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## BOARD NOTICES

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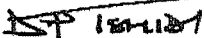
### BOARD NOTICE 27 OF 2010

#### FINANCIAL SERVICES BOARD REGISTRAR OF SHORT-TERM INSURANCE

#### SHORT-TERM INSURANCE ACT, 1998 (ACT NO. 53 OF 1998)

#### Prescribed requirements for the calculation of the value of the assets, liabilities and capital adequacy requirement of short-term insurers

1. I, Dube Phineas Tshidi, Registrar of Short-term Insurance, hereby prescribe, under paragraph 2 of Part I of Schedule 2 of the Short-term Insurance Act, 1998 (Act No. 53 of 1998), the requirements for the calculation of the value of the assets, liabilities and capital adequacy requirement of short-term insurers, as set out in the Schedule hereto.
2. This Board Notice will come into effect on 28 February 2010.



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DP TSHIDI,  
Registrar of Short-term Insurance

## SCHEDULE

### Prescribed requirements for the calculation of the value of the assets, liabilities and capital adequacy requirement of short-term insurers (Paragraph 2 of Schedule 2 of the Short-term Insurance Act, 1998)

#### 1. Definitions

In these Requirements, unless the context indicates otherwise:

**“Act”** means the Short-term Insurance Act, 1998 (Act No. 53 of 1998), and a word or expression to which a meaning has been given in the Act, has that meaning;

**“admissible assets”** means the kinds of assets specified in section 29 of the Act;

**“cash-back bonus”**, means a benefit specified in the policy document, where the policyholder receives a pre-determined benefit, in relation to the gross premiums received by the insurer, after a specified period of time under specified conditions as specified in the policy document;

**“capital requirement”**, in relation to a regulated financial institution, means the capital or solvency margin, and will include any additional asset requirements, as the case may be, required for that institution by the regulatory authority concerned;

**“cell”**, represents an equity participation as shareholder in a different class of shares that is restricted to the results of the insurance business which the shareholder places in an insurer; the results of such business are determined in accordance with an agreement with the participating shareholder; the different class of shares has specified dividend rights and/or capital risk financing;

**“group undertaking”** means a juristic person in which the insurer alone, or with its subsidiaries or holding company, directly holds 20% or more of the shares, if the juristic person is a company, or 20% or more of any other ownership interest, if the juristic person is not a company;

**“listed”** means listed on a stock exchange or similar trading facility, which is recognised generally by the international community of institutional investors;

**“net asset value”**, in relation to a group undertaking, means its net asset value calculated in accordance with paragraph 3.1.10;

**“regulated financial institution”** means:

- (a) a financial institution as defined in paragraph (a) of the definition of 'financial institution' in section 1 of the Financial Services Board Act, 1990 (Act No. 97 of 1990);
- (b) a bank as defined in section 1(1) of the Banks Act, 1990 (Act No. 94 of 1990), or a mutual bank as defined in section 1(1) of the Mutual Banks Act, 1993 (Act No. 124 of 1993);
- (c) an entity that carries on business similar to the business of an entity referred to in paragraphs (a) or (b), which is not regulated by a law that regulates an entity referred to in paragraph (a) or (b), but which is subject to substantially similar regulation outside South Africa;

**"return"** means the returns prescribed by the Registrar in terms of section 35 of the Act;

**"Schedule 2"** means Schedule 2 of the Act.

## 2. General requirements

2.1 Except if these Requirements or the Act specifically directs otherwise:

- (a) assets must be valued in accordance with financial reporting standards; and
- (b) the liabilities of an insurer must be determined in accordance with financial reporting standards.

2.2 Where the insurer applies materiality guidelines in the valuation of its assets or liabilities, they may not be less conservative than the materiality guidelines applied by its external auditors.

## 3. Valuation of assets

3.1 Value of a group undertaking

3.1.1 The value of a group undertaking must be limited to the percentage of the shareholding or other ownership interest of the insurer in the group undertaking, multiplied by the net asset value of the group undertaking.

3.1.2 If the group undertaking is listed, the value in paragraph 3.1.1 may be increased by -

A multiplied by B

Where -

A equals the difference between the fair value and the net asset value of the group undertaking, provided that A must be taken as nil if the net asset value is larger than the fair value;

- B equals the lower of 20% or the percentage of the holding by the insurer in the group undertaking.
- 3.1.3 If a group undertaking is not a regulated financial institution, and its fair value is less than 0,25% of the value of the liabilities of the insurer, it may be valued at fair value, notwithstanding paragraph 3.1.1.
- 3.1.4 If there is more than one group undertaking as contemplated in paragraph 3.1.3, each may be valued at fair value, provided that their combined fair value is not more than 2,5% of the value of the liabilities of the insurer. If their combined fair value is more than 2,5% of the value of the liabilities of the insurer, only so many of them, selected by the insurer, as will have a combined fair value of not more than 2,5% of the value of the liabilities of the insurer, may be valued at fair value. The others must then be valued as required by paragraph 3.1.1.
- 3.1.5 If an insurer holds shares in its holding company, the value of those shares must for purposes of valuation be limited to the following:
- (a) If the holding company is listed - 5% of the value of the liabilities of the insurer.
  - (b) If the holding company is not listed - nil.
- 3.1.6 Paragraph 3.1.5 applies also where the insurer, directly, or indirectly through a subsidiary or trust, holds shares in its holding company under a share incentive scheme linked to shares in its holding company.
- 3.1.7 Paragraph 3.1.5 does not apply where the insurer holds shares in its holding company under a collective investment scheme, an index-based investment scheme or any similar investment scheme that is recognised generally by the international community of institutional investors.
- 3.1.8 If an insurer has a cell in another licensed insurer, the value of those shares must for the purposes of valuation be limited to the fair value of the admissible assets held in the cell less the sum of the value of its liabilities and its capital requirement as reported by the insurer (that issued the cell) in respect of that cell.
- 3.1.9 If a negative asset value is reported in paragraph 3.1.8 and the shareholders' agreement stated that the insurer that owns the cell is accountable for losses and/or solvency, a liability must be raised for the full negative net asset value.
- 3.1.10 Net asset value of a group undertaking
- 3.1.10.1 If the group undertaking is a regulated financial institution
- (a) The net asset value of the group undertaking is the value of its assets, less the sum of the value of its liabilities and its capital requirement.

- (b) These values must be calculated as required by the regulatory authority concerned.
- (c) If the group undertaking is a company, and its main business is insurance business, the insurer must, in calculating these values, exclude so much of its capital and reserves as shareholders, other than the insurer, may withdraw in cash when they cease to be shareholders, in terms of the articles of association of, or a contract with, the group undertaking.

#### 3.1.10.2 In other cases

- (a) The net asset value of the group undertaking is the value of its assets, less the value of its liabilities.
- (b) If the group undertaking carries on most of its business in South Africa, these values must be calculated in accordance with financial reporting standards.
- (c) If the group undertaking carries on most of its business in another country, these values must be calculated in accordance with accounting standards generally accepted in that country.
- (d) In calculating these values, the following items must be excluded, to the extent that, according to the insurer, they can be ascertained with reasonable effort and are material:
  - (i) an amount that remains unpaid after the expiry of a period of 12 months from the date on which they became due and payable;
  - (ii) an amount representing administrative, organisation or business extension expenses incurred directly or indirectly;
  - (iii) an amount representing goodwill or an item of a similar nature;
  - (iv) an amount representing a prepaid expense or a deferred expense; and
  - (v) an amount representing a holding in a subsidiary of the group undertaking in excess of the net asset value, calculated on the same basis as contemplated in this paragraph 3, of the subsidiary.

## 4. Valuation of liabilities

### 4.1 Method of calculating the unearned premium provision (UPP)

4.1.1 In respect of policies, other than reinsurance policies, the minimum amount of the unearned premium provision referred to in section 32(1)(b) of the Act shall, subject to paragraph 3 of Schedule 2, be the amount calculated by means of the formula-

$$(A - B) \times (1 - C/D) + E$$

in which formula-

A represents the gross premium (excluding VAT) as stipulated in the policy document for the full term of the policy, irrespective of the frequency of the

premium payment, under all of the policies concerned for the whole of the period for which each of those policies is operative.

- B represents the sum of the following under all of the policies concerned for the whole of the period for which each of those policies is operative:
- (a) the total amount of so much of those premiums as has been refunded as a result of the cancellation or variation of the policy; and
  - (b) the total amount payable by the insurer as premiums under approved reinsurance policies in respect of the policies concerned; and
  - (c) the amount of the consideration, payable by the insurer in terms of section 48(1) of the Act to independent intermediaries in respect of the policies concerned, reduced by the total amount of any consideration payable to the insurer in respect of approved reinsurance policies under which its liabilities in respect of the policies concerned are reinsured: Provided that such reduction shall not exceed an amount equal to the maximum consideration which would have been payable to an independent intermediary in terms of section 48 of the Act had those contracts been policies other than reinsurance policies.
- C represents the number of days in the period from the date of the commencement of the incidence of risk under the policy until the day on which the calculation is made in accordance with this paragraph.
- D represents the total number of days during the whole period for which the risk is covered under the policy.
- E represents the total reserve for any type of cash-back bonus where this reserve is calculated as follows:
- (a) the percentage cash-back bonus stipulated in the policy document must be reserved for in full in respect of each premium received in respect of which a cash-back bonus will become payable in accordance with the policy document;
  - (b) the reserve can only be released either when:
    - (i) the liability ceases to exist; or
    - (ii) the benefit is paid out to the policyholder.

4.1.2 In respect of reinsurance policies, the minimum amount of the unearned premium provision referred to in section 32(1)(b) of the Act shall, subject to paragraph 3 of Schedule 2, be the amount calculated by means of the formula-

$(A - B) / 2$

in which formula -

- A represents the gross premium for the full term of the policy, irrespective of the frequency of the premium payment, under all of the policies concerned for the whole of the period for which each of those policies is operative
  - B represents the sum of the following under all of the policies concerned for the whole of the period for which each of those policies is operative:
    - (a) the total amount of so much of those premiums as has been refunded as a result of a cancellation or variation of the policy;
    - (b) the total amount payable by the insurer as premiums under approved reinsurance policies in respect of the policies concerned;
    - (c) represents the total amount of consideration payable at the start of the policy by the insurer in respect of those reinsurance policies, subject to a maximum of 30 per cent of the said premiums, reduced by the total amount of any consideration payable to the insurer in respect of approved reinsurance policies under which its liabilities in respect of the policies concerned are reinsured: Provided that such reduction shall not exceed the total amount of consideration paid by the insurer in respect of those policies.
- 4.1.3 An insurer shall apply to the Registrar to approve any other method than set out in paragraph 4.1.1 or 4.1.2 above and which the Registrar is satisfied places a more appropriate value on the liabilities concerned, based on the incidence of the risk covered under the policy.
- 4.1.4 The Registrar may by notice, in a particular case, or in general require an insurer to arrive at another minimum amount of its unearned premium provision by means of a calculation which is different from that set out in paragraph 4.1.1 or 4.1.2 above.
- 4.2 Method of calculating the outstanding claims reserve (OCR)
- 4.2.1 The outstanding claims reserve (OCR) is the amount which the insurer estimates will become payable in respect of claims incurred under policies which are reported but not yet fully paid, reduced by the amount which it estimates will be paid in respect of those claims under approved reinsurance policies.
- 4.3 Method of calculating the incurred but not reported reserve (IBNR)
- 4.3.1 The minimum amount referred to in section 32(1)(a)(ii) of the Act, shall be an amount equal to 7 per cent or such other percentage or method as the Registrar may approve, or by notice require, in a particular case, or in general, of the total amount of all of the premiums payable to the insurer under policies entered into by it in the period of 12 months preceding the date on which the amount is calculated, reduced by the total amount payable by the insurer as premiums under approved reinsurance policies in respect of the policies concerned.

#### 4.4 Method of calculating the contingency reserve -

4.4.1 An amount equal to 10 per cent of the total amount of all of the premiums payable to the insurer under policies entered into by it in the period of 12 months preceding the date on which the amount is calculated, reduced by the total amount payable by the insurer as premiums under any approved reinsurance policies in respect of the policies concerned; or

4.4.2 At any time during a period, not exceeding three years, as the Registrar may approve, such lesser amount as the Registrar may approve, subject to the conditions the Registrar determines, if the Registrar is satisfied that the insurer concerned -

- (a) has incurred claims under policies of such extent and as a result of such extraordinary events that it is reasonable to meet all, or such part as the Registrar may approve, thereof from the contingency reserve; and
- (b) will be able to restore the reserve to the amount required in terms of subparagraph 4.4.1 within that approved period.

#### 4.5 Method of calculating the unexpired risk provision

4.5.1 An unexpired risk provision if the insurer incurs an underwriting loss in the conduct of its short-term insurance business as reflected in any prescribed return in terms of this Act, and the insurer, in consultation with its auditor, considers it necessary to defray the possible cost of claims together with the costs to carry on the said business.

### 5. Calculation of the capital adequacy requirement

5.1 The capital adequacy requirement referred to in section 29 of the Act shall be determined as described in paragraph 5.2 below.

#### 5.2 Calculation of the capital adequacy requirement -

5.2.1 The capital adequacy requirement referred to in section 29(1) shall be an amount equal to the greater of the following amounts:

- A R5 000 000 or such smaller amount as the Registrar may, in a particular case and for a determined period, approve; or
- B 15 per cent of the greater of the amount of the premium income of the insurer after deduction of all premiums payable by it in terms of any reinsurance policies entered into by it in respect of any policies -
  - (i) during the period of 12 months immediately preceding the day on which the previous financial year ended; or
  - (ii) during the period of 12 months immediately preceding the day on which the calculation is made;



5.2.2 The capital adequacy requirement referred to in section 29(2) shall be an amount equal to the greater of the following amounts:

- A R5 000 000 or such smaller amount as the Registrar may, in a particular case and for a determined period, approve; or
- B 15 per cent of the greater of the amount of the premium income of the insurer in respect of the insurance business carried on by it in the Republic after deduction of all premiums payable by it in terms of any reinsurance policies entered into by it in respect of any policies -
  - (i) during the period of 12 months immediately preceding the day on which the previous financial year ended; or
  - (ii) during the period of 12 months immediately preceding the day on which the calculation is made.

**6. Process for the relaxation of a provision**

- 6.1 The Registrar may relax a provision in these Requirements, for such duration and on such conditions as the Registrar may determine.
- 6.2 An insurer must apply for such relaxation in writing, in the form and with the supporting information, documents and explanation the Registrar may require.

**7. Short title**

- 7.1 This Notice is called the Notice on the Prescribed Requirements for the Calculation of the Value of Assets, Liabilities and Capital Adequacy Requirement of Short-term Insurers, 2010.