

12.	Workmen's compensation	5% - current year 3% - one year preceding the current year 1% - two years preceding the current year
13.	Medical	3%
14.	Micro insurance	4%
15.	Miscellaneous	5%

Dated the 9th February, 2017.

GODFREY K. KIPTUM,
*Acting Commissioner of Insurance
and Chief Executive Officer.*
Insurance Regulatory Authority.

ABDIRAHIN H. ABDI,
Chairman,
Insurance Regulatory Authority.

LEGAL NOTICE No. 38

THE INSURANCE ACT

(Cap. 487)

IN EXERCISE of the powers conferred by section 3A (1) (a), (b) and (g) of the Insurance Act, the Insurance Regulatory Authority issues the following guidelines—

THE INSURANCE (VALUATION OF TECHNICAL PROVISIONS FOR LIFE INSURANCE BUSINESS) GUIDELINES, 2017

1. These guidelines may be cited as the Insurance (Valuation of Technical Provisions for Life Insurance Business) Guidelines, 2017.

Citation.

2. In these guidelines, unless the context otherwise requires—

Interpretation.

“appointed actuary” means an actuary who is independent to insurer or the related parties of the insurer and approved by the Authority with the qualifications of an actuary as set out in section 2(1) of the Act;

“best estimate” means a value that reflects anticipated experience with no provision for risk of adverse deviation;

“hedge” means actions taken to offset the impact of risks materialising;

“risk margin” means an amount included in a prudent estimate assumption that is intended to provide for estimation error and adverse deviation related to a corresponding anticipated experience assumption.

3. (1) An insurer shall submit an actuarial valuation report of its life insurance business at least once in every three months and at the end of the financial year.

Key requirements.

(2) An appointed actuary shall be responsible for preparing the annual valuation of technical provisions.

(3) The head of actuarial function shall be responsible for preparing the valuation of technical provisions once in every three months.

(4) The insurer's technical provisions for life insurance business shall be composed of—

- (a) best estimate liability; and
- (b) the risk margin.

(5) The risk margins shall be prescribed by the Authority and the insurer shall modify the best estimate assumptions by the prescribed margins:

Provided that an assumption shall be increased or decreased, respectively, if such increase or decrease results to an increase in the liability of the class of policies concerned.

(6) Where the insurer's technical provisions are hedged or replicated by a financial instrument, the technical provisions shall be hedged or replicated by a financial instrument with a reliable market value where the value of the technical provisions shall be equal to the market value of the hedging or financial instrument:

Provided that a separate computation of the best estimate and risk margin on the value of the hedging or financial instrument shall not be required in determining the technical provisions.

(7) The actuary may adopt any other valuation method for the valuation of technical provisions:

Provided it shall not result in a value lower than the value obtained using the best estimate assumptions and prescribed risk margin.

(8) The method used by the actuary in calculating technical provisions and the assumptions of the valuation shall not vary from one year to the next without the prior approval of the Authority.

(9) Where an insurer intends to adopt another valuation method other than the best estimate method for the valuation of technical provisions, the insurer shall seek the prior approval of the Authority and give—

- (a) the reasons for adopting the different valuation method; and
- (b) the details of the alternative assumptions and methodologies that the insurer shall rely on in determining the value of the technical provisions, including comparative results.

4. (1) Where an insurer is determining the value of the insurer's technical provisions, the insurer shall use a market consistent approach to the valuation which shall require that—

- (a) all assets shall be valued at the amount for which they could be exchanged between knowledgeable and willing parties in an arms' length transaction; and

Valuation
methodology.

- (b) all liabilities shall be valued at the amount for which they could be transferred or settled between knowledgeable and willing parties in an arms' length transaction.

(2) When an insurer values the insurer's technical provisions, no subsequent adjustment shall take account of the insurer's credit standing.

(3) An insurer shall use a mark-to-market approach in order to measure the economic value of assets and liabilities based on readily available prices in orderly transactions that are sourced independently.

(4) Where marking to market is not possible, mark-to-model techniques shall be used.

(5) In this paragraph—

- (a) "mark to market" means the practice of revaluing an instrument to reflect the current value of the relevant market variables; and
- (b) "mark-to-model" means any valuation technique which has to be benchmarked, extrapolated or otherwise calculated as far as possible from market input and where the insurer shall maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

5. (1) The technical provisions shall correspond to the current amount an insurer may pay if the insurer was to transfer the insurer's insurance obligations immediately to another insurer.

Technical provisions.

(2) The technical provisions shall be the sum of the Best Estimate Liability and the Risk Margin.

(3) The insurer shall segment the insurance obligations into homogenous risk groups and at least by the line of business when calculating technical provisions.

(4) An insurer shall use actuarial and statistical methods in calculating the technical provisions that shall be proportionate to the nature, scale and complexity of the risk supported by the insurer.

6. (1) An insurer shall ensure that the best estimate liability corresponds to the probability weighted average of future cash flows taking account the time value of money.

Best estimate liability.

(2) An insurer shall calculate best estimate liability using a prospective cash-flow gross premium valuation method.

(3) For the purpose of this paragraph "gross premium valuation method" means the method for placing a value on a life insurance company's liabilities that explicitly values the future office premiums payable, future expenses and also future discretionary benefits.

(4) An insurer shall calculate best estimate liability gross without deduction of the amounts recoverable from reinsurance contracts or other special purpose vehicles.

(5) The amounts recoverable from reinsurance contracts or other special purpose vehicles shall be calculated separately and disclosed as assets.

(6) An insurer shall use non-economic assumptions to compute the best estimate liability with no prudential margins and shall allow for all expected decrements and policyholder actions including lapses.

(7) An insurer shall take into account all relevant available internal and external data when arriving at the assumptions referred to in subparagraph (5).

(8) An insurer shall take into account future premiums up to the contract boundary which shall be the point at which an insurer can unilaterally terminate an insurance contract, refuse to accept a premium, vary the premium or the benefits in such a way that the premium fully reflect the risks insured.

(9) An insurer shall allow for future expenses needs to take account for overheads, directly attributable expenses and future expense inflation.

(10) The projection time horizon used in the calculation of the best estimate liability by an insurer shall cover the full time of all the cash inflows and cash outflows required to settle the obligations related to existing insurance and reinsurance contracts on the date of the valuation.

(11) In determining the best estimate liability the insurer shall consider the following cash inflows—

- (a) future premiums; and
- (b) future fund management charges or fees income.

(12) The cash inflows referred to in subparagraph (10) shall not take into account investment returns including interest and dividends.

(13) The cash outflows referred to in subparagraph (10) shall be divided between benefits to the policyholders or beneficiaries, expenses that will be incurred in servicing insurance obligations and other cash-flow items including taxation payments which are charged to policyholders.

(14) In determining the best estimate liability an insurer shall consider the following policyholder benefit cash outflows—

- (a) death benefits;
- (b) critical illness and disability benefits;
- (c) surrender benefits;
- (d) partial and full maturity benefits;
- (e) annuity payments; and
- (f) profit share commission payments.

(15) In determining the best estimate liability the insurer shall consider the following expense cash outflows—

- (a) administrative expenses;
- (b) investment management expenses;

- (c) claims management or handling expenses;
- (d) direct and override commissions which are expected to be incurred in the future;
- (e) overheads expenses;
- (f) premium levy and policyholder compensation levy; and
- (g) overhead expenses which shall include those related to general management and service functions which are not directly involved in new business or policy maintenance.

(16) In circumstances where the best estimate liability of technical provisions is negative for some individual contracts the insurer shall set to zero the value of the best estimate with respect to those individual contracts.

(17) The cash-flow projection by an insurer shall be based on a policy-by-policy approach but reasonable actuarial methods and approximations may be used.

7. An insurer shall value the insurer's group life business using methods prescribed for the valuation of technical liabilities for general business.

Group life business.

8. (1) The unit-linked liability shall be denominated partly in units and non-unit terms.

Unit-linked contracts.

(2) The liability relating to the unit shall be the number of units allocated to the policy multiplied by the prevailing unit price as at the valuation date

(3) The liability relating to the non-unit shall be the amount required to ensure that the insurer is able to purchase units in accordance with its contractual obligations, pay claims in excess of the unit liability and meet the insurer's continuing expenses without recourse to further finance.

(4) For the purpose of these guidelines, an insurance contract shall be deemed to be unit-linked if the value of the policy is linked directly to the market value of the underlying assets in a ring-fenced unit fund and policyholder pay-outs are not at the discretion of the insurer.

9. (1) The guaranteed funds in life insurance companies established to manage retirement savings or investment business shall be classified as discretionary participation business but index-linked or unit-linked business shall not be classified as discretionary participation business.

Discretionary participation or with-profit contracts.

(2) An insurer shall take into account future discretionary benefits which are expected to be made, whether or not the payments are contractually guaranteed in calculating the best estimate of the discretionary participation business.

(3) Discretionary benefits shall include—

- (a) historic non-vesting claims bonuses as at the valuation date;

- (b) other non-vesting bonuses; and
- (c) future vesting and non-vesting bonuses assumed to be declared in the calculation of the technical provisions including—
 - (i) future benefits assumed to be payable in terms of policyholder reasonable benefit expectations; or
 - (ii) considerations relating to the fair treatment of policyholders.

(4) The distribution of future discretionary benefits shall be a management action and assumptions about the distribution shall be objective, realistic and verifiable, and shall, in particular, take the relevant and material characteristics of the mechanism for their distribution into account.

(5) The insurer shall value the distribution of future discretionary benefits using—

- (a) a retrospective or asset share type valuation method; and
- (b) the valuation of future policy related liabilities including—
 - (i) the cost of financial options and guarantees;
 - (ii) the cost of smoothing;
 - (iii) planned future benefit enhancements; and
 - (iv) non-contractual commitments arising out of treating customer fairly obligations;
- (c) for the purpose of this paragraph “asset share valuation method” means the accumulation of past premiums, less expenses and the cost of cover at the actual rate of return on the assets.

(6) The assumptions on the future returns of discretionary participation business should be consistent with the relevant risk-free interest term structure including where a risk-neutral approach for the valuation is used.

(7) For the purpose of this paragraph “risk-neutral valuation approach” means the valuation method where the current value of financial assets is equal to their expected payoffs in the future discounted at the risk-free rate.

10. (1) An insurer shall be required to identify all contractual options and financial guarantees embedded in the insurer’s contracts.

(2) An insurer shall be required to take account of the value of financial guarantees and any contractual options included in the insurer’s contracts when the insurer calculates the insurer’s best estimate liability.

(3) The best estimate of contractual options and financial guarantees shall—

Options and guarantees embedded in contracts.

- (a) capture the uncertainty of cash-flows; and
- (b) take into account the likelihood and severity of outcomes from multiple scenarios combining the relevant risk drivers.

(4) An insurer shall value the best estimate of contractual options and financial guarantees by using one or more of the following methods—

- (a) a stochastic approach using a market-consistent asset model including both closed form and stochastic simulation approaches;
- (b) deterministic projections with attributed probabilities; or
- (c) a deterministic valuation based on expected cash-flows in cases where the valuation method delivers a market-consistent valuation of the best estimate liability.

11. (1) An insurer shall apply the Government bond yield curve as the default for the risk-free term structure of interest rates.

Economic assumptions.

(2) The risk-free term structure shall be used to discount the insurer's technical provisions.

(3) The insurer shall base the valuation discount rate term structure on the unadjusted term-dependent gross redemption yields published by the Nairobi Securities Exchange.

(4) In cases where the liability duration is longer than the term structure provided by the Nairobi Securities Exchange yield curve, the insurer shall assume that the yield curve shall remain flat from the latest term in the yield curve up to the point all liabilities expire.

(5) The insurer's investment expenses shall be allowed in the cash flows underlying the calculations of the insurer's technical provisions and not in the risk-free term structure of interest rates used to discount the technical provisions.

12. (1) The insurer's technical provisions shall consist of the best estimate liability and the risk margin.

Risk margin.

(2) The purpose of the risk margin shall be to increase the insurer's technical provisions to the amount that would be paid by another insurer in order for that other insurer to take on the best estimate liability.

(3) The risk margin shall be used to increase the insurer's technical provisions to the amount that reflects the risk that the actual experience deviates from the best estimate assumptions.

(4) The Authority shall determine what risk margins shall be loaded onto the insurer's best estimate assumptions.

(5) The risk margins shall be as outlined in Appendix 2.

13. (1) Once in each year, an insurer shall submit to the Authority an actuarial valuation report signed by the appointed actuary of the company.

Reporting on technical provisions.

(2) The insurer's actuarial valuation report shall be prepared in accordance with the provisions of the Act.

- (3) The actuarial valuation report shall contain—
- (a) a statement that the valuation method is in compliance with these guidelines;
 - (b) an actuarial opinion on the valuation;
 - (c) a detailed description of the actuarial valuation; and
 - (d) an explanation of special terms and concepts in the report.
- (4) The description of the annual actuarial valuation shall contain the following—
- (a) completeness and accuracy of the data of different insurance lines or categories and a description of the problems these data may have had;
 - (b) major assumptions of the actuarial valuation and reasons for adopting those assumptions;
 - (c) the variation between the actual result of the previous valuation and the actual experience;
 - (d) adequacy of reserving; and
 - (e) provision for expected allocations of profit to shareholders and the bonus rates declared for policyholders under section 46 of the Act.
- (5) The insurer's quarterly valuation report shall contain the following—
- (a) a statement that the applied method complies with these guidelines;
 - (b) the reserve value per line of business; and
 - (c) any other information that may influence the value of the reserves.

14. (1) Where the Authority determines that an insurer has not met the requirements of these guidelines, the Authority may impose any or all the remedial measures to correct the situation in accordance with the provisions of the Act.

Remedial measures.

(2) An insurer shall, within thirty days, inform the Authority if the insurer has breached or is likely to breach the prescribed capital requirements.

(3) A notice by an insurer of the breach or potential breach of these guidelines shall state the remedial action taken or planned to be taken and the period when action shall be taken.

(4) The level of supervisory intervention by the Authority to address a breach or potential breach of these guidelines shall be determined by the extent of the breach or potential breach.

15. Where the Authority determines that an insurer has not met the requirements of a directive, the Authority may impose any or all of its administrative sanctions to correct the situation in accordance with the provisions of the Act including—

Administrative sanctions.

- (a) prohibit the insurer from declaring or paying dividends;
- (b) suspend, dismiss, disqualify or revoke the appointment of an individual in a position as a board member, member of the senior management or key person in a control function;
- (c) impose additional reporting requirements on the insurer;
- (d) declare that a person may not take the office of appointed actuary or the head of the actuarial function;
- (e) withdraw or impose conditions on the business license of the insurer; and
- (f) take any other action as may be necessary.

APPENDIX 1

Guidance note on best estimate assumptions

This guidance note provides an outline on how the best estimate assumptions can be determined for the purpose of computing the best estimate liability.

A. Mortality, longevity and morbidity/disability rates

- (1) The KE 07/10 base mortality rates will be used, with an appropriate adjustment, to reflect the company's own experience.
- (2) Where no reliable assumptions are available, the assumptions used can be based on the insurer's own experience, industry study or other relevant studies.

B. Withdrawals

- (1) The lapse rate should reflect the expected experience of both existing and potential policyholders and the actuary should perform a lapse investigation using the insurer's past data.
- (2) If a sufficient volume of relevant experience is not available, then experience from similar contracts or industry wide data may be used.

C. Expenses and commissions

- (1) The actuary should make an allowance for expenses to include acquisition costs, underwriting and administration costs, investment costs, claim settlement costs and any future expenses.

D. Investment return

- (1) The actuary should take into account the following regarding the future investment return assumption—
- (2) the extent of any investment guarantees included—
 - (a) nature of contract, e.g. non-profit, with-profit; and
 - (b) level of investment guarantee.
- (3) the size of the reserve built up under the contract—

- (a) type of contract, e.g. term assurance, endowment assurance; and
 - (b) frequency of premium payment, e.g. single premium, regular premium.
- (4) The assumed rate of future investment return will depend on the mix of the assets held to match the liabilities.
- (5) Allowance should be made for any changes in the future economic environment.

E. Other assumptions

- (1) If a sufficient volume of relevant experience is not available, then experience from similar contracts or industry wide data may be used.

APPENDIX 2

Risk margins schedule

<i>Assumption</i>	<i>Prescribed margin as a percentage of the base assumption</i>
Mortality	10% increase in mortality for death assurances
Longevity	10% decrease in mortality for life assurances and annuities
Morbidity/disability	10% increase in inception rates 5% decrease in recovery rates
Lapses	25% increase or decrease in lapse rate depending on which alternative gives rise to an increase in the liability of the policy concerned
Interest rates	20% decrease
Surrenders	10% increase or decrease in surrender rates depending on which alternative gives rise to an increase in the liability of the policy concerned
Expenses	10% increase
Expense inflation	10% increase of the estimated escalation rate

Dated the 9th February, 2017.

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