving requirement. In practice this is reported as the amount of equity that companies should retain as a contribution to solvency. This is because the reported available equity can be viewed as being overstated because it is determined from a potentially "inadequate" balance sheet – the balance sheet is driven by the income statement. How should companies determine how much of their reported equity should be retained as a prudential reserve to ensure solvency in a range of adverse conditions?

Users of financial statements should be given enough information to be able to directly compare different companies' capital positions including prudential reserves calculated under a consistent basis. In the Society's view, the disclosures required under the proposal are not sufficient to ensure that this can happen. We note Banks are required to disclose their capital adequacy calculated under an industry standard.

Most life insurers apply the Society standards, publishing solvency positions which are comparable because they are determined on a consistent basis. Our concern relates to companies which do not use that standard. Without further information, users of such companies' accounts have no basis on which to compare their solvency positions to others in the market. Further disclosures need to be mandated to make such comparisons possible.

The Society would like to see the following disclosures in all life insurers' financial statements.

- a. **The amount of shareholder equity that the Directors have determined is appropriate for retention as a solvency reserve.**
- b. **A summary of the Directors' policy in relation to determining solvency reserves, including the methods and assumptions used in determining the amount disclosed.**
- c. **Further, if that amount has not been determined in accordance with the solvency standards of the Society:**
  - i. **Why the Directors took the view that it was not appropriate to apply the Society's solvency standards, and**
  - ii. **What the amount of the solvency reserves would have been if Society standards had been applied, and**
  - iii. **A summary of the main reasons for any differences in the amount of the solvency reserves determined by the Directors and the amount determined under Society standards.**

In forming our position the Society has considered principles of good governance and Director responsibility. After disclosing a PS5 figure Directors would need good reason to choose to ignore it. Hence our view that it should be mandatory to disclose why PS5 has been deemed inappropriate and to also disclose the effects of using the chosen methodology as opposed to that found in PS5.

If you would like to discuss any aspect in more detail at any time, please do not hesitate to contact the undersigned.

Yours sincerely,  
For/New Zealand Society of Actuaries (Inc)



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