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GUIDELINE ON VALUATION OF TECHNICAL PROVISIONS FOR

November 2015

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Insurance Regulatory Authority
IRA

To: All Insurance Companies

GUIDELINE ON VALUATION OF TECHNICAL PROVISIONS FOR LIFE INSURERS

This guideline on valuation of insurance technical provisions is issued pursuant to section 3A of the Insurance Act for observance by Insurance and Reinsurance Companies transacting life business.

The guideline sets principles for the consistent measurement and reporting of the insurance liabilities of all life insurers.

Financial soundness of the insurer and ultimate protection of policyholders is dependent on proper, realistic and consistent valuation of the insurance technical provisions.

To this end, the Insurance Regulatory Authority issues this guideline on valuation of insurance technical provisions to be effective from _________ 2015.

SAMMY M. MAKOVE

COMMISSIONER OF INSURANCE & CHIEF EXECUTIVE OFFICER

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THE INSURANCE ACT (CAP 487)

IRA/PG/16

GUIDELINE TO THE INSURANCE INDUSTRY

Valuation of Technical Provisions for Life Insurers

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1.0 AUTHORIZATION

IN EXERCISE of the powers conferred by sections 3A (a), (b) and (g) of the Insurance Act, the Insurance Regulatory Authority (herein referred to as Authority) issues the guideline set out here below, for observance by all insurers registered under the Insurance Act Cap 487, in respect of the valuation of technical provisions for life insurers.

2.0 INTRODUCTION

2.1. These Guidelines establish principles for the consistent measurement and reporting of the insurance technical provisions1for life insurance business.

2.2. The valuation of life insurance liabilities on prudent, realistic and consistent manner is important for the financial soundness of the insurer, and ultimately the protection of policyholders.

2.3. The insurer's Board and Senior Management shall place appropriate valuation on the insurer's technical provisions after considering actuarial and other professional advice.

3.0 KEY REQUIREMENTS

The key requirements of this guideline are:

3.1 The Board of an insurer shall submit an actuarial valuation report on a quarterly and annual basis.

3.2 The Appointed Actuary shall be responsible for the valuationof actuarial liabilities (technical provisions) on an annual basis while the Head of Actuarial Function shall be responsible for quarterly valuations.

3.3 Technical Provisions are composed of a best estimate liability and a risk margin.

3.4 The best estimate liability is the present value of expected future cashflows (benefits and expenses less premiums) based on best estimate assumptions, discounted using the relevant risk-free interest rate[2].

[1] Technical Provisions represent the reserves that need to be held to cover future insurance liabilities and it consists of a best estimate liability and a risk margin.

[2] Risk free interest rate is determined using the long dated government bonds yields.

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3.5 The risk margins are defined by the Authority and the insurer shall modify the best estimate assumptions by the prescribed margins provided that an assumption shall be increased or decreased depending on which alternative gives rise to an increase in the liability of the class of policies concerned.

3.6 For liabilities that can be hedged (i.e. replicated by a financial instrument with a reliable market value), the value of the technical provisions shall be equal to the market value of the hedging instrument. A separate computation of the best estimate and risk margin on the value of the hedging instrument is not required.

3.7 The Actuary or the Board may adopt any other valuation method provided it does not result in a value lower than that obtained using the best estimate assumptions and prescribed risk margin. The insurer shall in writing disclose the following to the Authority:

i. The reasons for adopting a different valuation methodology.

ii. Details of the alternative assumptions and methodologies used in determining the value of the technical provisions, including comparative results.

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4.0 VALUATION METHODOLOGY

4.1 BEST ESTIMATE LIABILITY

4.1.1 The best estimate liability shall be the present value of expected future cashflows, discounted using the "risk-free" interest rate in respect of:

(a) basic benefits for mortality, morbidity, lapses, withdrawals, surrenders and maturities excluding prescribed margins and discretionary margins, if any; and

(b) future commissions, expenses and expense inflation, excluding prescribed margins and discretionary margins, if any ; and

(c) the future cost of any guarantees that have been given under the contract, less future expense deductions, risk benefit premiums and management fees to be levied.

(d) Any other benefits that are in line with the reasonable expectations of policyholders and any established practices of an insurer for payment of benefits;

4.1.2 The insurer shall, when determining the liability in respect of unit linked business, ensure that the investment and the risk components are unbundled for the purposes of determining the technical provisions.

4.1.3 The cashflow projections should ideally be performed on a policy-by-policy basis.

4.1.4 The Actuary shall take into account all relevant available data, both internal and external, when arriving at assumptions that best reflect the characteristics of the underlying insurance portfolio.

4.1.5 A guidance note on determining the best estimate assumptions has been included as an appendix 1 to this guideline.

4.2 RISK MARGIN

4.2.1 The risk margin is intended to increase the technical provisions to the amount that reflects the risk that the actual experience deviates from the best estimate assumptions.

4.2.2 The risk margins to be loaded onto the best estimate assumptions shall be determined by the Authority from time to time.

4.2.3 The Risk margins are outlined in Appendix 2.

5.0 REPORTING ON TECHNICAL PROVISIONS

5.1 An insurer shall submit on an annual basis to the Authority an actuarial valuation report signed by the appointed actuary of the company. The report shall contain the following:

i. A statement that the valuation methodis in compliance with the provisions of these guidelines;

ii. An actuarial opinion on the valuation;

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iii. A detailed description of the actuarial valuation;

iv. Explanation of special terms and concepts in the report.

5.2 Description of the annual actuarial valuation shall contain the following:

i. Completeness and accuracy of the data of different insurance lines or categories, and a description of the problems these data may have had;

ii. Major assumptions of the actuarial valuation, and reasons for adopting such assumptions;

iii. The variation between the actual result of the previous valuation and the actual experience;

iv. Adequacy of reserving;

v. Provision for expected allocations of profit to shareholders, and the bonus rates declared for policyholders as per section 46 of the Insurance Act.

5.3 An insurer shall, on a quarterly basis, submit to the Authority an actuarial valuation report signed by the Head of the Actuarial function and the Principal Officer. The report shall contain the following:

i. A statement that the valuation method is in compliance with the provisions of these guidelines;

ii. An actuarial opinion on the valuation;

iii. iii. A description of the actuarial valuation;

iv. Explanation of special terms and concepts in the report.

6 REMEDIAL MEASURES

When the Authority determines the insurer's non-compliance with the provisions of this guideline; the Authority may take further steps in accordance with the provisions of the Insurance Act.

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7 ADMINISTRATIVE SANCTIONS

Where the Authority determines that an insurer has not met the requirements of this directive, the Authority may impose any or all of the administrative sanctions to correct the situation in accordance with the provisions of the Insurance Act, including but not limited to:

i. Prohibition from declaring and/or paying dividends;

ii. Declaration that a person may not take the office of the Appointed Actuary or the Head of the Actuarial Function;

iii. Suspension of the establishment of new branches or expansion into new financial activities;

iv. Suspension or closure of the insurer to new business;

v. Suspension or closure of an insurer;

vi. Suspension of acquisition of fixed assets; and

vii. Monetary penalties.

8 EFFECTIVE DATE

The effective date of this guideline is __________ 2015.

8.0 ENQUIRY

Enquiries on any aspect of this guideline shall be referred to;

Address: The Chief Executive Officer

Insurance Regulatory Authority,

P.O. Box 43505-00100,

Nairobi

Telephone: +254 20 4996000

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Facsimile: +254 20 2710126

E-mail: commins@ira.go.ke

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APPENDIX 1
Guidance note on Best Estimate Assumptions

This guidance note provides an outline on how the best estimate assumptions can be determined for the purpose of computing the best estimate liability.

Mortality, Longevity and Morbidity/Disability Rates

The KE07:10 base mortality rates will be used, with an appropriate adjustment to reflect the company's own experience.

Where no reliable assumptions are available, the assumptions used can be based onthe insurer's own experience, industry study or other relevant studies.

Withdrawals

The lapse rate should reflect the expected experience of both existing and potential policyholders and the Actuary should perform a lapse investigation using the insurers past data.

If a sufficient volume of relevant experience is not available, then experience from similar contracts and/or industry-wide data (if available) may be used.

Expenses and Commissions

The Actuary should make an allowance for expenses to include acquisition costs, underwriting& administration costs,investment costs, claim settlement costs and any other future expenses.

Investment Return

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The Actuary should take into account the following regarding the future investment return assumption:

- the extent of any investment guarantees included;
  - nature of contract e.g. non-profit vs. with-profit; and
  - level of investment guarantee.
- the size of the reserve built up under the contract;
  - type of contract e.g. term assurance vs. endowment assurance
  - frequency of premium payment e.g. single premium vs. regular premium.

The assumed rate of future investment return will depend on the mix of the assets held to match the liabilities.

Allowance should be made for any changes in the future economic environment.

Other Assumptions

If a sufficient volume of relevant experience is not available, then experience from similar contracts and/or industry-wide data (if available) may be used.

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APPENDIX 2
Risk Margins

Assumption	Prescribed margin as % of the base assumption
Mortality	10% increase in mortality for death assurances
Longevity	10% decrease in mortality for life assurances and annuities
Morbidity/Disability	10% increase in inception rates 5% decrease in recovery rates
Lapses	25% (increase or decrease in lapse rate depending on which alternative gives rise to an increase in the liability of the policy concerned)
Interest rate (Investment Return)	10% decrease
Surrenders	10% (increase or decrease in surrender rate depending on which alternative gives rise to an increase in the liability of the policy concerned)
Expenses	10% increase
Expense inflation	10% increase (of the estimated escalation rate)
Charges under linked long term Contracts	A reduction of 25%

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