23 November 2020

Reserve Bank of New Zealand
Financial System Policy and Analysis – Financial Policy
PO Box 2498
WELLINGTON 6140

Email: insurancesolvency@rbnz.govt.nz

Dear Sir/Madam

Submission on Insurance Solvency Standards Review Paper

1. Thank you for the opportunity to provide a submission on the Reserve Bank's **Insurance Solvency Standards Review Paper**.

2. The New Zealand Society of Actuaries (the Society) is the professional body representing actuaries in New Zealand.

3. The Society strongly supports this review of Insurer Solvency Standards noting the time since the current standards were introduced (albeit with some subsequent amendments), the reviews that have been carried out and the forth coming implementation of IFRS-17. As previously communicated to the Bank, members of the Society are prepared and willing to provide assistance to the Bank to support this review if required.

4. The Society is in agreement with the timelines envisaged in the paper.

5. The Society supports the Principles in the paper with the exception of Principle 6:

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

6. It is our view that the statement in Principle 6 regarding conservatism relative to international peers is a conclusion which does not appear to be supported in either the paper nor in the Bank's statement of approaches to prudential supervision and regulatory policy making.

7. We understand the reference to conservatism may reflect the Bank's "light handed" approach to supervision. However, it is our understanding that this light handed approach is changing with the Bank adopting a more pro-active approach.

8. We note that in the Reserve Bank's Issues Paper: **Review of the Capital Adequacy Framework for locally incorporated banks** a similar principle was included:

Capital requirements of New Zealand banks should be conservative relative to those of international peers, reflecting the risks inherent in the New Zealand financial system and the Reserve Bank's regulatory approach.

9. The reference to the “risks inherent in the New Zealand financial system” is important, and in the context of this review we believe that the Principle 6 should include reference to the “risks inherent in New Zealand insurers”.

10. In our view Principle 6 should also make reference to the Reserve Bank’s risk appetite and the desired level of security for policyholders. Without this it is not possible to determine if the Bank’s resulting capital requirements achieve their ultimate purpose which is to provide security for policyholders and protect their interests.

11. There are a number of elements of the New Zealand insurance market that result in the inherent insurance risk being lower than in many international peers, including:

    a. The prevalence of renewable term life, disability and health insurance products with premiums that are reviewable annually on the policy anniversary.
    b. Very low take up of guaranteed annuity products which have higher mortality and interest rate risks.
    c. The existence of a very small (legacy) portfolio of guaranteed life insurance, either non-profit whole or life or endowment policies or level term policies.
    d. The absence of “long tail” general policies such as accident compensation or personal injury. These have been a primary cause of insurer distress overseas due to the risk of under-reserving and under-pricing.

12. Offsetting these lower risk elements are factors such as:

    a. New Zealand is a small open economy, subject to international market shocks.
    b. The New Zealand insurance market is relatively small by international comparisons and therefore finding a “market solution” for a distressed insurer may be correspondingly more difficult.
    c. For property insurers, natural peril and earthquake risks are relatively high in New Zealand with limited ability for geographic diversification within the country.

Potential Consequences

13. Our concern is the impact on insurers and ultimately their customers if the Reserve Bank were to adopt capital requirements that are (materially) more conservative than international peers.

14. The consequence of adopting more conservative capital requirements is reduced efficiency in the New Zealand insurance market potentially resulting in:

    a. Increased premiums for policyholders as insurers seek to maintain the return on equity. Or alternatively, less capital being available if the return on capital reduces.

    b. Changes to risk sharing or corporate structures to reduce capital requirements and leverage the lower capital requirements in overseas territories, including increased use of: offshore reinsurance, branch structures, and direct placement offshore of larger commercial risks.

Our Preferred Approach

15. It is our view that capital requirements are converging internationally as a result of the IAIS work, and any approach adopted should be consistent with this where possible.

16. Within the IAIS framework, capital requirements for New Zealand insurers should reflect the risks inherent in New Zealand insurers and the Reserve Bank's regulatory risk appetite, i.e. the desired level of policyholder security.

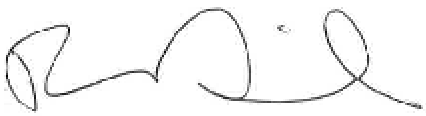
17. As a consequence we suggest Principle 6 is reworded as follows:

    Capital requirements of New Zealand insurers should reflect the Reserve Bank's desired level of security for policyholders and the risks inherent in New Zealand insurers.

18. In our opinion this will result in capital requirements that are appropriate to New Zealand conditions and which may, or may not be, more conservative than those of international peers depending on their relative levels of policyholder security and inherent insurer risk.

We are available to answer any questions you may have as a consequence of this submission.

Yours faithfully



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