



Reserve Bank of New Zealand
Financial System Policy and Analysis - Financial Policy
PO Box 2498
WELLINGTON 6140
Via email: insurancesolvency@rbnz.govt.nz

20 July 2022

To whom it may concern,

Re: Submission on the review version of the Interim Solvency Standard

We welcome the opportunity to make a second submission on the review version of the Interim Solvency Standard (Review ISS) that was published for consultation by the Reserve Bank of New Zealand (Reserve Bank) on 31 May 2022.

This submission follows on from our previous submission, dated 1 October 2021, on the exposure draft of the Interim Solvency Standard (ISS). We acknowledge the work that the Reserve Bank has done in terms of updating wording of the ISS and communicating reasons for the changes where wording changes have not been proceeded with. A number of our previous submission points have been addressed in the Review ISS.

However, there are a small number of issues that remain unaddressed or may have been introduced unintentionally in the drafting updates. This submission highlights these points, focussing on where there are potential technical inaccuracies as opposed to practical difficulties.

The NZSA recognise the importance of the regulatory capital standards to actuaries more broadly and the level of effort required to refresh and calibrate these standards. As noted in our May submission, we would like to work constructively with the Reserve Bank in finalising the Review ISS and we are open to discussing any points with you before the finalise the ISS.

Background

The NZSA is the professional body for actuaries practicing in New Zealand. Most of the Appointed Actuaries to New Zealand's licensed insurers are members of the NZSA. The Appointed Actuary regime was enacted through the Insurance (Prudential Supervision) Act 2010 (Act) and each licensed insurer must have an Appointed Actuary. The ISS is of particular interest to many of our members due to the special position of Appointed Actuaries and the important obligations placed upon them.

Paragraph 160 of ISS states: *"The appointed actuary must ensure that all actuarial work carried out for the purposes of, or supporting, this solvency standard is carried out in accordance with the New Zealand Society of Actuaries' Professional Standards"*. Given the reliance the Reserve Bank places on the Society's Professional Standards, the Society will require time to review and update standards once the final ISS is published. Alternatively, the Reserve Bank may wish to consult with the Society during the development of the ISS so that Professional Standards could be updated contemporaneously.



The professional standards directly affected are:

- PS20 Determination of Life Insurance Policy Liabilities
- PS30 Valuation of General Insurance Claims
- PS21 Life Insurers - Financial Condition Report
- PS31 Non-Life Insurers - Financial Condition Report
- PS90 General Actuarial Practice
- Code of Professional Conduct

These standards are part of the self-regulation framework of the NZSA and will likely be affected by changes to the solvency regulations. These professional standards both support the regulatory framework and codify the expectations the NZSA has of members in the role of Appointed Actuary.

In order to produce this submission, we have relied on questions submitted by members through the 30 June 2022 Reserve Bank webinar on the Review ISS and feedback gathered via the practice committees.

Items that have been addressed

The following items from our previous submission have been addressed through updates to the drafting of the Review ISS or communication from the Reserve Bank:

- The effective date has been shifted to align with the effective date of NZ IFRS 17.
- The differences between “long-term” and “short-term” products have been clarified. In particular, the catastrophe risk charge is now more specific to product classes.
- While the operational risk capital charge remains in the Review ISS, the impact is now phased in over time to mitigate the impact on insurers.
- Changes made to the reinsurance likelihood test in Appendix 2 have ensured that additional capital is not required for treaties that provide a genuine risk transfer.
- “In dispute” in the context of reinsurance recoveries have been defined further to help with implementation and consistency.
- The interest rate risk capital charge has been restricted to standardised insurance liabilities that are greater than the CTV, which should address most unintended consequences.
- There is a new requirement that allows insurers to use items from the Premium Allocation Approach (PAA) method under NZ IFRS 17 to calculate their capital requirements.

We thank the Reserve Bank for making the above changes to make the standard more practical for actuaries involved in producing solvency calculations and returns.

The FCR and role of the AA

The Review ISS includes significant additional responsibilities for the Appointed Actuary, principally to comment on:

- outsourcing arrangements
- conduct risk
- reinsurance adequacy, and
- premium adequacy.

Our previous submission set out reasons why the Appointed Actuary may not be the appropriate person to comment on some of these issues as it is outside the expertise of a typical actuary. Without utilising paragraph 163 with sufficient reliance on others and appropriate caveats, Appointed Actuaries risk breaching their Code of Professional Conduct.



We understand that the FCR was chosen as a document for these comments because it is the main document received by the Reserve Bank that covers solvency and risk. This may be reviewed as part of Stage 2, which is now scheduled to go live in 2026/27. We understand the reasoning for this temporary solution but would like to note that the commentary provided by Appointed Actuaries is likely to be heavily caveated with significant reliances on others, which may in itself reduce the value of such commentary for the purposes of prudential supervision.

Other items that have not been addressed

The following items have not been addressed in full and we view that further minor wording changes are needed:

- **Health insurance:** We previously submitted on the treatment of health insurance and whether members view this as being more similar to long-term or short-term contracts. There is a mix of approaches in the market depending on whether the insurer writing health business is a standalone health insurer or a life insurer. Our recommendation was to grandfather existing approaches and treat health insurance as short-term contracts with potential for long-term characteristics in Stage 2 of your review. We note that the revised ISS does not include capital factors for short-term health insurance and there may be health insurers that meet the revised definition of short-term. In this case, we recommend that the Reserve Bank add additional capital factors for health and disability income business that meets the definition of short-term. We view underwriting risk as being relatively low risk for these classes of business, although disability income with long benefit periods has some higher risk characteristics with respect to claims run-off risk.
- **Operational risk premium measure:** The term "Gross Written Premium" has been replaced with NZ IFRS 17 insurance revenue. However, it is noted that NZ IFRS 17 insurance revenue for the current and prior years may not be readily available for some time. We recommend allowing an alternative measure in these circumstances (such as NZ IFRS 4 gross premium revenue).
- **Operational risk discretions:** We resubmit that ISS Appendix 7 related to discretions be changed to allow discretions to reduce the operational risk charge for product lines where the policyholder bears the majority of the risk (Participating and Unit-Linked as clear examples).
- **Treatment of tax:** Members have noted that the treatment of tax remains unclear, particularly when populating the Quantitative Impact Assessment that clearly requires net of tax information but all charges are gross of tax. We recommend that further worked examples be created to demonstrate how actuaries should be allowing for tax, both in the calculations and in the solvency return template. Please let us know if you would like support with preparing these worked examples.

New items introduced or identified

As a result of wording changes, the following new items have been introduced in the Review ISS that are a concern to members:

- **Availability of bond yields:** Discount rates are now to be determined by the observed New Zealand Government bond yields. A publicly available source for these yields is the Reserve Bank's website, which covers durations of 1, 2, 5 and 10 years. Sometimes the one or two year bond yield is not available and this means an entire yield curve is based on 3 or 4 points with the long-term forward rate effectively applies from year 6. This may lead to a lot of variability in solvency results as a result of discount rates and it will miss information from



longer term Government bonds currently available in the market, which extend out to 30 years. We recommend that the Reserve Bank ask Treasury to add further Government bond yields (e.g. 15 and 20 year bond yields at a minimum) to the table to extend the curve out further for longer term liabilities or provide the details in an accessible format underpinning the monthly snapshot of the New Zealand government yield curve¹.

- **Clarity around outstanding claims:** Guidance exists around the fact that outstanding claims liabilities should be included in the definition of insurance items. However, it is not clear in paragraphs 29 to 33 of the Review ISS as to whether outstanding claims are to be included in the standardised insurance liabilities due to references to NZ IFRS 17 terms like “fulfilment cash-flows”, “General Measurement Model” and “premium allocation approach”. Members understand that the intention of the standardised insurance liabilities is to include all outstanding claims liabilities to avoid an unintended impact upon standardisation. However, we recommend that this be clarified via additional wording or guidance.
- **Inconsistency with the Standardised Liability for Remaining Coverage under GMM and PAA:** Under the PAA standardisation, paragraph 32 i adjusts for premiums receivable. Under the GMM standardisation, paragraph 30 viii adjusts for “amounts of premiums that have fallen due but have not been received”. This may not be equal to premiums receivable. See the example in the Appendix. We recommend this inconsistency is addressed via revised wording and some worked examples for insurers to illustrate what the Reserve Bank is expecting.
- **Capital charge for DAC asset:** Paragraph 32 allows short-term insurance contracts to employ a NZ IFRS 17 premium allocation approach with modifications including establishing a DAC asset. However, there is no charge on the DAC asset in the asset risk capital charge, which may be interpreted as requiring a 40% “other asset” charge. This is inconsistent with applying the GMM approach where there is an implicit DAC asset. We recommend the Reserve Bank clarify in the standard that a no factor needs to be applied to any DAC asset established under paragraph 32 to address this inconsistency.

Summary

The Review ISS, as drafted, is an improvement on the ISS, but has some issues remaining to ensure a smooth transition. Worked examples for how the standard applies in respect of tax and those with PAA business would aid understanding.

Regulatory capital requirements are an area that is close to the heart of many actuaries as they are theoretical constructs calibrated to a specific risk appetite. We would be happy to answer any questions on our submission points. The NZSA remains available to work with the Reserve Bank, particularly on worked examples to aid implementation and ensure consistency across the industry.

Kind regards

Ross Simmonds
President of the New Zealand Society of Actuaries

¹ See a chart of the monthly snapshot of the New Zealand government yield curve here:

<https://www.rbnz.govt.nz/statistics/series/exchange-and-interest-rates/wholesale-interest-rates/special-note>
where no history is maintained and the information is not in an accessible (downloadable) format.



Appendix: Potential GMM and PAA inconsistency

The following example contract, where premiums are paid monthly in 12 equal instalments of \$100, illustrates a potential inconsistency in interpretation when applying the GMM and the PAA approaches under paragraphs 30 and 32 of the Review ISS. The working assumptions :

Item	Assumption
Annual premium	1200
Acquisition costs	200
Expected claims	720
Maintenance expenses	180
Risk adjustment	72
Unearned profit	28

Under the PAA approach in paragraph 32, the following calculations would apply in the early parts of the contract. In each case, the standardised insurance liabilities are \$972, which is equivalent to the outcome for premium liabilities under the existing solvency standard.

Under PAA	Initial recognition	Acquisition costs paid	First monthly premium received
Cash	0	200	100
Insurance contract liabilities	0	-200	-100
<i>DAC</i>	0	-200	-200
<i>UPR</i>	1200	1200	1200
<i>Premiums receivable</i>	-1200	-1200	-1100
<i>32 i (add premiums receivable)</i>	1200	1200	1100
<i>32 ii (establish DAC)</i>	-200	n/a	n/a
<i>32 iii (deduct expected profit margins)</i>	-28	-28	-28
Standardised insurance liabilities	972	972	972

Under the GMM approach in paragraph 30, there is the potential to have very different outcomes depending on the view of what paragraph 30 viii means in respect of “premiums fallen but not received”. For most general insurers, this may be deemed to be premiums receivable from 32 i, above, but others may view this as \$0 because there are no overdue premiums at any date below.

Under GMM	Initial recognition	Acquisition costs paid	First monthly premium received
Cash	0	200	100
Insurance contract liabilities	0	-200	-100
<i>Future cash flows</i>	-100	-300	-200
<i>Risk adjustment</i>	72	72	72
<i>CSM</i>	28	28	28
<i>30 ii a (deduct CSM)</i>	-28	-28	-28
<i>30 ii b (deduct any amounts relating to IACF)</i>	-200	0	0
<i>30 viii (premiums fallen due but not received)</i>	0	0	0
Standardised insurance liabilities	-228	-228	-128