South African Reserve Bank
Prudential Authority

Prudential Standard FSI 2.1

Valuation of Assets and Liabilities Other than Technical Provisions

Objectives and Key Requirements of this Prudential Standard

This Standard sets out further details of the requirements that insurers must adhere to when valuing assets and liabilities (other than technical provisions), particularly for items where the valuation differs from those used for general financial reporting purposes. This Standard also sets out additional approvals that are required from the Prudential Authority on asset encumbrance.

The ultimate responsibility for ensuring that the valuation of an insurer's assets and liabilities meet the requirements of this Standard rests with its board of directors.

Table of Contents

1. Application

1.1. This Standard applies to all insurers licensed under the Insurance Act, 2017 (the Act), other than microinsurers, Lloyd's and branches of foreign reinsurers.

1.2. Unless otherwise indicated, all references to "insurer" in this Standard can be read as a reference to life insurers, non-life insurers and reinsurers. Similarly, a reference to "insurance" obligations/policies in this Standard can be read as a reference to "reinsurance" obligations/policies, unless otherwise specified.

2. Roles and Responsibilities

2.1. An insurer's board of directors is ultimately responsible for ensuring that the valuation of assets and liabilities comply with the principles and requirements of this Standard. The board of directors must ensure that the insurer has in place appropriate systems, procedures and controls to meet the requirements of this Standard on an ongoing basis.

2.2. An insurer's auditor appointed under section 32 of the Act must audit the financial soundness of an insurer in accordance with its legal and regulatory obligations. The auditor must report to the board of directors and Prudential Authority any matters identified during the performance of its responsibilities that may cause the insurer to be not financially sound.

2.3. The roles and responsibilities of the board of directors are described in more detail in the Governance and Operational Standards for Insurers (GOI 3).

3. Commencement and Transition Provisions

3.1. This Standard commences on 1 July 2018.

Version Number	Commencement Date
1	1 July 2018

4. General Approach

4.1. As set out in FSI 2 (Valuation of Assets, Liabilities and Eligible Own Funds), the valuation of assets and liabilities should be undertaken using an economic, market-consistent approach that conforms to valuations carried out under International Financial Reporting Standards (IFRS) unless otherwise specified.[1]

4.2. Sections 5 and 6 below set out those assets and liabilities (other than technical provisions) where a valuation approach that differs to IFRS is required for the purposes of financial soundness.

4.3. All assets and liabilities listed under sections 5 and 6 of this Standard should be defined in accordance with the relevant definition under IFRS, unless otherwise specified. As set out in FSI 1 (Framework for Financial Soundness of Insurers), insurers must adopt the definition that applies under IFRS at the relevant point in time.

4.4. Deferred taxes should be calculated based on the difference between the values ascribed to assets and liabilities in accordance with the principles of this Standard and FSI 2 (Valuation of Assets, Liabilities and Eligible Own Funds), and the value ascribed to the same assets and liabilities reported for tax purposes.

4.5. Any transaction (or set of transactions) that may result in an asset being encumbered must be approved by the Prudential Authority before the transaction(s) can be undertaken.[2] Approval for asset encumbrances will be considered on a case-by-case basis by the Prudential Authority. The following types of assets should be regarded as leading to possible encumbrance:

a) Assets of insurers held in branches: Where the law in a foreign jurisdiction in which a branch of an insurer is established requires that the assets covering the liabilities of the branch be held in trust in the jurisdiction, the assets may be regarded as encumbered as the insurer may not be free to use the assets to cover policyholders' liabilities in South Africa;
b) Assets backing financial commitments: Where an insurer has formally committed to the injection of additional capital in another entity, the assets backing the commitment may be regarded as encumbered as the assets may be invested in the entity at a future date;

[1] In a number of instances departures from valuations carried out under IFRS may be required. These include instances where the values derived under IFRS may deviate from an economic valuation, or where it is prudent or reasonable from a financial soundness perspective to depart from economic values. Departure from economic values may be required to ensure greater consistency with the principles for valuing technical provisions and the calculation of the Solvency Capital Requirement (SCR).

[2] Section 36 of the Act provides that the Prudential Authority may prescribe requirements in this regard.

c) Margins on financial contracts:[3] Where an insurer maintains a margin to trade with financial contracts, the margin may be regarded as encumbered as the assets may not be withdrawn in full until the trade is closed out;
d) Collateral assets/security deposit: Assets that are held as collateral/security (e.g. for the repayment of a loan or a guarantee from a credit institution or a deposit received from a reinsurer) may be regarded as encumbered as the assets may not be withdrawn in full until the collateral/security expires;
e) Finance leases: The right of use assets may be regarded as encumbered if the assets do not meet the IFRS definition of an intangible asset;
f) Subordinated loans: Where an insurer grants a subordinated loan to a subsidiary, the assets representing the loan may be regarded as encumbered; and
g) Other claims on assets: Claims on assets that are only enforceable or realisable if the party that wishes to enforce or realise the claim has met all its obligations may be regarded as encumbered.[4]

4.6. Any asset that is encumbered and has been approved by the Prudential Authority must only be recognised for the purposes of determining eligible own funds under the Financial Soundness Standards for Insurers as determined by the Prudential Authority.

5. Assets Requiring a Different Treatment to IFRS

Goodwill on acquisition

5.1. For financial soundness purposes, goodwill on acquisition must be valued at nil.[5]

Intangible assets

5.2. For financial soundness purposes, the fair value of intangible assets measured under IFRS must only be recognised if it is separable and some evidence exists of exchange transactions for similar types of assets.[6] If a fair value measurement of an intangible asset is not possible, or when its value is only observable on a business combination, such assets must be valued at nil.

Participations[7]

5.3. If the participation is listed, the valuation must be based on the quoted market value using the listed prices (if available).

5.4. If a quoted market value is not available, then the participation must be valued according to the "adjusted net equity" method. The “adjusted net equity” method requires the value of the participation to be based on the insurer’s share of the

[3] Financial contracts can be described as arrangements that take the form of individually negotiated contracts or options to buy, sell, lend, swap, or repurchase, or other similar individually negotiated transactions commonly entered into by participants in the financial markets.

[4] For example, an *en commandite* partnership in which assets are invested, but the asset may only be accessed (as per the terms of the partnership agreement) if the partnership makes a profit.

[5] The IFRS definition of goodwill applies. IFRS defines goodwill acquired in a business as the payment made by the acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised.

[6] The IFRS definition of intangible assets applies. An intangible asset is identifiable if it is separable or if it arises from contractual or other legal rights. An insurer must have the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

[7] Participations should be defined in accordance with FSI 1 (Framework for Financial Soundness of Insurers).

excess of assets over liabilities less any goodwill or intangible assets not recognised under this Standard. In particular:

a) For insurance participations licensed by the Prudential Authority, the value should be the basic own funds as defined in the Prudential Standards;
b) For insurance participations in jurisdictions on the Prudential Authority's equivalence list, the value should be the equivalent of the basic own funds as defined in the Prudential Standards; and
c) For any other participation, the value should be the net asset value using IFRS principles, less any goodwill or intangible assets not recognised under this Standard, if applicable.

5.5. Where a quoted market value is not available, and the "adjusted net equity" method is not possible, the insurer may use the value as reported in their financial accounts. Otherwise, insurers may use either quoted prices of similar participations, or a mark-to-model approach. The participation's value using any of these alternate methods should be adjusted for goodwill and intangibles not recognised under this Standard.

5.6. For participations in Asset Holding Intermediaries (AHIs), insurers should look-through to the underlying assets and liabilities of the AHI when valuing the participation on an economic basis. That is, the assets and liabilities of the AHI should be treated as if they were the assets and liabilities of the insurer for valuation and financial soundness purposes.

Financial assets

5.7. For financial soundness purposes, financial assets must be measured at fair value in all instances, regardless of whether IFRS allows for these assets to be measured at cost in some instances.[8]

6. Liabilities (Other than Technical Provisions) Requiring a Different Treatment to IFRS

Financial liabilities

6.1. For financial soundness purposes, financial liabilities should be valued in conformity with IFRS fair value upon initial recognition.[9] For financial liabilities that relate to an insurer's own debt instruments issued, the value should reflect the insurer's own credit standing at inception; no subsequent adjustments should be made to take account of the change in the insurer's own credit standing. Adjustments for changes in the risk-free rate must be accounted for.

Contingent liabilities

6.2. For financial soundness purposes, contingent liabilities should be defined and valued according to IFRS, but recognised as a liability.[10] Contingent liabilities should be reported to the Prudential Authority and be subject to continuous assessment.

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[8] The IFRS definition of financial assets applies. Financial assets include items such as loans receivable and payable, debt and equity securities, asset backed securities, repurchase agreements and derivatives.

[9] The IFRS definition of financial liabilities applies. Financial liabilities should be recognised when an entity becomes a party to the contractual provisions of the instrument.

[10] The IFRS definition of contingent liabilities applies. A contingent liability is either:

a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the insurer; or

6.3. For clarity, contingent assets must not be recognised for financial soundness purposes.

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b) A present obligation that arises from past events but is not recognised because:
   i. It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
   ii. The amount of the obligation cannot be measured with sufficient reliability.