

# NZSA GI Seminar – A Perfect Storm

## New Zealand's GI Solvency Standard

October 2009

## OUTLINE

The Industry will change to having a local regulator, RBNZ, who will follow an 'APRA lite' model.

One of the key components of the new regime is a Solvency Standard. This requires a minimum capital level calculated from a number of factors to cover for various risks.

Insurers must have an appointed actuary who will review or prepare the solvency calculations and Financial Condition Report.

The Industry will no longer be largely self-regulated.

RBNZ will follow an 'APRA Lite' model

- Minimal extra requirements if already report to APRA
- Reduce compliance costs by relying on external experts (credit rating agencies, auditors, actuaries)

Key Components:

- Licensing, including fit and proper requirements
- Prudential regulation
- Statutory Funds (for life insurance only)
- Supervision (information requests and investigations)
- Distress Management

## Prudential Regulation & “Whistle Blower” responsibilities

### Prudential Regulation components include:

- Solvency standards
- Credit Ratings
- Risk Management Programs
- Auditors and Actuaries
- Financial Condition Report (FCR)

### “Whistle Blower” responsibilities

- Auditors
- Actuaries

## Process & Principles

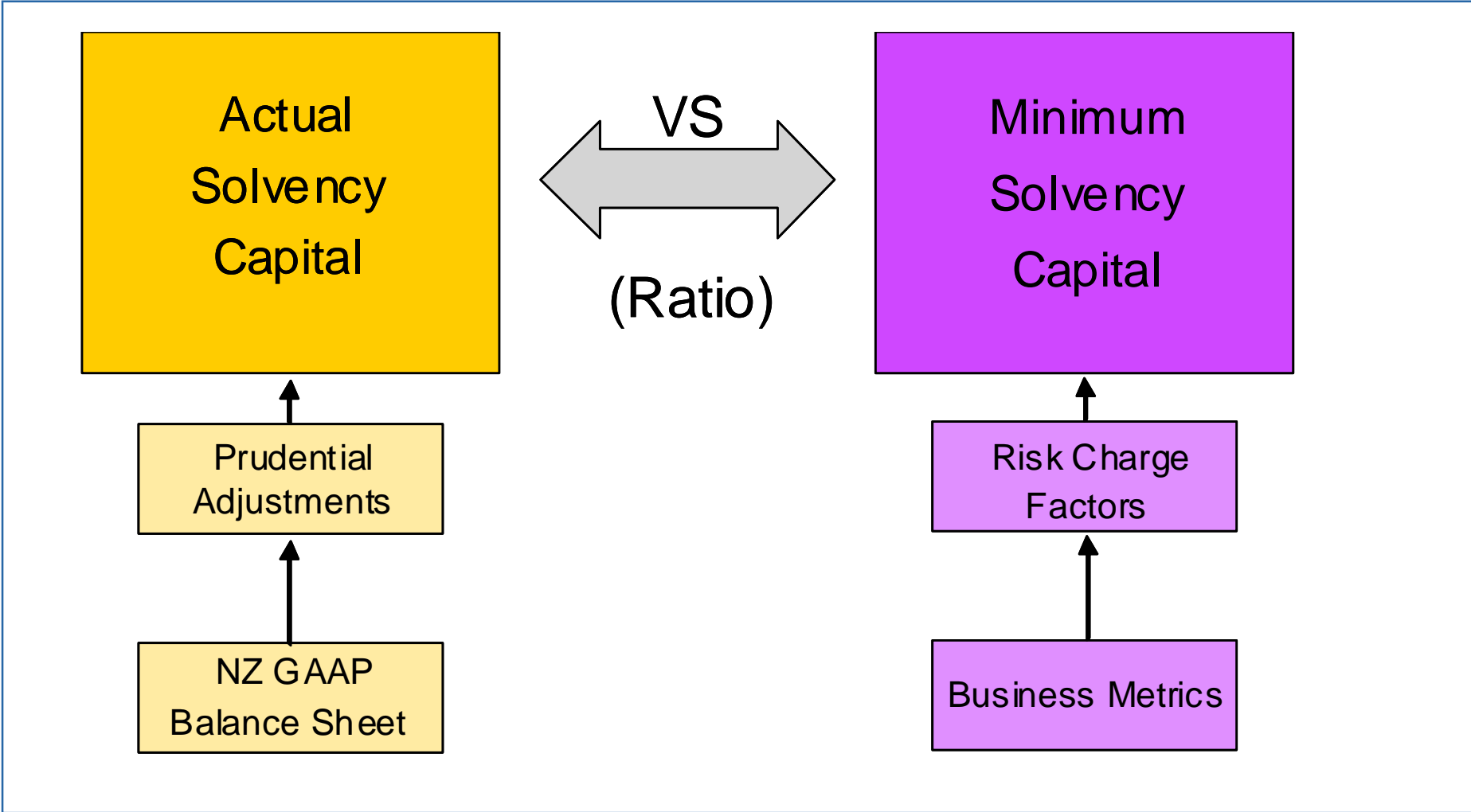
### Process:

- RBNZ employed a consultant to draft the standard
- NZSA Working Group oversaw development of standard
- Draft issued jointly by NZ Society of Actuaries and RBNZ
- Submissions received and being considered
- Standard will go into regulation and be “owned” by RBNZ

### Principles:

- Based on APRA, but simplified
- Explicitly a solvency standard (Capital Adequacy is dealt with through the forecast solvency requirements)
- 99.5% sufficiency over 1 year in principle

# Solvency Capital



The Solvency Standard for non-life insurance

## Calculation - Actual Solvency Capital

### Start with NZ GAAP Capital

- Tier I or Equity Capital only (including Retained Earnings & some Reserves)
- Debt excluded as it can still be done via a holding company

### Prudential Adjustments – Deductions from Capital

- Goodwill and intangible assets
- Future tax benefits
- Related party equity and loans (incl. other financial institutions)
- Anticipated dividend or capital repayment

The Solvency Standard for non-life insurance

## Calculation - Minimum Solvency Capital

Calculate Risk Capital Charges for:

- Insurance risk
- Catastrophe risk
- Asset risk
- Reinsurance recovery risk
- Non-insurance activity

Note: Operational risk implicit (too hard to quantify)

The Solvency Standard for non-life insurance

## Calculation - Minimum Solvency Capital

### Calculate Insurance Risk Capital Charges:

Underwriting R.C.C. =  $\Sigma$  **Net Written Premium** \* U/writing Factor

Run-off R.C.C. =  $\Sigma$  **OSC Provision (75% POS)** \* Run-off Factor

<b>Class of Insurance Business</b>	<b>Underwriting Risk Capital Factor</b>	<b>Run-off Risk Capital Factor</b>
Domestic property	7%	9%
Private motor	7%	9%
Commercial property	8%	11%
Commercial motor	7%	9%
Liability classes	11%	15%
Marine	8%	11%
Health & Personal Accident	8%	11%
Travel	7%	9%
Other	8%	11%

The Solvency Standard for non-life insurance

## Calculation - Minimum Solvency Capital

Calculate Catastrophe Risk Capital Charges:

Net cost of a catastrophe relative to a one in 250 year event  
+  
Cost of reinstating the full catastrophe reinsurance program

## The Solvency Standard for non-life insurance

### Calculation - Minimum Solvency Capital

#### Calculate Asset Risk Capital Charges:

$$= \sum \text{Asset Class Value} * \text{Factor (see below)} \\ + \text{Other charges (next slide)}$$

Asset Class	Asset Risk Capital Factor
1 Cash and Sovereign Debt	0.5%
2 AA fixed interest < 1 yr	1%
3 AA fixed interest > 1 yr	2%
4 A fixed interest	4%
5 Unpaid premiums < 3 mths	4%
6 BBB fixed interest	6%
7 Other fixed interest	15%
8 Listed equity & trusts	30%
9 Unlisted equity, property, any other assets	40%
10 Inadmissible assets	100%

## The Solvency Standard for non-life insurance

### Calculation - Minimum Solvency Capital

#### Calculate Asset Risk Capital Charges:

$$\begin{aligned} &= \sum \text{Asset Class Value} * \text{Factor} \\ &+ \text{Concentration charge (see below)} \\ &+ \text{Liquidity charge} \\ &+ \text{Other charges (A/L Mismatch, related party)} \end{aligned}$$

Nature of Obligation	Limit (% of total assets of the insurer)
Guaranteed by the New Zealand government or by a national government or supra-national agency of rating grade 1	100%
Guaranteed by a New Zealand local government or State Owned Enterprise	50% (or \$5m if greater)
Secured by bank bills or deposits with a New Zealand bank	25% (or \$5m if greater)
Any other asset or counterparty exposure	10% (or \$2m if greater)

## Calculation - Minimum Solvency Capital

Calculate Reinsurance recovery Risk Capital Charges:

$$= \Sigma \text{ Reinsurance Recoverable} * \text{Counterparty Factor}$$

S&P / Fitch (as example)	Counterparty Grade	Risk Factor
AAA	1	2%
AA- to AA+	2	2%
A- to A+	3	4%
BBB- to BBB+	4	10% up to a proportionate threshold, and higher above that limit (to be finalised)
Below or Unrated	5	20% up to a proportionate threshold, and higher above that limit (to be finalised)

The Solvency Standard for non-life insurance

## Calculation - Minimum Solvency Capital

### Calculate Non-insurance Risk Capital Charges:

“... an assessment of the level of capital customary in the relevant business for sound and prudent operations (the ‘non-insurance activity capital requirement’)”

## Monitoring & Transition

### Monitoring by RBNZ

- Actual and minimum solvency capital
- Solvency Ratio (will there be a minimum requirement?)
- Forecast solvency

### RBNZ favour an orderly transition to the new regime

- Transition is not written into the legislation
- Transition may be dealt with on a case by case basis as part of the licensing requirements
- FCR may initially just be a report on solvency

## Obligations for the Insurer and the Actuary

What the Insurer and appointed actuary need to do

### Insurer's obligations

- Appoint an actuary
- Annual solvency return and financial statements, both audited, to the RBNZ in 3 months
- Financial Condition Report to RBNZ
- Half-yearly solvency return
- Advise RBNZ if solvency likely to be breached in next 12 months

### Appointed Actuary's obligations

- Appointed actuary must sign-off on liabilities and LAT in the financial statements
- Appointed actuary reviews solvency calculations

What the Insurer and appointed actuary need to do

## Financial Condition Reports

- Need to be confidential and OIA proofed
- Unlikely to be an APRA-like tome at least initially
- No industry consensus as to usefulness of an FCR yet
- Up to the industry in being proactive in making the FCR a useful document for their board as well as the Regulator
- Boards tend to be more in favour than management

We are likely to need a Society standard on this

## SUMMARY

The Industry will change to having a local regulator, RBNZ, who will follow an 'APRA lite' model.

One of the key components of the new regime is a Solvency Standard. This requires a minimum capital level calculated from a number of factors to cover for various risks.

Insurers must have an appointed actuary who will review or prepare the solvency calculations and Financial Condition Report.

## What does the future hold?

### Unresolved issues

- Minimum Capital Requirement - RBNZ needs to advise how many millions this will be
- Quantifying the impact on individual companies
- Transitional provisions
- Scope of the FCR

### Future

- RBNZ will expand insurance capacity (3 people to 15 or so)
- Unclear as to how actively they will “supervise”
- FCRs will become more extensive
- Some rationalisation of the industry is inevitable