

New Zealand Captive Insurance Association

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Submission to the Reserve Bank

Solvency Standards for Non Life Insurance
(Consultation Version 2)

23 March 2010

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Reserve Bank of New Zealand & The New Zealand Society of Actuaries Solvency Standard for Non Life Insurance Business (Consultation Version 2)

Consultation Paper

General Comment

The Solvency Standard (Consultation Version 2) as prepared by the Reserve Bank of New Zealand has included some refinements to the first Consultation Paper but does not address the fact that such solvency requirements are unnecessarily onerous on captive insurance companies.

The NZCIA believe 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:

46. The Catastrophe Risk Capital Charge is intended to reflect the exposure of the 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:

47. For an insurer with significant property exposures, the largest single event is likely to be a natural catastrophe and the insurers catastrophic reinsurance programme will be a key deterrent in their cost. In this situation the risk capital charge is a net cost to the 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.

48. For an 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 insurer plus the cost of one reinstatement of the catastrophe reinsurance program.

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

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All captive insurance companies are subsidiaries of corporations and only insure the risks of their parent, affiliates, subsidiaries and members of the corporate group. It has a better understanding of its risk profile that enables greater risk retention than traditional insurance companies.

This is an unreasonable penalty to be applied and ignores the nature of the captive insurance company and the fact that it only writes the risks of the Parent (and Consolidated group).

For example, captive A is a subsidiary of a large multi-national New Zealand corporation. They are retaining \$10 million each and every 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.

The NZCIA has polled every captive insurance company in New Zealand and with the Catastrophic Risk Capital Charge applied, every captive insurer would be insolvent.

The NZCIA believe that captives should be exempt from this catastrophic Risk Capital Charge.

B) 3.3 Asset Risk Capital Charge

Concept:

51. The Asset Risk Capital Charge is intended to reflect the exposure of the 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 insurance company. In well managed captives investment strategies include cash, sovereign debt, bank deposits and inter-company investments.

In early years a significant number of captives will invest its assets through a secure loan agreement to its parent company. This loan agreement is secured by a 24 hour call and pays a market rate of interest.

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 inadmissible assets and be subject to a 100% capital charge.

The NZCIA believe that this capital charge is excessive, 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. The NZCIA believe that captive insurance companies should be exempt from the Asset Risk Capital Charge due to the nature of the risks they underwrite.

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NZCIA Comment

Captive insurance companies regularly utilise loans to members of the corporate group as part of their investment strategy. These loans are supported by signed, 24-hour demand notes and pay a commercial rate of interest.

These loans are allowable in recognised captive domiciles such as Singapore, Bermuda, Dublin, Vermont. The NZCIA believes that captive insurance companies should be exempt from this solvency requirement.

Therefore, we believe 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 by Captive Insurance Companies.

C) Asset Concentration Risk Capital Charge

58. In order to determine the Asset Concentration Risk Charge, the insurer must first calculate the total value of its assets that represent obligations of one entity or group related entities.

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

“Any other asset or counterparty exposure (except for reinsurance recoverable assets dealt with elsewhere)” the limit would be 10% (or \$2 million if greater and triple risk weights for anything in excess.

These would include all assets that were not guaranteed by the New Zealand Government or bank bills or deposits with a New Zealand bank. Therefore, captive insurance companies that lent funds back to the parent would incur a asset concentration charge at triple the risk weight for any investment back to the parent above 10% (or \$2 million if greater) of its total assets.

The NZCIA believe 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 its 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 and detrimental to their financial health.

D) 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 in which the captive is underwriting long tail business.

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E) 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 on captive insurance companies. The costs involved in providing the information and having the actuary complete assessments through a) through i) would create an uncompetitive situation for most captive insurance companies. The NZCIA believe that this scope of Financial Condition report could be catalyst to drive New Zealand captive insurers from New Zealand.