South African Reserve Bank
Prudential Authority

Prudential Standard FSB 3

Valuation of Technical Provisions by Branches

Objectives and Key Requirements of this Prudential Standard

This Standard sets out how branches of foreign reinsurers in South Africa (branches) must value their technical provisions for the purposes of meeting the security requirements for insurance business conducted in South Africa.

The ultimate responsibility for the accurate valuation of technical provisions arising from insurance business conducted by branches in South Africa rests with the foreign reinsurer and the representative of the branch. The head of the actuarial function is responsible for providing assurance to the representative regarding the accuracy of the calculations and the appropriateness of the assumptions underlying the valuation of the branch's technical provisions.

The key principles and requirements of this Standard are:

- *Branches must establish technical provisions that correspond to the current value of their insurance obligations;*
- *Branches must segment their insurance obligations into homogeneous risk groups when calculating the value of technical provisions;*
- *The calculation of the technical provisions must incorporate a best estimate and a risk margin;*
- *Branches must use actuarial and statistical methods that are proportionate to the nature, scale and complexity of the risks to calculate their technical provisions;*
- *The calculation of technical provisions must take account of the time value of money by using the relevant risk-free interest rate term structure specified by the Prudential Authority; and*
- *Branches are permitted to apply simplified methods in calculating technical provisions, subject to such methods satisfying the principle of proportionality.*

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1. Application

1.1. This Standard applies to all branches of foreign reinsurers licensed under the Insurance Act, 2017 (the Act).

1.2. Unless otherwise indicated, all references to "insurer" in this Standard or in any other Standard referred to in this Standard can be read as a reference to a branch of a foreign reinsurer. Similarly, a reference to "insurance" obligations/policies can be read as a reference to "reinsurance" obligations/policies, unless otherwise specified.

2. Roles and Responsibilities

2.1. The foreign reinsurer and the representative of the branch are ultimately responsible for ensuring that the valuation of the liabilities stemming from its insurance business in South Africa complies with the principles and requirements set out in this Standard. The representative of the foreign branch must ensure that the branch has in place the necessary resources, systems, procedures and controls to value insurance liabilities according to the principles and requirements of this Standard on an ongoing basis.

2.2. The head of the actuarial function is responsible for expressing an opinion to the foreign reinsurer and the representative of the branch on the valuation of technical provisions. In providing this assurance, the head of the actuarial function must have regard to the principles and requirements of this Standard, as well as relevant professional standards of the Actuarial Society of South Africa or a society or institute that has mutual recognition with the Actuarial Society of South Africa.

2.3. The auditor appointed under section 32 of the Act by the branch must provide assurance to the foreign reinsurer and the representative of the branch that the valuation of technical provisions complies with the requirements of this Standard. The auditor must report to the foreign reinsurer, the representative and the Prudential Authority any matters identified during the performance of its responsibilities that may cause the branch not to comply with the requirements of this Standard.

2.4. The roles and responsibilities of the representative of a branch and the head of the actuarial function are described in more detail in the Governance and Operational Standards for Branches (GOB 1).

3. Commencement and Transition Provisions

3.1. This Standard commences on 1 July 2018.

Version Number	Release Date
1	1 July 2018

4. General Principles for Valuing Technical Provisions

4.1. A branch must value its technical provisions according to the principles and requirements of Prudential Standard FSI 2.2 (Valuation of Technical Provisions), except where specifically mentioned in this Standard. This Standard follows the same structure as FSI 2.2, highlighting exceptions and adjustments to the requirements of FSI 2.2 where appropriate to the nature of the insurance business conducted by branches in South Africa.

4.2. All general principles for valuing technical provisions set out in section 4 of FSI 2.2 (with an adjustment to section 4.2 of FSI 2.2 as outlined below) apply to the valuation of a branch's liabilities stemming from its insurance obligations in respect of its insurance business.

4.3. Section 4.2 of FSI 2.2 is replaced by the following:

The value of technical provisions must comprise a best estimate and a risk margin. The best estimate must be calculated on a gross basis, without deducting the amounts recoverable from reinsurance contracts. The branch may then allow for all amounts recoverable from reinsurance contracts to calculate the net best estimate. The risk margin must be calculated by reference to the cost of providing an amount of eligible own funds[1] necessary to support insurance obligations over their lifetime.

5. Segmentation

5.1. All requirements set out in section 5 of FSI 2.2 apply.

6. Methodology for Calculating the Best Estimate Liability

6.1. The requirements set out in section 6 of FSI 2.2 apply, subject to the exceptions and adjustment set out below.

6.2. The requirements set out in sections 6.31 to section 6.40 of FSI 2.2 do not apply.

6.3. The requirements set out in section 6.5 of FSI 2.2 are replaced by the following requirements:

The best estimate must be valued on a gross basis, without deducting the amounts recoverable from eligible reinsurance contracts. Recoverables from eligible reinsurance contracts must be calculated separately. Where co-insurance applies, the cash-flows of each co-insurer must be calculated based on the proportion of the expected cash-flows for each insurer, without deducting amounts recoverable from eligible reinsurance.

6.4. All sections in Attachment 2 (Cash-flow projections) of FSI 2.2 apply.

[1] Eligible own funds for branches is defined in section 14.3.

7. Recognition of Insurance Contracts

7.1. All requirements set out in section 7 of FSI 2.2 apply.

8. Contract Boundary

8.1. All requirements set out in section 8 of FSI 2.2 apply.

9. Recognition of Insurance Premiums

9.1. All requirements set out in section 9 of FSI 2.2 apply.

10. Valuation of Options and Guarantees

10.1. All requirements set out in section 10 of FSI 2.2 apply.

11. Treatment of Future Discretionary Benefits

11.1. The requirements set out in section 11 of FSI 2.2 apply, subject to the exception set out below.

11.2. The requirements set out in section 11.2 of FSI 2.2 do not apply.

12. Recoverables

12.1. The requirements set out in section 12 of FSI 2.2 apply, subject to the adjustments set out below.

12.2. A branch must only use eligible reinsurance contracts as risk mitigation instruments.

12.3. The requirements of section 12.5 of FSI 2.2 are replaced by the following requirements:

Any assumptions regarding the amounts recoverable from eligible reinsurance contracts used in the valuation of technical provisions must adhere to the principles and methodology set out in section 12 of FSI 2.2 and Attachment 3 (Adjusting Recoverables for Counterparty Default Risk) of FSI 2.2. Notwithstanding this provision, branches are not required to calculate a risk margin for amounts recoverable from eligible reinsurance contracts, given that a single net calculation of the risk margin must be performed.

12.4. The requirements of section 12.9 of FSI 2.2 are replaced by the following requirements:

If payments to a branch from reinsurers do not directly depend on the claims against the cedant,[2] the amounts recoverable for future claims should only be taken into account to the extent it is possible for the structural mismatch between claims and amounts recoverable to be measured in a prudent, reliable and objective manner.

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[2] Instances where this may arise include arrangements where payments are made according to certain external indicators, such as an earthquake index.

12.5. All sections in Attachment 3 (Adjusting Recoverables for Counterparty Default Risk) of FSI 2.2 apply.

13. Discount Rates

13.1. All requirements set out in section 13 of FSI 2.2 apply.

13.2. All sections in Attachment 4 (Deriving the Risk-free Interest Rate Term Structure for Foreign Currencies) of FSI 2.2 apply.

14. Risk Margin

General methodology for calculating the risk margin

14.1. All requirements set out in section 14 of FSI 2.2 apply.

14.2. References to "SCR" in section 14 of FSI 2.2 should be read as reference to the regulatory capital requirement calculated according to the jurisdictional legislation where the foreign reinsurer is licensed and supervised.

14.3. References to "eligible own funds" in section 14 of FSI 2.2 should be read as reference to the capital resources deemed eligible to cover the regulatory capital requirements under the jurisdictional legislation where the foreign reinsurer is licensed and supervised.

14.4. The branch may calculate the risk margin according to a methodology that is different to that specified in the section 14.1 above, subject to the approval of the Prudential Authority.

15. Calculating Technical Provisions as a Whole

15.1. All requirements set out in section 15 of FSI 2.2 apply.

16. Taxation

16.1. All requirements set out in section 16 of FSI 2.2 apply.

17. Simplifications for Valuing Technical Provisions and the Principle of Proportionality

17.1. All requirements set out in section 17 of FSI 2.2 apply.