

# New Zealand Captive Insurance Association

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Submission to the Reserve Bank

Solvency Standards for Captive Insurers  
Transacting Non Life Insurance Business

Version 28/7/10

# New Zealand Captive Insurance Association

## Reserve Bank of New Zealand

### Solvency Standard for Captive Insurers Transacting Non Life Insurance Business

Draft Version – 28/7/10

## Consultation Paper

### General Comment

The Solvency Standard (Draft Version 28/7/10) as prepared by the Reserve Bank of New Zealand has included some refinements to the second Consultation Paper but does not address the fact that such solvency requirements are unnecessarily onerous on captive insurance companies.

This Standard, if enacted in its current form, may mean that all captive insurers, owned by New Zealand Corporates, could be forced to relocate from New Zealand to a recognised captive domicile that has a more mature understanding of captive insurance companies.

These forced redomestications will mean the loss of employment, tax revenue (\$10 million in 2010) and international opportunities and reputation.

We urge the Reserve Bank to amend the Solvency Standard as advised in the attached pages.

The NZCIA believes that such solvency requirements do not reflect the nature of captive insurance companies but rather lump them in with commercial insurers. By not differentiating between commercial insurers and captive insurance companies these solvency standards will discourage a captive insurance industry in New Zealand.

**The NZCIA will now directly comment upon sections of the Solvency Standard as requested by the Reserve Bank.**

### **(A) 3.2 Catastrophe Risk Capital Charge**

Concept:

56. The Catastrophe Risk Capital Charge is intended to reflect the exposure of the licensed insurer to very large claims, including those arising from an event that results in claims on more than one insurance contract, such as an earthquake or storm.

Calculation:

57. For an insurer with significant property exposures, the largest single event is likely to be a natural catastrophe and the licensed insurers catastrophic reinsurance programme will be a key determinant in their cost. In this situation the risk capital charge is a net cost to the licensed insurer of a catastrophic event occurring including any gap or shortfall in the reinsurance cover relative to a 1 in 250 year event and the cost of one reinstatement of all catastrophic reinsurance program.

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58. For a licensed insurer without significant property exposures, or with other per risk exposures greater than the insurers catastrophe retention, the Catastrophe Risk Capital Charge is two times the largest per risk retention of the licensed insurer plus the cost of one reinstatement of the catastrophe reinsurance program if applicable.

**The Catastrophic Risk Capital Charge will cause a considerable and unnecessary financial burden on captive insurance companies.**

All captive insurance companies are subsidiaries of corporations that only insure the risks of their parent, affiliates, subsidiaries and members of the corporate group. In most cases, the captive will issue one policy to its parent company. The captive and parent company have a better understanding of its group risk profile that enables greater risk retention than traditional insurance companies which have numerous clients and risk profiles.

For example, captive A is a subsidiary of a large multi-national New Zealand corporation. They are retaining \$10 million each and every year for their Material Damage / Business Interruption insurance. (Commercial property). Under this section of the draft Solvency Act this captive would have to put up \$10 million in capital to meet the minimum standard as proposed by the Standard. This is excessive, does not recognise the unique understanding of the risk, nature of captive insurance companies and the insurance policies they underwrite. Further, it does not recognise the strength of the parent company balance sheet and commitment to its captive insurer.

This is an unreasonable penalty to be applied, it ignores that captives only insure the risks of the Parent (and Consolidated group) and does not allow for a captive to grow by increasing its retention. The catastrophic risk charge is restrictive and regressive in its approach to risk management. Most captives would not be able to continue to underwrite risk for the benefit of their parent companies.

All captives are formed because their risk profile and loss history are superior to the insurance industry as a whole. This charge does not recognise this fact. This charge will restrict a captive's ability to retain risk and thus decrease the cost savings that can be achieved for the parent company. By decreasing the cost savings that could be achieved, this Standard will reduce the competitive advantage for New Zealand companies in the international market.

## **Recommendation**

**The NZCIA believes that captives should be exempt from this Catastrophic Risk Capital Charge.**

### **(B)3.3 Asset Risk Capital Charge**

Concept:

61. The Asset Risk Capital Charge is intended to reflect the exposure of the licensed insurer to losses on investment assets, and some other minor asset classes. It is intended to reflect credit risk in respect of the relevant assets, as well as asset concentration and liquidity risks.

Captive insurance companies have investment strategies prepared for by their managers and approved by the Board of Directors of the captive

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insurance company. In well managed captives investment strategies include cash, sovereign debt, bank deposits and inter-company investments.

## **NZCIA Comment**

In early years a significant number of captives will invest its assets through a secure loan agreement to their parent companies. These loan agreements are secured by a 24 hour call option and pay a market rate of interest.

These loans are allowable in recognised captive domiciles such as Singapore, Bermuda, Dublin, Vermont.

Under the definitions of asset classes and capital factors as defined in Solvency Standard for Non Life insurance business, these types of assets would be subject to a 15% capital charge.

The NZCIA believes that this capital charge is unreasonable, does not take into consideration the unique nature of a captive insurance company and the capital support received from its parent. The ability of the captive to invest its funds with its parent through a secure note is recognised in major domiciles that have adopted Risk Based Capital Solvency rules and the International Association of Insurance Supervisors recommendations.

## **Recommendation**

NZCIA believe s that an exemption is appropriate in the application of a Asset Risk Capital Charge on loans made on commercial terms repayable on demand made to the Parent Company of a Captive Insurance Company.

## **(C) Asset Concentration Risk Capital Charge**

68. In order to determine the Asset Concentration Risk Charge, the licensed insurer must first calculate the total value of its assets that represent obligations of one entity (counter-party) or group related entities (to the extent that the asset values have not been excluded from, or reduced in, the determination of Actual Solvency Capital in Section 2).

Under the Asset Concentration Risk Limits an investment in an asset described as:

“Exposures to the parent owner of the Captive Insurer – 33% (or \$5 million if greater) and double risks weights for anything in excess.”

## **NZCIA Comment**

A captive insurance company that lends funds back to the parent would incur an asset concentration charge at double the risk weight for any investment back to the parent above 33% (or \$5 million if greater) of its total assets.

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## Recommendation

The NZCIA believes that captive insurance companies should be exempt from this requirement due to the nature of the business they underwrite and their prudent investment strategies. Captive insurance companies are unique entities and they only underwrite risks of their parent, affiliates and subsidiaries and use those funds to the best interests of the total group. In its infancy most captive insurance companies will invest a significant portion of their assets back into the parent to ensure minimum opportunity cost and maximum benefit for the group as a whole.

This risk charge will be detrimental to the growth of captive insurance companies.

This section of the Standard penalises companies by limiting their investment capability. It further penalises a company for adhering to Group Treasury Standards that have been approved by a Board of Directors.

It also penalises a company for investing in a parent company loan after allowing the investment in paragraph 61 Asset Risk Capital Charge. The NZCIA believes that captive insurance companies should not be penalised twice for the same investment and captives should be exempt from this charge.

## **(D) Foreign Currency & Interest Rate Risks**

80. 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.
82. Interest Rate Risk  
An interest rate capital charge is calculated by reference to fixed interest bearing assets and fixed interest bearing liabilities. For the purpose of determining the interest rate capital charge.
- (a) Fixed interest bearing assets are those assets and derivative positions bearing a fixed interest for a period of time (reset period) beyond the balance date of solvency calculation performed; and
  - (b) Fixed interest bearing liabilities are insurance liabilities and derivative positions and any other liabilities where the economic value depends upon discounting actual or expected cashflows; in other words those liabilities where the value depend implicitly or explicitly on interest assumptions; and
  - (c) Interest rate liabilities are premium liabilities as defined in the Solvency Standards and the net outstanding claims provision at a minimum 75% proficiency of sufficiency, as advised by the appointed Actuary.

### **NZCIA Comment**

The majority of captive insurance companies assets consist of cash at bank and short term loans to parent companies. These assets are valued in accordance with New Zealand Generally Accepted Accounting Practices which are defined as acceptable in this Solvency Standard.

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Captive insurance companies rarely suffer an interest rate exposure on their balance sheet. This is due to the assets being short term in duration and highly liquid in nature. The calculation of the interest rate capital charge is best suited for retail insurance companies that sell insurance products to the New Zealand public not for captive insurers. As captives do not sell insurance products to the New Zealand public, they should not be penalised by this risk charge. This will create an additional capital charge which will further make New Zealand owned captives uncompetitive in the international marketplace. The NZCIA believes that captives should be exempt from the interest rate capital charge.

## **(E) 4.1 Appointment of an Actuary**

84. 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.

## **(F) 5.3 Financial Condition Report**

108. 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.