IAG New Zealand submission

to the

Reserve Bank of New Zealand

on the

Review of Insurance Solvency Standards

12 November 2020

1. Introduction

1.1 This submission is a response by IAG New Zealand Ltd (IAG, we) to the Reserve Bank of New Zealand (RBNZ) on the Review of Insurance Solvency Standards, specifically the review paper released on 1 October 2020.

1.2 IAG is New Zealand's leading general insurer. We insure more than 1.8 million New Zealanders and protect over $650 billion of commercial and domestic assets across New Zealand. We receive more than 650,000 claims a year and pay $1.365 billion in settling them.

1.3 In this submission we provide feedback on the planned timing of, and proposed principles for, the Review of Insurance Solvency Standards.

1.4 IAG's contacts for matters relating to this submission are:

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2. Feedback on planned timing and proposed principles for the Review of Insurance Solvency Standards

Planned timing for the Review

2.1 IAG welcomes the commencement of the Review of Insurance Solvency Standards and an early focus on addressing the implications of IFRS 17.

2.2 The planned timing for concluding Phase 1 of the Review may however not be realistic given the progress of insurers in implementing IFRS 17, particularly those such as IAG that will need to apply the general measurement model (GMM). Specifically, depending on what exactly is intended, the planned calibration exercise in late 2021 may be too early to enable a detailed calibration to be undertaken. It will need to be scoped to recognise where insurers are at in terms of IFRS 17 implementation at that time.

2.3 IAG will make best endeavours to work with the RBNZ on developing and testing the changes to the solvency standard, however, we note IAG will not be reporting IFRS 17 financial statements until the year-ended 30 June 2024 and so we would expect that, notwithstanding the planned Phase 1 timeline, RBNZ will not be anticipating insurers to apply any new solvency standard until IFRS 17 has in fact been applied.

Proposed principles for the Review

2.4 We welcome the consultation on the proposed principles for the Review. We have overarching comments on principles for the Review, two additional principles that we consider should be added, and feedback on the eight principles outlined in the review paper.

Overarching comments on principles for the Review

2.5 We have three overarching comments on the principles for the Review:

- the principles need to better reflect the risk appetite that is being used to calibrate the standard and this needs to be clearly linked to wider policy settings;
- adopting principles from the Bank Capital Review risks overlooking the important differences in the nature of insurer capital; and
- the proposed principles relate only to the design of a solvency standard and not to the process of the Review itself.

2.6 A number of the eight proposed principles touch on the approach to risk management. There is a need to more clearly define the overall objectives for the solvency standard in terms of risk management and the risk appetite, and how these relate to wider policy settings.

2.7 The proposed principles include for example that 'capital requirements of New Zealand insurers should be conservative relative to those of international peers', which is already evidenced through the use of the 1:1000 standard for catastrophe insurance. RBNZ has also stated on a number of occasions that it does not operate a 'no-failure' model. This begs the question of what risk appetite is underlying the review of the solvency standard?

2.8 Capital requirements for insurers are presumably to be set at a level that promotes the maintenance of a sound and efficient insurance sector while recognising that there may still be individual insurer failures (i.e. it is not a no-failure regime) and with a recognition that some possible but unlikely events could still have systemic impacts (e.g. extreme natural disaster events).

2.9 Amongst the proposed principles there is currently a lack of a clear statement of what the solvency standard is trying to achieve overall (i.e. what is the risk appetite?), recognising that the solvency requirements for private insurers are just one part of a broader puzzle that New Zealand has in regard to maintaining resilience to different sorts of risks. For example, credit risk should be considered differently to natural disaster exposures.

2.10 Also, while we recognise that adapting the principles from the Bank Capital Review provides a degree of consistency across sectors, it is necessary to recognise that insurer solvency is fundamentally different from bank capital, for example the key role played by reinsurance. This needs to be reflected in the principles generally and we have made some specific suggestions below on this.

2.11 Finally, we note that the proposed principles relate to what the solvency standard should be, rather than acting as principles for the Review of Insurance Solvency Standards itself. If there is an intention to also cover the latter then principles related to the process of the Review, with commitments to engagement/consultation, open-mindedness etc., should also be included.

Additional principles that should be added

2.12 The following additional principles should also be included:

- The importance of consistency of application and outcomes in relation to the protection for customers and the treatment of insurers.
- Avoiding unnecessarily distorting the market's ability to protect New Zealanders from insurable risks. For example, regard must be had to the affordability or availability of insurance for customers and any resulting impacts on insurance penetration.
- A principle that gives more explicit recognition to the fact the solvency standard sits within the wider prudential regime under IPSA (e.g. the expectation that an insurer will operate well above its required capital amount or that RBNZ has prescribed discretion in some areas).

Specific comments on the eight principles outlined in the review paper

2.13 Further to our overarching comments and suggested additional principles, in the following table we provide specific feedback on the eight proposed principles outlined in the review paper.

	Proposed Solvency Standard Review Principles	**Feedback**
1	We will have regard to international comparability, particularly LAGIC (Australia), Solvency II (Europe), International Capital Standard (IAIS) and the Insurance Core Principles (IAIS), with the caveat that principle number 2 will take precedence.	Support regard being given to relevant international comparability. The structure and ordering of the principles needs to be reconsidered as this first principle is overridden explicitly by Principle 2, and also by Principle 6. The relationship to international solvency requirements could be more clearly articulated, perhaps in a single principle.
2	We take a substance over form approach and tailor our requirements to New Zealand. This principle will take precedence over international comparability.	
3	Capital must readily absorb losses before losses are imposed on policyholders.	We support this principle, while noting it largely just describes what a solvency standard does. This is an area where different language could be appropriate to recognise the different nature of insurer solvency to bank capital, for example the role played by reinsurance.
4	Capital requirements should be set in relation to risks that may impact insurer balance sheets.	This principle is logical. It could be made more specific and refer to a range of risk factors that may adversely impact a general insurer's ability to meet its obligations.
5	Insurers should be subject to a single method of determining capital requirements and the use of judgement should be limited to the extent possible.	While consistency of application is important what is meant by a single method is not clear and may not necessarily be appropriate, noting for example: • that a variety of cat models can legitimately be applied to determining solvency; • whether RBNZ should be prescriptive on which models should be used by insurers; and • the role of insurer's judgment on appropriate models etc. in the context of self-discipline.
6	Capital requirements of New Zealand insurers should be conservative relative to those of international peers, reflecting the Reserve Bank's regulatory approach.	We note this principle is identical to the equivalent principle applied to the Bank Capital Review. What this principle is intended to mean for insurance is not clear from the principle itself and it is also problematic to focus the setting of capital requirements on a relative basis to other jurisdictions. As commented on above in paragraphs 2.6 - 2.9 of this submission it is necessary for the Solvency Standard for Non-life Insurance Business to be based on a clear view of the risk appetite.

7	The solvency framework should be practical to administer and minimise unnecessary complexity and compliance costs.	Support.
8	The solvency framework should be transparent to enable effective market discipline.	Support.