



RESERVE BANK OF MALAWI

# **DIRECTIVE**

**NO. RI04-08/MC&SRL**

## **MINIMUM CAPITAL AND SOLVENCY REQUIREMENTS FOR LIFE INSURERS**

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# MINIMUM CAPITAL AND SOLVENCY REQUIREMENTS FOR LIFE INSURERS

## 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 life insurance 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 L1 (Balance Sheet) less inadmissible assets, adjustments for discounted assets, supplementary capital items, adjustment for mortality risk and adjustment for additional reserving requirement;
- 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 cumulative after-tax profits in the current year-to-date<sup>1</sup> (100% in the event of loss); less investments in other companies<sup>2</sup>, 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 weighted for purposes of solvency calculations;
- 6) “**life insurance business**” means the business of assuming obligations as an insurer under life policies, funeral policies, industrial policies, or sinking fund policies;
- 7) “**life insurance fund**” means the fund to which the receipts of an insurer in respect of his life insurance business are carried;
- 8) “**impaired capital**” means a solvency deficiency to the extent of endangering policyholders and/or other creditors;

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

<sup>2</sup> 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) “**inadmissible assets**” means assets that are not allowable by the Registrar for purposes of calculating solvency;
- 10) “**insurer**” means all registered insurance companies authorised to conduct life insurance business;
- 11) “**minimum capital requirement (MCR)**” means required level of capital, for regulatory purposes, that each life insurer must maintain to enable them sufficiently meet insurance obligations under a wide range of circumstances;
- 12) “**registrar**” means the Registrar of Insurance;
- 13) “**related parties**” means a person who –
  - a. has a significant interest, directly or indirectly, in a class of shares of the life insurer;
  - b. is a director or officer of the entity that controls the life insurer;
  - 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 life insurer or person that controls the life insurer has a significant investment;  
or
  - e. is an entity in which a spouse or a family member of a person described in (d) has a significant investment
- 14) “**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;
- 15) “**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;
- 16) “**solvency deficiency**” is defined as a failure to meet the solvency requirements of this directive;
- 17) “**solvency margin**” means the minimum amount of adjusted net assets that must be held by a life insurer;
- 18) “**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 life insurers have an adequate cushion of net assets to absorb losses beyond the coverage of their technical reserves;
- 3) To help life insurers grow their capital base in relation to the size, complexity and risks of their business;
- 4) To ensure life insurers maintain internationally recognised capital and solvency standards;
- 5) To promote self-discipline in the management of insurance companies and emphasize the fact that it is the responsibility of a life insurer's Board and senior management to ensure that life insurer's capital resources are appropriate to size, business mix and complexity of its business;

### **Sec. 2: Rationale**

- 1) Sufficient margin of solvency enables life insurers 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) Life insurers need to maintain a specified level of net assets to promote public confidence and to protect policyholders interest;

## **PART III: CAPITAL AND SOLVENCY REQUIREMENTS**

### **Sec. 1: Minimum Capital and Solvency Requirements**

- 1) The minimum paid up capital for a life insurer is K75.0 million<sup>3</sup>
- 2) The minimum core capital requirement for an existing registered life insurer is K75.0 million.
- 3) A registered institution shall be deemed as having a sufficient margin of solvency if the value of the adjusted net assets of the life insurer is not less K75.0 million.

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<sup>3</sup> The minimum paid up capital is subject to review by the Registrar as and when necessary.

- 4) The solvency margin must be represented by the following adjusted net assets:
  - a. Net assets (total assets –total liabilities) as per Form L1 (Balance Sheet).
  - b. Less: inadmissible assets
  - c. Less: adjustment for discounted assets
  - d. Less: adjustment on capital items
  - e. Less: adjustment for mortality risk<sup>4</sup>
  - f. Less: additional reserving requirement;<sup>5</sup>
  
- 5) If the core capital of a life insurer or the adjusted net assets of the insurer as calculated in sub section 4 above is less than K75.0 million, then the life insurer has insufficient net assets 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 insurance 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<sup>6</sup>;
  - d. Loans to insurance brokers and insurance agents;
  - e. Loans overdue more than 180 days;
  - f. Insurance premiums overdue by more than 180 days;
  - g. Inward reinsurance overdue by more than 180 days;
  - h. Reinsurance recoveries overdue by more than 180 days;
  - i. Amounts secured or pledged on any asset or assets;
  - j. Merchandise inventory;
  - 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	3%

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<sup>4</sup> A mortality risk adjustment, consisting of 0.5% of the net sum at risk, where the “net sum at risk” equates to the total of potential death benefits minus the total of reserves. Negative reserves, if any, are counted as zero.

<sup>5</sup> Comprising 3% of policyholders’ reserves.

<sup>6</sup> Unless such investment is less than 25 percent of paid up capital of the company in which the investment is made.

e. Real estate mortgages	3%
f. Loans on insurer's policies	3%
g. Direct real estate investments, owner occupied	10%
h. Shares in listed companies	10%
i. Commercial Loans	10%
j. Direct real estate investments rented to third parties	15%
k. Shares in companies not listed on the stock market	15%
l. Receivables outstanding >90 days but <180 days	20%
m. Non current assets <sup>7</sup>	20%
n. Other Loans to third parties	20%

- 3) The following capital items will be discounted as follows:
  - a. Current year after tax profit<sup>8</sup> 20%
  - b. Supplementary capital items<sup>9</sup> 50%

**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) and investment property 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 subsection 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).

<sup>7</sup> Includes both moveable and immovable non current assets but excludes intangibles.

<sup>8</sup> The current year after tax profit under the audited annual return should be discounted by a zero factor.

<sup>9</sup> Restricted to 100% of total core capital

- 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).

**Sec5: Inspection and Verification of Accuracy**

- 4) All assets must be held by the life insurer at all times. They cannot be transferred out to any other person or group, including a related party or head office.
- 5) The Registrar may use its powers under Section 66 of the Insurance Act to inspect and verify the accuracy of Form L12 (i.e. Report on Capital Adequacy and Solvency) and direct a life insurer to adjust or correct this form based on the findings of such inspection.
- 6) Each life insurer shall require its auditor, as appointed under Section 19 of the Insurance Act, to verify the accuracy of Form L12 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.
- 7) In determining the computation for capital adequacy and solvency requirements, the Registrar shall assess if the life insurer is in compliance with its directives on prudential guidelines and reserving requirements, and as such, it shall determine if the life insurer 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 life insurer 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 life insurer 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 life insurer'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 life insurer in accordance with section 12(1)(b) or may cancel a life insurer'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 1<sup>st</sup> October 2008. However existing life insurers have up to 1<sup>st</sup> January 2009 to adapt their Management Information Systems to the requirements of the new directive.

**Sec. 2: Transitional Arrangements**

1. All applicants for a licence to conduct business as a life insurer must comply with the minimum paid up capital requirement of K75.0 million.
2. All existing life insurers are expected to be in compliance with the core capital requirement of K75.0 million.
3. All existing registered life insurers who are currently not compliant with the solvency margin requirement of K75.0 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**  
**GOVERNOR**

*23 September 2008*

**REPORT ON CAPITAL ADEQUACY AND SOLVENCY  
LIFE INSURANCE BUSINESS**

**FOR THE QUARTER/YEAR ENDED:**

**NAME OF LIFE INSURER:**

**TABLE 1 MINIMUM CAPITAL REQUIREMENT TEST**

Item	Amount (MK'000)
1. Minimum Core Capital Requirement	75,000
2. Paid up Capital	
3. Share Premium	
4. Retained Earnings (prior years)	
5. 80% Current year after tax profit	
6. Less: Investment in other companies	
<b>7. Total Core Capital (add items 2 to 6)</b>	
<b>MINIMUM CAPITAL TEST =7-1</b>	

**TABLE 2 SOLVENCY MARGIN TEST**

Item	Amount (MK'000)
1. Solvency Margin Requirement	75,000
<b>Represented by:</b>	
2. Net assets (i.e. Total capital) as per form L1	
3. Less: inadmissible assets as per Table 2.1 below	
4. Less: discounted assets as per Table 2.2 below	
5. Less: discounted supplementary capital items as per Table 2.3 below	
6. Less: adjustment for mortality risk as per Table 2.4 below	
7. Less: adjustment for additional reserving requirement as per Table 2.5	
<b>8. Net assets available to meet solvency (items 2-3-4-5-6-7)</b>	
<b>SOLVENCY MARGIN Test (Item 8 less item 1)</b>	

**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 Insurance 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	
<b>TOTAL – transfer to item 3 in Table 2</b>	

**TABLE 2.2: DISCOUNTED ADMISSIBLE ASSETS:**

Item	Total Amount (M'000)	Discount Rate (%)	Inadmissible Amount (MK'000')
1 Corporate bonds		3%	
2 Real estate mortgages		3%	
3 Loans on insurer's policies		3%	
4 Direct real estate investments, owner occupied		10%	
5 Commercial loans		10%	
6 Shares in listed companies		10%	
7 Shares in non listed companies		15%	
8 Direct real estate investments rented to third Parties		15%	
9 Receivables outstanding >90 days but <180 days		20%	
10 Non-current assets		20%	
11 Other loans to third parties		20%	
<b>12 TOTAL – transfer to item 4 in Table 2</b>			

**TABLE 2.3: 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%	
<b>3 TOTAL – transfer to item 5 in Table 2</b>			

**TABLE 2.4: ADJUSTMENT FOR MORTALITY RISK**

Item	Total Amount (M'000)	Adjustment Rate (%)	Adjustment Amount (MK'000')
1 Total potential death benefits		-	-
2 Less: Total reserves		-	-
<b>3 Net sum at risk – transfer to item 6 in Table 2</b>		<b>0.5%</b>	

**TABLE 2.5: ADJUSTMENT FOR ADDITIONAL RESERVING REQUIREMENT**

Item	Total Amount (M'000)	Adjustment Rate (%)	Adjustment Amount (MK'000')
1 Life		3%	
2 Pension Fund		3%	
3 Annuities		3%	
4 Funeral		3%	
5 Other		3%	
<b>6 Total – transfer to item 7 in table 2</b>		<b>3%</b>	

Date

Chairman

Principal Officer

Finance Manager/External Auditor