



RESERVE BANK OF MALAWI

DIRECTIVE

NO. RI05-08/MC&SRR

MINIMUM CAPITAL AND SOLVENCY REQUIREMENTS FOR REINSURERS

Arrangement of Sections

PART I

Preliminary

SECTION

1. Short Title
2. Authorization
3. Application
4. Interpretations

PART II

Statement of Policy

SECTION

1. Objectives
2. Rationale

PART III

Capital and Solvency Requirements

SECTION

1. Minimum Capital and Solvency Requirements
2. Inadmissibility and Discounting of Assets and Other Capital Instruments
3. Unrealised Gains in the Value of Fixed Assets and Financial Instruments
4. Treatment of investments in equities
5. Inspection and Verification of Accuracy

PART IV

Remedial Measures and Administrative Sanctions

SECTION

1. Remedial Measures
2. Administrative Sanctions

PART V

Effective Date

SECTION

1. Effective Date
2. Transitional Arrangements

DIRECTIVE NO. RI05-08/MC&SRR

MINIMUM CAPITAL AND SOLVENCY REQUIREMENTS FOR REINSURANCE BUSINESS

PART I: PRELIMINARY

Sec. 1: Short Title - Capital Adequacy and Solvency Requirements.

Sec. 2: Authorization – being applied by the Registrar of Insurance under delegated authority in terms of the order published in the Malawi Government Gazette Notice No. 23 of 22 February 1991 which transferred all the regulatory and supervisory responsibilities of the Minister of Finance as provided for under Section 82 of the Insurance Act of 1957 to the Governor of the Reserve Bank of Malawi.

Sec. 3: Application - All registered institutions transacting reinsurance business in Malawi.

Sec. 4: Interpretation - In this directive, unless the context otherwise requires-

- 1) **“adjusted net assets”** means net assets as presented in Form G1 (Balance Sheet) less inadmissible assets, discounted assets, adjustments for weighted policyholders reserves and discounted capital items;
- 2) **"capital adequacy"** means the maintaining of sufficient core capital as is specified in the requirements of this directive;
- 3) **"core capital"** consists of paid-up ordinary shares and the following disclosed reserves; retained profits from prior years, share premiums, and 80% of after-tax profits in the current year-to-date¹ (100% in the event of loss); less investments in other companies², and does not include revaluation reserves;
- 4) **"directives on prudential guidelines"** means the directives issued by the Registrar with regard to reserving requirements and treatment of non-performing assets, and income recognition of such non-performing assets;
- 5) **“discounted assets”** means admissible assets that are risk weighted for purposes of solvency calculations;
- 6) **"reinsurance business"** means the business of undertaking liability to pay money to insurers or reinsurers in respect of contractual liabilities or insurance business incurred by insurers or reinsurers and includes a retrocession;
- 7) **"impaired capital"** means a solvency deficiency to the extent of endangering policyholders and/or other creditors;
- 8) **“inadmissible assets”** means assets that are not allowable by the Registrar for purposes of calculating solvency;

¹ This only applies when reporting under the quarterly return. Audited year end results should include up to 100 percent of after-tax profit.

² Unless the investment is less than 25 percent of paid up capital of the company in which it is made. Only the initial investment outlay is deductible.

- 9) **"reinsurer"** means a person whose predominant business is to carry on reinsurance or retrocession business and includes both a local reinsurer and an external reinsurer;
- 10) **"minimum capital requirement (MCR)"** means required level of capital, for regulatory purposes, that each reinsurer must maintain to enable them sufficiently meet reinsurance obligations under a wide range of circumstances;
- 11) **"registrar"** means the Registrar of Insurance;
- 12) **"related parties"** means a person who –
 - a. has a significant interest, directly or indirectly, in a class of shares of the reinsurer;
 - b. is a director or officer of the entity that controls the reinsurer;
 - c. is a spouse or a family member of the person in (a) or (b) above;
 - d. is an entity in which a director or officer of the reinsurer or person that controls the reinsurer has a significant interest; or
 - e. is an entity in which a spouse or a family member of a person described in (d) has a significant interest;
- 13) **"revaluation reserve"** means the increase in book value of a fixed asset or other tangible asset based on a professional appraisal as to the market value of such asset;
- 14) **"significant interest"** in relation to "related parties" means a person who, in his personal capacity or through entities controlled by him, owns more than 10 percent of all the outstanding shares of that class;
- 15) **"solvency deficiency"** is defined as a failure to meet the solvency requirements of this directive;
- 16) **"solvency margin"** means the minimum amount of adjusted net assets that must be held by a reinsurer;
- 17) **"supplementary capital"** consists of other capital instruments where such capital instruments have received prior approval of the Registrar. Such capital items may include capital instruments that combine certain characteristics of equity and debt. These are only admitted if they have close similarity to equity whereby they are able to support losses on an on going basis without triggering liquidation, i.e. they should be unsecured, subordinated and fully paid up. Perpetual subordinated debt and preference shares may fall in this category.

PART II: STATEMENT OF POLICY

Sec. 1: Objectives

- 1) To protect the interests of policyholders, creditors, and the public in general;
- 2) To help ensure that reinsurers have an adequate cushion of net assets to absorb losses beyond the coverage of their technical reserves;
- 3) To help reinsurers grow their capital base so as to enable the industry develop the required capacity to underwrite large risks arising within

Malawi thereby assist in conserving valuable national foreign currency reserves;

- 4) To ensure reinsurers maintain internationally recognised capital and solvency standards;
- 5) To promote self-discipline in the management of reinsurance companies and emphasize the fact that it is the responsibility of a reinsurer's Board and senior management to ensure that reinsurer's capital resources are appropriate to size, business mix and complexity of its business;

Sec. 2: Rationale

- 1) Sufficient margin of solvency enables reinsurers to have the needed cushion to absorb adverse events either within their control or due to external factors to prevent insolvency or an unsound position.
- 2) Reinsurers need to maintain a specified level of net assets to enhance insurers' and other stakeholders' confidence in the insurance industry;

PART III: CAPITAL AND SOLVENCY REQUIREMENTS

Sec. 1: Minimum Capital and Solvency Requirements

- 1) The minimum paid up capital for a reinsurer is K100.0 million³.
- 2) A registered institution shall be deemed as having a sufficient margin of solvency if;
 - a) It has a solvency ratio of no less than twenty percent (20%) being the percentage that adjusted net assets of the reinsurer bears to the net premium written (NPW)⁴ for the corresponding period; and
 - b) The value of the core capital of the reinsurer is not less than K100.0 million.
- 3) The solvency margin must be represented by the following adjusted net assets:
 - a. Net assets (total assets –total liabilities) as per Form R1 (Balance Sheet).
 - b. Less: inadmissible assets
 - c. Less: adjustment for discounted assets
 - d. Less: weighted policyholders reserves
 - e. Less: adjustment on capital items
- 4) If the adjusted net assets of the reinsurer as calculated in 3 above is less than twenty percent (20%) of NPW or if its core capital is less than

³ This amount is subject to review by the Registrar as and when necessary.

⁴ The solvency ratio deliberately employs NPW as a base to encourage insurers to have adequate reinsurance arrangements in place. The formula will be reviewed after 36 months when only 50% of premiums ceded out will be taken into account.

K100.0 million, then the reinsurer has insufficient capital to meet the solvency margin requirement and is therefore deemed insolvent unless capital is immediately injected into the company.

Sec. 2: Inadmissibility and Discounting of Assets and Other Capital Instruments

1) The following assets shall not be included in the solvency margin, and are therefore inadmissible for the purposes of calculating the reinsurance company's solvency margin:

- a. Intangible assets;
- b. Loans to, or any amounts due from related companies or related parties;
- c. Investments in other companies;
- d. Loans to insurance brokers and insurance agents;
- e. Loans overdue more than 180 days, including:
- f. Earned premiums overdue by more than 180 days,
- g. Inward reinsurance overdue by more than 180 days, and
- h. Reinsurance recoveries overdue by more than 180 days;
- i. Amounts secured or pledged on any asset or assets;
- j. Merchandise inventory; and
- k. Prepaid expenses.

2) The following admissible assets are to be discounted as follows:

a. Cash , and bank balances	0%
b. Government securities	0%
c. Term deposits	0%
d. Corporate bonds	5%
e. Real estate mortgages	5%
f. Shares in listed companies	10%
g. Commercial loans	15%
h. Direct real estate investments, owner occupied	15%
i. Direct real estate investments rented to third parties	20%
j. Shares in companies not listed on the stock market	20%
k. Receivables outstanding >90 days but <180 days	20%
l. Non-current assets ⁵	20%
m. Other loans to third parties	20%

3) The following policyholder reserves are to be weighted as follows:

a. Unearned premiums	5%
b. Outstanding claims	10%
c. IBNR	15%

4) The following capital items will be discounted as follows:

a. Current year after tax profits ⁶	20%
b. Supplementary capital items ⁷	50%

⁵ Includes both moveable and immovable non current assets but excludes intangibles.

⁶ The current year after tax profit under the audited annual return should be discounted by a zero factor.

⁷ Inclusion of the discounted supplementary capital amount is restricted to 100% of core capital.

Sec. 3 Unrealised Gains in the Value of Fixed Assets and Financial Instruments

- 1) Unrealised gains on the value of fixed assets shall be reported to the revaluation reserve account;
- 2) Unrealised gains in the value of financial assets (shares, bonds, etc) shall be deferred to the revaluation reserve account which is non distributable and not reported to the retained earnings account;
- 3) All registered institutions shall make sure that any anomaly in the reporting of unrealised gains in the value of such financial assets is immediately corrected as provided in 2 above.

Sec. 4: Treatment of Investment in Equities

- 1) Where investment in shares of other companies constitutes 25 percent or less of the paid up capital of the company in which the investment is made, the investment shall be discounted based on whether the shares are traded on the stock market or not (report under item 6 or 7 of table 2.2);
- 2) Where investment in shares of other companies constitutes more than 25 percent of the paid up capital of the company in which the investment is made, the investment shall not be admitted for solvency calculations, whether the shares are traded on the stock market or not (report under item 2 of table 2.1).
- 3) Where investment in shares of other companies constitutes more than 25 percent of the paid up capital of the company in which the investment is made, the initial investment and any other outlays by the insurer shall be deducted from the core capital of the insurer (report under item 6 of table 1).

Sec. 5: Inspection and Verification of Accuracy

- 1) All assets must be held by the reinsurer at all times. They cannot be transferred out to any other person or group, including a related party or head office.
- 2) The Registrar may use its powers under Section 66 of the Insurance Act to inspect and verify the accuracy of Form R4 (i.e. Report on Capital Adequacy and Solvency) and direct a reinsurer to adjust or correct this form based on the findings of such inspection.
- 3) Each reinsurer shall require its auditor, as appointed under Section 19 of the Insurance Act, to verify the accuracy of Form R4 computations as of the financial year-end date and to so alert the Registrar of any errors or

adjustments to this form as of any other quarter end period during the financial year under review.

- 4) In determining the computation for capital adequacy and solvency requirements, the Registrar shall assess if the reinsurer is in compliance with its directives on prudential guidelines and reserving requirements, and as such, it shall determine if the reinsurer has made adequate provisions for all technical reserves and bad debts and followed proper guidelines with regard to income recognition, specifically accrual of premium income and reserving methodologies. The Registrar may call for adjustments to capital and solvency calculations with respect to increased provisions and/or premium income accrual if a reinsurer is found not to be in compliance with the two directives.

PART IV: REMEDIAL MEASURES AND ADMINISTRATIVE SANCTIONS

Sec. 1: Administrative Sanctions

- 1) When the Registrar determines that a reinsurer has not met the capital adequacy and solvency requirements of this directive and thus has a solvency deficiency, the Registrar may impose any or all of the following administrative sanctions in a bid to correct the situation:
 - a. Prohibition from declaring and/or paying dividends;
 - b. Suspension of the establishment of new branches and/or expansion into new insurance or financial activities;
 - c. Suspension of certain classes of insurance business;
 - d. Suspension of the acceptance of new risks;
 - e. Suspension of acquisition of fixed assets;
 - f. Suspension from declaring and/or paying salary incentives, severance package, management fees, or other discretionary compensation schemes to directors or managing officers.

Sec. 2: Remedial Measures

1. When the Registrar determines that a reinsurer's solvency deficiency is severe enough to have resulted in impaired capital, shareholders shall be called upon to inject additional capital within a reasonable time frame (period not exceeding 12 months).
2. When the Registrar determines that the shareholders are not in a position to address the situation within the prescribed period, the Registrar may not register a reinsurer in accordance with section 12(1)(b) or may cancel a reinsurer's licence in accordance with section 60(F) of the Insurance Act 1957.

PART V: EFFECTIVE DATE

Sec. 1: Effective Date

The effective date of this Directive is immediate for new applicants and 1st January 2008 for existing reinsurers. This is to allow existing reinsurers to adapt their Management Information Systems to the requirements of the new directive.

Sec. 2: Transitional Arrangements

1. All existing reinsurers are expected to be in compliance with the 20% solvency ratio requirement immediately.
2. All applicants for a licence to conduct business as a reinsurer must comply with the minimum paid up capital requirement of K100.0 million.
3. All existing registered reinsurers who are currently not compliant with the minimum core capital requirement of K100.0 million shall be required to regularise their status within twenty four (24) months from the effective date of this Directive.

Questions relating to this directive should be addressed to the Department of Supervision of Non Bank Financial Institutions of the Reserve Bank.

Victor Mbewe
REGISTRAR OF INSURANCE

12 September 2008

**CAPITAL ADEQUACY AND SOLVENCY REPORT
REINSURANCE BUSINESS**

FOR THE QUARTER/YEAR ENDED:

NAME OF REINSURER:

TABLE 1 MINIMUM CAPITAL REQUIREMENT TEST

Item	Amount (MK'000)
1. Minimum Core Capital Requirement	100,000
2. Paid up Capital	
3. Share Premium	
4. Retained Earnings (prior years)	
5. 80% Current year after tax profit (100% for audited yr end profit)	
6. Less: Investment in other companies	
7. Total Core Capital (add items 2 to 5 minus item 6)	
MINIMUM CAPITAL TEST =7-1	

TABLE 2 SOLVENCY MARGIN TEST

Item	Amount (MK'000)
1. Net Premium Written (NPW)	
2. Solvency Required: at least 20% of item 1	
Represented by:	
3. Net assets (i.e. Total capital) as per form R1	
4. Less: inadmissible assets as per Table 2.1 below	
5. Less: discounted assets as per Table 2.2 below	
6. Less: weighted policyholders reserves as per Table 2.3 below	
7. Less: discounted capital items as per Table 2.4 below	
8. Net assets available to meet solvency (items 3-4-5-6-7)	
SOLVENCY RATIO (Item 8 divided by item 1) x 100	
SOLVENCY MARGIN TEST (Item 9 less item 2)	

TABLE 2.1: INADMISSIBLE ASSETS:

Item	Amount (MK'000)
1. Intangible assets	
2. Investments in other companies	
3. Portion of any asset pledged	
4. Loans to related corporations	
5. Loans to insurance brokers and insurance agents	
6. Earned premiums overdue >180 days	
7. Inwards reinsurance overdue >180 days	
8. Reinsurance recoveries overdue >180 days	
9. Other loans to third parties overdue >180 days	
10. Merchandise inventory	
11. Prepaid expenses	
12. TOTAL – transfer to item 4 in Table 2	

TABLE 2.2: DISCOUNTED ADMISSIBLE ASSETS:

Item	Total Amount (M'000)	Discount Rate (%)	Inadmissible Amount (MK'000')
1. Corporate bonds		5%	
2. Real estate mortgages		5%	
3. Direct real estate investments, owner occupied		15%	
4. Direct real estate investments, rented to third parties		20%	
5. Commercial loans		15%	
6. Shares in listed companies		10%	
7. Shares not listed on stock exchange market		20%	
8. Receivables outstanding >90 days but <180 days		20%	
9. Non current assets		20%	
10. Other loans to third parties		20%	
11. TOTAL – transfer to item 5 in Table 2			

TABLE 2.3: WEIGHTED POLICYHOLDERS RESERVES

Item	Total Amount (M'000)	Discount Rate (%)	Inadmissible Amount (MK'000')
1. Unearned premium reserves		5%	
2. Outstanding claims		10%	
3. IBNR		15%	
4. TOTAL – transfer to item 6 in Table 2			

TABLE 2.4: DISCOUNTED CAPITAL ITEMS

Item	Total Amount (M'000)	Discount Rate (%)	Inadmissible Amount (MK'000')
1. Current year after tax profit		20%	
2. Supplementary capital items		50%	
2. TOTAL – transfer to item 7 in Table 2			

Date:

Chairman

Principal Officer

Finance Manager/External Auditor