

SCHEDULE 2 SOLVENCY STANDARD

PART 1 INTRODUCTION

1. Purpose of solvency standard

Clause 1 states the provisions of the Act to which the solvency standard relates and the purpose of the standard.

Subclause 1 (2) provides that the solvency reserve to be calculated under the solvency standard is to be based on a run-off view of the fund in order to ensure that the insurer will be able to meet the liabilities of the fund in the event that the fund is terminated.

2. Application

Clause 2 provides that the solvency standard applies to each fund conducted by an insurer.

3. Interpretation

Subclause 3 (1) defines terms used in the standard.

Subclause 3 (2) requires the application of relevant accounting standards in the valuation of assets and liabilities under the standard.

Subclause 3 (3) provides that the management capital amount for each fund is \$1 million. This amount is used in the calculation of the solvency reserve in clause 6 of the standard.

4. Related parties

Clause 4 defines a related party for the purposes of the standard. This term is used in Part 7 of the Standard, which specifies the inadmissible assets amount for a fund.

PART 2 Solvency Reserve

5. Solvency Obligation

Clause 5 imposes on an insurer a solvency obligation in relation to each of its health benefits funds.

Subclause 5 (1) provides that an insurer must at all times keep its health benefits funds solvent by ensuring that the value of the capital of each fund equals or exceeds the solvency reserve for the fund calculated under this standard at the valuation date.

Subclause 5 (2) requires an insurer to disclose in its financial statements the solvency reserve for each of its funds.

6. Determination

Clause 6 imposes on an insurer a requirement to determine the solvency reserve for each fund.

Subclause 6 (1) requires an insurer to determine the solvency reserve for each of its funds in accordance with the standard.

Subclause 6 (2) specifies the elements of the calculation of the solvency reserve. The calculation of those amounts is detailed later in the standard, with the exception of the management capital amount, which is defined as \$1 million for each fund.

7. Treatment of negative amounts in calculations

Clause 7 provides that an amount or a component of an amount calculated under this standard which results in a negative value will be taken to be zero.

PART 3 PRINCIPLES

8. Asset exposure

Clause 8 requires an insurer to take account of certain asset and investment risks related to the insurer in applying the standard.

9. Integrity of asset risk calculations

Clause 9 requires an insurer to determine whether to increase amounts calculated under this standard to ensure solvency in light of risks associated with diversification, liquidity and credit risks.

10. Discounting of insurance liabilities

Clause 10 provides the basis on which discounting of future claims liabilities is permitted under the standard.

11. Adjustment for taxation

Subclause 11 (1) provides for adjustment of the solvency insurance liabilities amount to account for the impact of taxation.

Subclause 11 (2) provides for adjustment relating to tax benefits arising from increases in liabilities.

PART 4 MATERIALITY

12. Materiality standards

Clause 12 provides a materiality test to enable simplification of valuations that are to be undertaken in the determination of the amounts that comprise the solvency reserve under the standard.

Subclause 12 (1) provides that if an amount is material in accordance with the clause, strict compliance with the standard is required in its calculation for the purposes of determining the solvency reserve of the fund. Where an estimated amount is immaterial under this clause, a reasonable alternative valuation method can be adopted.

Subclauses 12 (2) and 12 (3) specify the method for determining whether amounts are material or immaterial for the purposes of the standard.

Subclause 12 (4) requires an insurer to consider at each reporting date whether detailed valuations are required to demonstrate the continued appropriateness of any alternative valuation methods that have been adopted.

PART 5 EXPENSE AMOUNT

13. Calculation of the expense amount

Clause 13 provides the formula to calculate the expense amount for the purposes of the determination of the solvency reserve. Non-claim expenses are expenses of the fund other than benefit payments.

PART 6 SOLVENCY INSURANCE LIABILITIES AMOUNT

This Part provides for the calculation of an amount, which forms part of the solvency reserve, to provide for the risks arising from assumptions in valuing the accrued liabilities of the fund.

14. Calculation of solvency insurance liabilities amount

Clause 14 provides for the calculation of the solvency insurance liabilities amount, being the sum of the components set out in clauses 15 and 16.

15. Calculation of solvency health insurance liabilities component

Clause 15 sets out the four components that when added together, form the solvency health insurance liabilities amount.

16. Calculation of solvency health-related insurance liabilities component

Clause 16 sets out the two components that when added together, form the solvency health-related insurance liabilities amount.

17. Outstanding claims liability

Clause 17 provides for the calculation of liabilities of a fund in respect of outstanding claims, which is part of the health insurance liabilities component and the health-related insurance liabilities component.

The outstanding claims liability is a central estimate of all outstanding claims liabilities at the valuation date. Historical data must be considered in calculating the outstanding claims liability.

There will be two different outstanding claims liability components calculated for each fund: one for health insurance business of the fund, and one for any health-related insurance business of the fund.

18. Risk equalisation outstanding claims liability

Clause 18 provides for the calculation of the risk equalisation outstanding claims liability, which is part of the risk equalisation outstanding claims component of the solvency health insurance liabilities component.

19. Unearned premium liability and unexpired risk liability

Clause 19 provides for the calculation of the unearned premium liability and unexpired risk liability, which is part of the health insurance liabilities component and the health-related insurance liabilities component.

PART 7 INADMISSIBLE ASSETS AMOUNT

20. Calculation of the inadmissible assets amount

Clause 20 provides for the calculation of the inadmissible assets amount, which is a part of the solvency reserve, to reflect certain asset risks to the fund.

Subclause 20 (1) provides that the inadmissible assets amount is the sum of components that reflect risks associated with:

- assets which have values that are dependent upon the continuation of the business;
- holdings in an associate and subsidiary entities; and
- asset concentration.

21. Assets used for the conduct of business component

Clause 21 provides for the calculation of a component that represents the amount by which the value of the assets of a fund would be reduced if it was in a run-off situation.

Subclause 21 (1) specifies that the component is the amount by which the stated value of the assets exceeds the value that the assets would have if the fund was in terminating management.

Subclause 21 (2) specifies requirements to be observed in the valuation of assets in the calculation of the component.

22. Holdings in associate and subsidiary entities component

Clause 22 provides for the calculation of a component that represents the value to a fund of its holdings in associate and subsidiary entities.

Subclause 22 (1) requires an insurer to determine the value of a fund's holdings in associate and subsidiary entities.

Subclauses 22 (2) to (4) specify requirements to be observed in the calculation of the component.

23. Asset concentration risks component

Clause 23 provides for the calculation of a component that represents the risks to the fund arising from asset or credit concentration risks.

Subclause 23 (1) specifies that the component is the sum of the amounts by which any asset of the fund of a kind listed in subclause (2) exceeds the amount specified in that subclause for that kind of asset. For any other kind of asset, the component is calculated as the amount by which any such asset exceeds 10 per cent of the value of the assets of the fund.

Subclause 23 (2) specifies, for the purposes of the calculation in subclause (1), the relevant amounts for various kinds of assets.

PART 8 RESILIENCE AMOUNT

24. Determination of resilience amount

Clause 24 provides for the calculation of an amount that represents the risk to the assets of a fund associated with the occurrence of shocks to the economic environment.

Subclause 24 (1) specifies the formula for the determination of the resilience amount for a fund.

Subclause 24 (2) prescribes the formulae to be applied to asset values to reflect the economic changes applicable to the assets of the fund that fall within the classes listed in the table.

Subclause 24 (3) defines the diversification factor (DF) which appears in the formulae in the table in subclause (2).

PART 9 SUBORDINATED DEBT AND ALTERNATIVE SOURCES OF CAPITAL

25. Overview

Subclause 25 (1) states the purpose of the Part, which is to specify the terms on which subordinated debt qualifies as subordinated debt within the meaning of the Part and to specify the amount of subordinated debt that may be counted for the purposes of the standard.

Subclause 25 (2) provides that the capital adequacy obligation may be satisfied from either shareholder or member capital or the use of alternative sources of capital support where the obligations to the debtor are subordinate to the other obligations of the fund.

Subclause 25 (3) specifies that it is only subordinated debt within the meaning of the Part that will qualify as an alternative source of capital for the purposes of the standard.

26. Subordinated debt

Clause 26 specifies requirements for debt to be subordinated debt within the meaning of the Part.

Subclause 26 (1) requires proposals to issue or borrow subordinated debt to be approved by the Council before the debt can be taken into account under the standard.

Subclauses 26 (2) to (4) specify further requirements for the approval of subordinated debts and for their continued application under the standard.

27. Amount of subordinated debt to be counted

Clause 27 provides the maximum amount of subordinated debt that may be counted for the purposes of the standard.

Subclause 27 (1) provides the maximum amount of subordinated debt that may be counted for the purposes of the standard.

Subclauses 27 (2) and (3) provide a transitional treatment for funds to count for the purposes of this standard subordinated debts that were approved under the previously applicable standards made under the National Health Act.