



27 May 2011

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Dear Richard,

### **Solvency Standard for Life Insurance**

The New Zealand Society of Actuaries (“the Society”) welcomes the opportunity to comment on the draft solvency standard for life insurance. We have given specific commentary on the major issues and also commented on a number of drafting issues in the Appendix.

### **Consultation process**

The Life Insurance Practice Committee has sought input from the Society’s membership and has initiated this response, which has been approved by the Council of the New Zealand Society of Actuaries.

### **Support for standards**

The New Zealand Society of Actuaries is supportive of mandatory solvency standards for insurers and for those standards to be issued by the Reserve Bank of New Zealand. The Society agrees with and supports the structure and principles of the standard. Most of this has already been discussed and submitted on.

The second consultation draft of the solvency standard has significantly evolved from the first consultation draft in a well thought out manner and it is pleasing to see that feedback has been taken on board.



## **Comments on the draft Standard**

### ***Consistency between Life and Non-Life Standards***

In general the Life and Non-Life Solvency standards should be consistent unless there is a good reason for them not to be. Although we have not carried out a full comparison between the two standards a number of inconsistencies have been noted including the inconsistency of the role of the Appointed Actuary (section 1.7 in the Life standard which has no equivalent in the Non-Life standard).

### ***Referencing NZSA Professional Standards (146)***

This has the effect of giving the NZSA Professional Standards the weight of law which we consider to be inappropriate.

### ***Application of the Standard (3, 4)***

Unless a separate solvency standard is issued for “small” insurers this standard will apply to all life insurers which we didn’t think was the intention of the RBNZ.

Paragraph 4 implies that consumer credit insurance will be written outside the statutory fund which runs counter to what we would expect. It is difficult to comment on this as the statutory fund guidelines have not been released.

This addition presents difficulties for insurers trying to establish their statutory funds in the licensing phase. We submit that consumer credit business is permitted to be in a statutory fund.

### ***Tax (14, 27, 55, 121)***

The Best Estimate Liability, Policy Liability and Solvency Liability are all required to be calculated on a net of tax basis. A number of insurers have moved to a gross of tax basis for risk business with a separate deferred tax reserve. We submit that a gross of tax calculation should be acceptable as long as the associated deferred tax reserve is also allowed for.

The last 10 words of paragraph 121a should be deleted as the tax components are effectively embedded in the Solvency Liability.

Paragraph 121 b should then be re-written as:

“Additional current or deferred taxation liabilities or assets that arise as a result of the capital charge calculations in (a) above must be clearly identified and must be arrived at using a prudent assessment .....



### ***Solvency Capital (18)***

Solvency Capital is still held outside the statutory fund which runs counter to the purpose of a statutory fund. This lessens the benefits of putting regulations in place to protect assets within a statutory fund for the protection of policyholders if there is no requirement to actually hold those assets within the fund.

### ***Solvency Margin Definition (33,34,131)***

The definition of Solvency Margin should be restricted to ratio or percentage as otherwise it contradicts paragraph 131. It follows that paragraph 34 also needs to change such that the Solvency Margin be not less than 1.

### ***Catastrophe Risk Charge (58-61)***

It is pleasing to note that the RBNZ has adopted a specific charge for pandemic risk. It is unclear though what “loss” in paragraph 59 means. It could be interpreted as either a specific charge equal to anticipated extra mortality claims or the loss that might be shown in the financial statements of an insurer after such an event (so for instance whether expected net cash flows should be used to offset the additional expected claims or the release of any reserves should be taken into account).

Understandably, given its very company specific nature, the risk concentration charge can't be specified. There may well be, at least initially, different interpretations of how to implement this.

We also submit that the catastrophe risk charge should be the greater of the pandemic charge and the concentration charge rather than the sum of the two given the very small likelihood of both these events occurring in a similar time period.

Catastrophe cover is written under different terms for Life insurance and Non-Life insurance. The requirement for the cost of a reinstatement of catastrophe cover will be irrelevant under most Life catastrophe covers so we submit that this reference be removed.

### ***Derivation of Charges***

Although the RBNZ does not have to justify any of the factors in the standard it would be helpful to know what components have been considered in those factors. For instance do the CEP charges contain a component that allows for transactions costs on sale (which is specifically allowed for under PS5.01 under section 11.9).



***Reinsurance Recovery Risk Capital Charge (98)***

There would be practical problems with splitting out future liabilities by each individual reinsurer. Individual products are often reinsured by more than one reinsurer, yet an insurer's valuation is done at product level (not reinsurer level). We submit that this paragraph be removed.

The reinsurance recovery risk capital charge should have an allowance for the credit risk of reinsurers involved in reinsuring catastrophe risk. This is likely to be the most important component of reinsurance recovery risk. We submit that a new paragraph be added requiring capital to be held in respect of catastrophe reinsurance recovery risk.

***Clarity regarding net or gross of tax***

Specific mention is made that the 1.75% yield adjustments are gross of tax. It would be helpful if the status of the CEP and FX charges can be clarified for the purposes of taxation treatment in the resilience scenarios.

***Cross Referencing***

With the substantial changes that have taken place since the initial draft a number of cross-referencing errors have appear in the second draft.

Yours sincerely  
for New Zealand Society of Actuaries (Inc)

Ian Perera  
**President**

Hamish Farrar  
**Life Insurance Convenor**



## **Appendix – Drafting and Wording Issues**

### **Paragraph 44**

It should be clarified that the “entity accounts” refer to the “Parent Accounts” not the “Group Accounts”

### **Paragraph 71**

It is unclear exactly what should be done in practical terms if the ‘look through’ approach can’t be applied.

### **Paragraph 90**

If the solvency calculation is done at Life Fund level then “total value of its assets” should be replaced by “total value of the assets in the Life Fund”.

### **Paragraph 102**

We believe that AM Best use different ratings for financial strength and security issue meaning that Table 4 can’t be used for both.

### **Paragraphs 107 and 108**

These paragraphs may need to be revised given the addition of Section 1.7.

### **Paragraph 131**

In line 15 “solvency standard” should be replaced by “solvency standard(s)”

### **Appendix A – Paragraph 11**

“Risk margins” should be defined.