NON-BANK FINANCIAL INSTITUTIONS REGULATORY AUTHORITY (NBFIRA)

INSURANCE PRUDENTIAL RULES

In terms of Section 50 of the NBFIRA Act – Section 51 on Reporting

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LR3

Valuator's Annual Report
Long Term Insurance

Effective March 1, 2012

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1. Introduction

1.1. Background

1. The inclusion of a Valuator’s report as part of the annual returns to NBFIRA and in the annual financial statements is mandatory for all long-term insurers. This document sets out the requirements for the Valuator’s report for long term insurers, regarding both the format and minimum content of the report. The aim is to help ensure consistency and completeness of disclosure.

2. These requirements are stipulated by NBFIRA in the Insurance Industry Act as part of the required statutory returns, and comprise three sets of documents:

   a. LR1 is the annual Long Term Return, which contains relevant financial data about the company.
   b. LR2 is the Financial Condition Report, outlining the financial position of the company as well as key risks faced by the insurer and its management of those risks
   c. LR3 is the Valuator’s Report

3. The Valuator’s Report is adapted from professional guidance prepared by the Actuarial Society of South Africa (“ASSA”). However, where the focus of the guidance issued by ASSA was aimed at an actuarial report for company profit reporting purposes, the requirements in this LR3 is in respect of a report covering the Prescribed Valuation. This approach has been adopted by NBFIRA as most appropriate to the local market. LR3 applies to Valuator’s Reports in respect of all life insurance companies operating in Botswana, regardless of the actual professional affiliation of the Valuator.

1.2. Definitions

4. **Prescribed Basis**: The basis used according to the Prescribed Valuation Method (“PVM”) for valuing assets and liabilities and determining Prescribed Capital Target (“PCT’) requirements as provided to NBFIRA in annual LR1 Statutory Returns, in accordance with NBFIRA Insurance Prudential Rules LR1, LR2 and LR3.

5. **Published Reporting Basis**: The basis used for valuing assets and liabilities published in the primary financial statements, in accordance with GAAP or IFRS.

2. The Valuators Report and the Financial Statements

6. The content of the Valuator’s Report is aimed at providing necessary disclosures on the solvency of the life insurer, and the focus of the Report is therefore on the Prescribed Valuation Method (“PVM”).

7. There are now (or are likely to be) differences between the value placed on assets and liabilities for Published Reporting and for PVM purposes (refer to IPR 1L, IPR 2L and IPR 3L). The Valuator’s Report must therefore also include disclosure of the value of the assets, value of the liabilities and net assets as contained in the Financial Statements, prepared according to the Published Reporting Basis, and reconciliation of these amounts to the Prescribed Valuation Method.

8. The information contained within a Valuator's report and the manner in which it is presented is the responsibility of the Valuator. The board of directors is responsible for the annual financial statements

9. If, in the Valuator’s opinion, the financial results presented in the annual financial statements are materially inconsistence with the Insurance Prudential Rules or the requirements of the Long Term Insurance Returns, the Valuator is required to report this inconsistency to the Regulatory Authority within seven days of the publication of the annual financial statements.

10. The timelines for the production of the financial statements may be shorter than the timelines for providing the statutory returns to the NBFIRA. The Valuator’s report that appears in the financial statements may therefore differ slightly from the final Valuator’s Report issued to the NBFIRA. The Valuator is responsible for ensuring that there are not significant differences, and where they are to draw these to the attention of the NBFIRA.

3. Required Disclosure

11. The Valuator’s report shall contain the following minimum information:

3.1. Results on Prescribed Basis

12. A statement reflecting the values of assets and liabilities on the Prescribed Valuation Basis, the excess of the value of assets over the value of liabilities (excess assets), the total amount of the Prescribed Capital Target (“PCT”), and the ratio of excess assets to the PCT. The values of assets and liabilities and the amount of the PCT shall be determined in accordance with the methods set out in Insurance Prudential Rules IPR 1L, IPR 2L and IPR 3L and the Long Term Insurance Return LR1. The statement shall reflect the values as at the current reporting date and as at the previous year-end.

3.2. Results on Published Reporting Basis

13. A statement reflecting the values of assets and liabilities on the Published Reporting Basis, and the excess of the value of assets over the value of liabilities (excess assets). The values of assets and liabilities shall be determined in accordance with Generally Accepted Accounting Practice or IFRS, and shall be consistent with those provided elsewhere in the financial statements. Guidance to Valuators can be found in the Insurance Prudential Rules. The statement shall reflect the values at the current reporting date and at the previous year end.

3.3. Certification

14. A certificate signed by the Valuator that the Prescribed Valuation has been conducted and that the Valuator's report has been produced in accordance with applicable Insurance Prudential Rules and Long Term Insurance Returns, and that the long term insurer is financially sound on the Prescribed Basis and is likely to remain financially sound in the foreseeable future.

15. If the financial position is such that the excess assets on the prescribed basis are less than the Prescribed Capital Targets, or that the Valuator is unable for any other reason to certify that the long term insurer is financially sound or is likely to continue to remain financially sound, then the certificate shall be amended accordingly, and explanatory commentary shall be provided setting out the reasons for the insurer's financial condition and the steps required to restore or ensure financial soundness.

3.4. Analysis of Change in Prescribed Basis

16. An analysis of the change in the excess of the value of assets over the value of liabilities on the Prescribed Basis over the reporting period, split into at least the following components:

    a. Any capital raised.
    b. Any dividends paid.
    c. Investment returns (including realised and unrealised capital appreciation or depreciation) generated by the excess of assets over liabilities. Where funds are 'borrowed' from shareholder funds to finance the business (such as for unamortised acquisition expenses), this reduces the shareholder funds that are invested externally, and a notional interest payable on this 'loan' should be charged against operating profit and included here.
    d. Insurance surplus emerging, excluding the effect of changes in valuation methods or assumptions. Insurance surplus emerging should include the effect of items such as corporate expenses and support provided to policyholder funds (for Bonus Stabilisation reserves).
    e. The financial effect of changes in the valuation methods or assumptions. This is the capitalised value of the corresponding profit or loss that would have arisen in future years if the method or assumption change had not been made.
    f. Tax.
    g. Changes to amount of assets disallowed in terms of the Prudential Rules.

17. The above items may alternatively be shown net of tax, if preferred.

3.5. Reconciliations

18. Where reported earnings provided in the annual financial statements differ from the change in the excess assets as reflected in 3.4 above, after excluding the effect of any capital raised or any dividends paid, a reconciliation between two items shall be provided.

19. Where the excess assets on the Prescribed Basis differs from excess assets on the Published Reporting Basis, a reconciliation reflecting, and an explanation of, the main differences shall be provided.

3.6. Changes in Prescribed Valuation

20. A brief description of any material changes in methods or assumptions (including changes in the method or assumptions used for determining discretionary margins) since the previous reporting period shall be provided. Disclosure of the financial effect thereof is provided for in 3.4 above.

3.7. Prescribed Valuation: Liabilities

21. A description of the valuation methods and assumptions according to which various broad categories of liabilities were valued for the Prescribed Valuation shall be given. For items such as mortality and expenses, the report shall state how each of the main assumptions compare with recent actual experience. The nature of and dates of the most recent experience investigations for the main classes of business should be provided. Should there be expected future deviations, e.g. the effect of AIDS on mortality, the way in which this is taken into account shall be stated. The assumptions for items like investment return, bonuses assumed for discounted cash flow valuations, expense inflation, discount rates and growth of dividends/rents as well as the relationship between the different items shall be disclosed.

22. Where discretionary margins have been added to compulsory margins, the following information must be disclosed:

    a. Definitions of all explicit and implicit discretionary margins
    b. Quantification of discretionary margins where they are explicit
    c. Reasons for adding discretionary margins

23. The way in which policyholders' reasonable benefit expectations were provided for shall also be shown, for example by showing the level of future bonus rates, (e.g. supportable or last declared) provided for. Supportable bonuses are those that could be declared if investments returns assumed in the valuation were earned, before taking account of any bonus stabilisation reserves. Where a bonus rate for any of the ensuing three annual bonus declarations is assumed that is lower than the lesser of the supportable bonus rate and last declared bonus rate, or where a bonus rate beyond three years is assumed that is lower than the supportable bonus rate, this shall be disclosed with details of the reductions in bonus assumed. Any increases in the assumed bonus rates should also be disclosed.

24. A description shall be provided of the basis for calculating the provision for the proportion of net investment returns earned on underlying policy assets expected to be allocated to shareholders.

25. A description shall be provided of the way in which any bonus stabilisation reserves are determined and have been allowed for. For a prospective valuation, where it is assumed that the future bonuses differ from supportable bonuses (as contemplated above in the preceding paragraph), there is an implicit bonus stabilisation reserve that must be quantified. This implicit bonus stabilisation reserve is defined as the difference between the reserve based on supportable bonuses and the reserve based on assumed bonuses. When calculating bonus stabilisation reserves, appropriate allowance shall be made for bonuses accrued up to the valuation date (at declared, interim or expected bonus rates, depending on the timing of the valuation and the bonus declarations).

26. Where the bonus stabilisation reserve for any class of business is more negative than -7.5% of the corresponding liabilities at the valuation date, this fact shall be disclosed. It is recommended that an explanation of what caused this to occur be provided. If the bonus stabilisation reserve is more negative than -7.5% of corresponding liabilities at the valuation date, the Valuator shall also state why he/she believes that this can be recovered through under-declaration of bonuses during the ensuing three years.

27. Any reduction, whether by cancellation or temporary suspension, of previously declared non-vested bonuses shall be described, and the financial effect thereof shall be quantified and disclosed. The extent to which the financial effect of such reduction of previously declared non-vested bonuses differs from the underlying asset value movement shall be quantified and the accounting treatment thereof described, with specific reference to its effect on bonus stabilisation reserves and disclosed earnings. Similar disclosures shall be made in the event of the reversal of any such reduction in non-vested bonuses.

28. The description of the liability valuation methods and assumptions may be succinct and may cover broad principles for major classes of business only, provided these classes account for at least 75% of total liabilities.

3.8. Prescribed Basis: Assets

29. A brief description of the methods and assumptions used for valuing the assets, which shall be within the confines of the Insurance Prudential Rules. In addition, a description shall be included of the way in which asset values are smoothed, if applicable. The descriptions may be succinct and may cover broad principles for major classes of assets only.

3.9. Prescribed Capital Target

30. A brief summary of the main assumptions adopted for calculating the Prescribed Capital Target shall be provided. These assumptions include the material off-setting management actions assumed (including those actions that may already have been assumed in calculating the liabilities), the circumstances in which these actions would be taken, and the manner in which the capital itself is invested. The financial effect on the PCT of all the assumed management actions shall be provided, and the management actions described shall account for at least 90% of this financial effect. For assumed off-setting management actions, the Valuator shall certify that these actions have been approved by specific resolution by the board of directors, and that he/she expects that these actions would be taken if the corresponding risks were to materialise.

31. A statement shall be made as to whether the Ordinary Capital Target (OCT), Termination Capital Target (TCT), or Minimum Capital Target (MCT) applied.

3.10. Other

32. If the Valuator is unable to reconcile major differences between the valuation data and the accounting data, or major differences in the build-up of the valuation data, the problem shall be discussed with the company and with the auditor. If the differences cannot be reconciled and are material, it will be

necessary to disclose this fact and to give an opinion of the extent and effect of the discrepancy, and to state what allowance has been made in the valuation for the discrepancy.

33. Any other descriptions or explanations considered necessary to enable a reader to gain a meaningful appreciation of the figures presented.

3.11. Notes

34. The requirements detailed above, and any other information included in the report, shall be presented in a way that minimises the possibility of misinterpretation.

35. Section 4 includes recommendations regarding the content and format of the report (based on the example given in PGN103 of the Actuarial Society of South Africa). The format provided below is illustrative, not prescriptive. Variations thereof may be appropriate in individual circumstances. The statement reflecting the values of assets and liabilities may, for example, be incorporated into the balance sheet.

4. Addendum: Outline for Valuator's Report

4.1. Assets, Liabilities, Excess Assets and PCT

Prescribed Basis

P'000	31.12.2008	31.12.2007
Value of assets on the PVM basis	**112 100**	**101 750**
Value of policy liabilities	100 000	90 000
Current and other liabilities	3 000	2 700
Total value of liabilities	**103 000**	**92 700**
Excess Assets	9 100	9 050
Prescribed Capital Target	6 000	5 400
Ratio of Excess Assets to PCT	1.5 x	1.7 x

Published Reporting Basis

P'000	31.12.2008	31.12.2007
Total value of assets as per balance sheet	**115 600**	**103 750**
Value of policy liabilities	101 000	90 000
Current and other liabilities per balance sheet	2 850	2 700
Total value of liabilities	**103 850**	**92 700**
Excess Assets	11 750	11 050

4.2. Certification of Prescribed Financial Position

I hereby certify that:

a. The valuation on the Prescribed Basis of the ABC Life Assurance company as at 31 December 2008, the results of which are summarised above, has been conducted in accordance with, and this Valuator's report has been produced in accordance with, applicable Insurance Prudential Rules and Long Term Insurance Returns; and

b. The company was financially sound on the Prescribed Basis as at the valuation date, and in my opinion is likely to remain financially sound for the foreseeable future.

Signed: …………………………............

Name:

Valuator:

Qualifications:

Date:

4.3. Prudential Basis: Change in Excess Assets

The excess of the value of assets over the value of liabilities has changed as follows over the reporting period:

	Year to 31.12.2008	**Year to 31.12.2007**
Excess Assets as at end of reporting period	11 750	11 050
Excess Assets as at beginning of reporting period	11 050	10 000
Change in Excess Assets over the reporting period	**700**	**1 050**

This change in the excess assets is due to the following factors:

P'000	**31.12.2008**	**31.12.2007**
Investment return generated by excess assets over liabilities:		
Investment income	600	550
Capital appreciation	900	450
Total Investment return	1 500	1 000
Insurance surplus emerging	1 400	1 250
Changes in valuation methods or assumptions	100	- 150
Change in admissibility of assets as per Prudential Statements	-850	
Tax	- 450	-350
Total surplus emerging	1 700	**1 750**
Capital raised		
Dividends	- 1 000	- 700
Total change in excess assets	**700**	**1 050**

4.4. Reconciliation to Reported Earnings

Total earnings as per the above table	1 700	1 750
Reported earnings in annual financial statement	1 740	1 750
Difference	-40	-

The reasons for this difference are as follows……

4.5. Reconciliation of Excess Assets between Published Reporting Basis and Statutory Basis

	31.12.2008	**31.12.2007**
Excess Assets on Prescribed Basis	9 100	9 050
Excess Assets on Published Reporting Basis	11 750	11 050
Difference	- 2 650	- 2 000

The reasons for this difference are as follows……

4.6. Changes in Prescribed Valuation Methods or Assumption

The value of liabilities as at 31.12.2008 decreased by P100 000 as a result of changes to valuation assumption.

The main assumption changes causing this decrease were as follows…..

4.7. Prescribed Basis

The valuation was performed using the Prescribed Valuation Method.

The result of the valuation methods and assumptions is that profits for insurance contracts are releases appropriately over the term of each policy, to avoid the premature recognition of profits that may give rise to losses in later years.

4.8. Prescribed Basis: Liabilities

In the calculation of liabilities for insurance contracts, provision has been made for:

- **a.** The best-estimate of the future experience, plus
- **b.** The **compulsory margins** prescribed by LR1 , plus
- **c.** **Discretionary margins** as follows to release profits consistent with policy design:
    - **i.** **Valuation rate**: for liabilities reduced by 0.25 percentage points to release profits consistent with the amount of assets managed from year to year.
    - **ii.** **Mortality and morbidity**: increase assumption by 10% to release expected risk profits consistent with the amount of cover provided from year to year.
    - **iii.** **Shareholders' participation**: of 10% participation of the expected reversionary and terminal bonus payable each year in respect of conventional with profit business was allowed for. An allowance for the shareholders 10% participation of the bonus expected to be declared each year in respect of smoothed bonus business.

The following are the main assumptions used to calculate the value of the liabilities:

- a. **Experience**: The assumptions (before adding margins) with regard to future surrender, lapse, disability payment termination, mortality, medical claims and morbidity rates were consistent with the company's recent experience and provision has been made for the expected increase in the occurrence of AIDS-related claims. The most recent main experience investigations were….
- b. **Expenses**: Provision (before adding margins) starts at a level consistent with the company's current experience and allows for 5% escalation per annum thereafter (previous year 6%).
- c. **Guarantees, lapses, surrenders**: Where relevant, liabilities include provisions to meet maturity, mortality and disability guarantees and for losses in respect of potential lapses and surrenders.
- d. **Margins and tax**: The discount rates quoted below are before the allowance for compulsory and discretionary margins and tax.
- e. **Discount rate**:
    - i. For non-profit annuities, liabilities have been calculated by discounting expected future annuity instalments and expenses at interest rates based on the bond yield curve at the valuation date.
    - ii. A discount rate of 8% (previous year: 9%) has been used to value other non-profit business.
    - iii. Profit-sharing life and term annuity instalments and future expenses in respect of these instalments have been discounted at 8% per annum (previous year: 9%). Future growth is provided for at the latest declared growth rate.

f. **Reversionary bonus policies**: a gross premium valuation was done. Future bonuses were provided for at the latest declared reversionary bonus rate and a final bonus rates supported by the assumed investment return of 8% p.a. A discount rate of 8% per annum (previous year: 9%) was used. Bonus stabilisation reserves were held to equate the liabilities to the market/fair value of the corresponding assets.

g. **Individual unbundled policies** of which the bonuses are stabilised/ smoothed: a gross premium valuation was done. Future bonuses were provided for at bonus rates that would be declared should an investment return of 8% per annum be earned. A discount rate of 8% per annum (previous year: 9%) was used to place a present value on assumed future cash flows. A negative Pula reserve has been allowed for, equal to the present value of future charges not required for risk benefits and renewal expenses. Bonus stabilisation reserves were held to equate the liabilities to the market value of the corresponding assets.

h. **Market –related unbundled business**:(e.g. those where a portion of the premium is allocated to an accumulation account) the liability was taken as the market value of the units notionally credited to the policies, less the present value of future charges not required for risk benefits and renewal expenses. For the purpose of calculating the Pula reserves, the same discount rates as applied to individual investment series policies above, were used.

i. **Group policies**: In case of group policies for which the bonuses are stabilised, the liabilities are equal to the balances of the investment account plus corresponding bonus stabilisation reserves. Group linked business was valued at the market value of the underlying assets

j. **Policyholders' reasonable benefit expectations**: have been allowed for as follows……

k. **Bonus stabilisation reserves**: have been determined as follows…..

   i. No bonus stabilisation reserve for any class of business was more negative than -7.5% of corresponding liabilities at the valuation date.

   [Note to Valuator: Where the bonus stabilisation reserve for any class of business is more negative than -7,5% of corresponding liabilities at the valuation date, this fact must be disclosed. It is recommended that an explanation of what caused this to occur be provided. If the bonus stabilisation reserve is more negative than -7,5% of corresponding liabilities at the valuation date, the Valuator must also state why he/she believes that this can be recovered through under-declaration of bonuses during the ensuing three years]

4.9. Prudential Basis: Assets

All assets (including the excess of assets over liabilities) have been valued at market value/fair value. The assets have been impaired as required in terms of LR2.

[Note to Valuator: This paragraph should refer to the "normal" accounting notes, where more information would be provided about what is meant by market value/fair value: for example, how properties and unlisted subsidiaries were valued]

4.10. Prescribed Capital Target

The PCT has been calculated in accordance with LR3. The following main assumptions have been used to calculate the investment resilience PCT:

a. That a decline of 30% in equity asset values, 15% in property and 10% in fixed interest asset values (as a result of an increase of 25% in fixed-interest yields) will occur, in accordance with LR3.

b. That 50% of accumulated non-vested bonuses would be removed should asset values decline to the extent and not subsequently recover within a few months. This assumption reduced the capital adequacy requirements by P 5 million.

I certify that the off-setting management actions assumed above have been approved by specific resolution by the board of directors, and that I am satisfied that these actions would be taken if the corresponding risks were to materialise.

For the purpose of grossing up the intermediate ordinary capital target (IOCT) to determine the ordinary capital target (OCT), it has been assumed that assets backing the PCT are invested 80% in equities and 20% in fixed interest assets.

The OCT exceeded the termination capital target (TCT), and thus the PCT has been based on the OCT.

4.11. Other

[Note to Valuator: Comment on any material unreconciled differences between the valuation data and the accounting data, or in the build-up of the valuation data, on the extent and effect of any such discrepancies, and on what allowance has been made in the valuation for any such discrepancies.

Provide any other descriptions or explanations considered necessary to enable a reader to gain a meaningful appreciation of the figures presented]