New Zealand Captive Insurance Association

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SUBJECT: RESERVE BANK OF NEW ZEALAND – SOLVENCY STANDARD FOR CAPTIVE INSURERS TRANSACTING NON-LIFE INSURANCE BUSINESS

On 21 October 2010 the Reserve Bank issued the second consultation document for Solvency Standard of Captive Insurers. This draft has been issued by the Insurance Policy Group of the Reserve Bank after meetings with Peter Lowe of Willis NZ Ltd, the NZCIA and representation by members of the NZCIA.

The key areas of concerns were:

1. **The Catastrophic Risk Charge**
Under the previous Solvency Standard you are required to have $1 in capital for every $1 retained risk in its largest exposure. eg. If you were retaining $5 million in the Material Damage / Business Interruption policy and you would be required to have a minimum of $5 million in capital. This was very restrictive for the growth of your captive and its ability to retain more risk in a capital effective manner.

   After detailed explanations of how a captive insurance company operates, the Reserve Bank has removed this charge from the Solvency requirement.

2. **Asset Risk Capital Charge**
The Solvency Standard allocates an Asset Risk Capital Charge of 15% to companies that have a parental loan arrangement. This charge has not been amended.

3. **Asset Concentration Risk Capital Charge**
Captives which have inter-company loans to their parent were being charged an additional capital charge of 15%, where the value of the inter-company loan was greater than 33% or $5 million of your captive's total assets. After detailed discussions regarding the operations of a captive and its interaction with the parent company, the Reserve Bank has now increased the Asset Concentration Charge to 66% of total assets.

4. **Foreign Currency & Interest Rate Risks**

   In applying the Solvency Standard, a licensed insurer must consider the degree of mis-matching between assets and liabilities in terms of foreign country, currency and interest rate risks.

   The Reserve Bank did not amend this charge.

5. **4.1 Appointment of an Actuary**

Each licensed insurer must appoint an actuary, as required by Section 76 of the Proposed Act.

The NZCIA believes that the actuary should be limited to commentary and establishment of outstanding claims reserves in respect of long tail business. We therefore do not believe that the appointment should be an automatic requirement but subject to circumstances where captive is underwriting long tail business.

The Reserve Bank did not amend this requirement.

6. **5.3 Financial Condition Report**

The appointed Actuary must prepare a Financial Condition report in accordance with Section 56 of the Proposed Act.

The NZCIA believes that this section is an over-burdensome response in relation to captive insurance companies and is simply unnecessary. The costs involved in providing the information and having the actuary complete assessments would create an uncompetitive situation for most captive insurance companies. The NZCIA believes that this scope of the Financial Condition report could be a catalyst to drive New Zealand captive insurers from New Zealand.

The Reserve Bank did not amend this requirement.

The Reserve Bank have added the following new sections to the Solvency Standard.

1. **Section 1.2, Paragraphs 3 & 4**
Licensed insurer may be both a captive insurer and an insurer that is not a captive insurer and may be subject to more than one Solvency Standard. If a captive insures non-parent company business then it would be considered general insurance business and the captive would be subject to the Solvency Standard for general insurers. The Standard points out that both Standards would apply to an insurer conducting both forms of insurance business.

2. **Section 2.3, Deferred Acquisition Costs, Paragraph 40**
The Standard states; "the amount of deferred acquisition cost that may be included in the actual Solvency capital is limited to the amount that can be supported after applying a liability and liquidity test which:

(a) Incorporates a risk margin to achieve a probability of sufficiency of at least 75%;
(b) Does not defer acquisition costs beyond the current insurance contract period;
(c) Is otherwise in accordance with NZIFRS; and
(d) Is signed off by the appointed Actuary in accordance with the professional standards of the New Zealand Society of Actuaries.

NZCIA Comment
All current clients should be complying with Section (a), (b) and (c) as stated above if you have deferred acquisition costs capitalised on your balance sheet. The NZCIA believe that part (d) of the above the signing off by the appointed Actuary is excessive and we will be writing to the Reserve Bank asking them to remove this section from the Standard.

3. **Section 3.1, Insurance Risk Capital Charge, Paragraph 43**

The Insurance Risk Capital Charge is intended to recognise and reflect:

(a) The risk to the insurer of writing unprofitable insurance business; and
(b) The exposure of a licensed insurer to operational risk (although this is not a substitute for adequate management of operational risk); and
(c) The risk to the licensed insurer of inadequate provision being made for outstanding claims liabilities.

4. **Calculation**

Paragraph 44

The Insurance Risk Capital Charge is an amount equal to 20% of the largest foreseeable retention of the licensed insurer plus the cost of one reinstatement of the relevant reinsurance programme if any.

Paragraph 45

The largest foreseeable per event retention is the cost to the licensed insurer of the largest individual claim or series of claims, relating to a single event, to which it could be reasonably exposed to other policies, net of reinsurance recoveries.

Paragraph 46

If the licensed insurer issues policies that do not have a maximum sum insured, or are not protected by excess of loss from reinsurance, then the licensed insurer may need to seek the advice of its appointed Actuary as to a reasonable approximation of its largest foreseeable per event retention.

NZCIA Comment

The NZCIA believe this is an excessive capital charge for a captive insurer. A captive insurer underwrites risk for its parent company and in all cases that risk is profitable business. Significant analysis has been performed by the parent company to support the formation of a captive insurer.

In the unlikely event that a captive would underwrite unprofitable business, that unprofitable business would be supported by the initial capital contribution of $1 million plus the parent company injecting funds to ensure that the captive remains solvent. The captive issues an insurance policy to its parent to underwrite the risks it believes are better managed internally than in the external insurance market. This Insurance Risk Capital Charge does not adequately address or recognise the inherent support a captive insurer has from its parent company and that the parent company is also the beneficiary of the policy issued by the captive

The NZCIA will be writing to the Reserve Bank requesting that this section be removed from the Captive Solvency Standard.

The NZCIA will be drafting a response for all our clients to be submitted by you to the Reserve Bank by 12 November 2010.