



Prudential Communication 12 of 2023

Financial Sector Regulation Act, 2017 (Act No. 9 of 2017)

Prudential Authority Government Bond Curve: Ultimate Forward Rate and Convergence Term

Objective of this Prudential Communication

This communication relates to the implementation of recommendations from the Position Paper on the Prudential Authority Government Bond Curve Review as these relate to the Ultimate Forward Rate and Convergence Term.

1. Application

- 1.1 This Prudential Communication is applicable to all insurers as defined in the Insurance Act, 2017 (Act No. 18 of 2017) (the Act) and supervised by the Prudential Authority (PA).

2. Purpose

- 2.1 The purpose of this communication is to inform all insurers of the implementation of recommendations from the Position Paper on the PA Government Bond Curve Review (Position Paper) as these relate to the Ultimate Forward Rate (UFR) and Convergence Term which the PA has adopted to take effect from 1 January 2024.
- 2.2 Data sets incorporating these recommendations will be published in addition to current PA Government Bond Curve for the periods 1 October 2023; 1 November 2023; 1 December 2023 and 1 January 2024, to allow insurers to determine the impact of these changes to the PA Government Bond Curve on their technical provision valuations.

3. Introduction

- 3.1 In terms of paragraph 13.1 of Prudential Standard FSI 2.2 [Valuation of Technical Provisions], prescribed in terms of the Act:

“Unless otherwise approved by the Prudential Authority, insurers must use the government bond curve published by the Prudential Authority as the risk-free interest rate term structure to discount cash-flows for the purposes of valuing technical provisions.”

- 3.2 The PA adopted the recommendations as set out in the Position Paper (published during September 2023), which include that:
- 3.2.1 The EIOPA¹-derived expected real short-term interest rate should be adopted as the assumption for the PA Government Bond Curve UFR as it bears the most consistency with the principles of setting this assumption; and
- 3.2.2 The convergence term of the UFR will be set at 120 years.
- 3.3 A method based on an adjustment of the EIOPA-method to construct the nominal UFR will be implemented, namely the nominal UFR in calendar year $t =$ the EIOPA real expected short-term rate (published in calendar year $t-1$) + the midpoint of South Africa's inflation target range (4.5%).
- 3.4 The PA will publish two sets of risk-free rates for the period 1 October 2023 to 1 January 2024:
- 3.4.1 The current risk-free rates based on the current UFR and convergence term of 150 years; and
- 3.4.2 The revised risk-free rates based on the revised UFR and convergence term of 120 years.
- 3.4.3 This will enable insurers to internally perform parallel runs and submit any queries for clarification.
- 3.4.4 Insurers are not required to submit two sets of regulatory returns. All regulatory returns up to 31 December 2023 must be submitted based on the current published risk-free rates.
- 3.5 The changes to the PA Government Bond Curve will take effect from 1 January 2024.

4. Enquiries

- 4.1 Any enquiries regarding this communication can be directed to PA-STANDARDS@resbank.co.za for the attention of Mrs Nonhlanhla Ndlovu.

Fundi Tshazibana
Chief Executive Officer

Date:

¹ European Insurance and Occupational Pensions Authority