नेपाल बीमा प्राधिकरण
NEPAL INSURANCE AUTHORITY

RISK BASED CAPITAL AND SOLVENCY DIRECTIVE

FREQUENTLY ASKED QUESTIONS

2082

Preface

The implementation of the Risk Based Capital framework represents a significant step toward strengthening the risk management practices, and the financial resilience of the insurance industry. In order to support insurers in understanding and effectively implementing the provisions of the Risk Based Capital and Solvency Directive, Nepal Insurance Authority (NIA) has published this Frequently Asked Questions (FAQ) document as a practical guidance note.

The objective of this FAQ is to clarify key concepts, address common interpretational issues, and provide explanatory guidance on the scope, application, and supervisory expectations under the Risk Based Capital and Solvency Directive. The document is intended to promote consistent implementation across the insurance sector, enhance transparency, and facilitate a smoother transition toward a more risk-sensitive prudential regime.

Foreword

As the insurance market evolves and becomes more complex, a robust and risk-sensitive capital framework is essential to safeguard policyholders' interests and support sustainable growth of the industry. Pursuant to this, Nepal Insurance Authority (NIA) implemented the risk based capital framework with the issue of the Risk Based Capital and Solvency Directive in 2022.

This Frequently Asked Questions (FAQ) document has been issued to address commonly raised questions and interpretational matters and foster a shared understanding across the insurance industry. We have issued this document to serve as supplementary guidance, and it should be read together with the RBC-S Directive, RBC Technical Specifications, and other relevant documents issued by the Authority. We expect that this document will assist insurers in strengthening capital adequacy assessment, risk management practices, and overall solvency positions, thereby contributing to a stable, resilient, and well-governed insurance sector.

I would like to express sincere appreciation to the Technical Assistance Team of the World Bank for their valuable support and technical guidance for development and implementation of the Nepalese risk-based capital framework tailored to the specific characteristics of the Nepalese insurance industry and aligning it with international best practices. I also acknowledge the dedicated efforts of Director Ms. Pujan Dhungel Adhikari, Deputy Director Ms. Nirmala Malla and the members of the Risk Management Department, whose contribution has been instrumental in the development of this FAQ.

Chandrakala Poudel

Chairperson

Frequently Asked Questions

1. What is the reporting frequency of RBC Submission under the Risk-Based Capital (RBC) framework?

   Insurers are required to submit RBC reports at least annually as at the end of each financial year, along with the prescribed QRRT and supporting documents, within the timeline specified by the Nepal Insurance Authority (NIA).

2. What is the deadline for RBC Submissions?

   The deadline set out for RBC Submissions is 90 days after the end of each financial year (Ashwin end). However, during the transition period the deadline for submission is extended to 120 days after the end of each financial year (Kartik end).

3. Does RBC-S Directive replace the previous solvency provisions?

   The RBC-S directive aligns with the Solvency II approach based on international best practices. The previous approach to solvency assessment was based on simple rule-based approach which used fixed factors to determine required capital. Solvency II measures the solvency position of the insurer based on insurer specific risk profile and market consistency. The solvency position shall be assessed based on the RBC-S Directive effective from 2080/81.

4. Which technical provisions shall be used for the declaration of bonuses?

   Life insurers shall use the technical reserves derived from the best estimate liability and margin over best estimates, without transitional provisions, for the declaration of bonuses.

   The Authority shall accept the policyholders' bonus calculation based on the surplus calculated using transitional provisions if recommended by the insurer's appointed actuary. However, the insurer's appointed actuary must ensure that the declared bonus using transitional benefits is sustainable.

5. Which QRRT sheets must be certified by the Appointed Actuary? While submitting the RBC return, which QRRT sheets are required to be prepared and certified by the Appointed Actuary, and which sheets may be prepared by the insurer and submitted without actuarial certification?

As mentioned in the QRRT RBC Technical specifications, both the QRRT and the RBC Valuation Note shall be certified by the Appointed Actuary. Key responsibilities of the Appointed Actuary include setting assumptions that materially affect technical provisions, determination of the technical provisions in line with the RBC-S Directive using appropriate methodology, certification of solvency position of the insurer at the valuation date, surplus allocation, comment on the bonus sustainability.

Other parts of the templates, excluding the technical provisions and reinsurance technical provisions, may be prepared by the insurer, subject to internal controls and supervisory review. However Appointed actuary must certify the overall solvency position of the insurer.

Additionally, the year-end Solvency position should be certified by the Auditor and the CEO of the insurer.

6. Some assets are valued at nil in the solvency BS. Why?

   Some assets, such as intangible assets and assets held with related parties on a non-commercial basis may not be readily marketable, may have a value other than that which can be used to fulfill policyholder obligations, or may be unavailable due to encumbrances, special privilege or other third-party interests, and therefore, are generally inadmissible or not available for solvency purposes.

7. How should investment in properties be split into "Properties Own Use" and "Investment properties"?

   Insurers have the freedom to select the segregation method provided it is based on objective and robust criteria, which shall be kept unless sufficient documented justification for its improvement.

8. Can Margin Over Best Estimate (MOBE) be considered as Future Embedded Profit?

   Under the risk-based capital framework, MOBE is intended to reflect the market valuation for uncertainty above the best estimate of insurance contracts and cannot be considered either as present or future profit. When calculating the expected future profits embedded in the insurance contracts, it lacks sense to consider that the part of premium corresponding to finance the MOBE reflects a future profit, because such part of the premium is financing insurance liability, rather than generating earnings. Moreover, IAIS ICPs do not allow for including MOBE as Available Capital Resources, either directly or indirectly.

9. Is it necessary to assess the impact of stress factors on all the assets and liabilities while calculating the risk-based capital requirement?

   Under the stress-based approach to the calculation of risk-based capital, the application of the total balance sheet approach requires that all assets and liabilities on the solvency balance sheet be revalued under the prescribed stress scenarios. However, where a particular stress has no impact on the value of a specific asset or liability, it is acceptable to use its value under the normal(unstressed) scenario as the stressed value. For example, a mortality stress would not affect the value of investments in equity.

10. Are capital charges applied on investment made in accordance with the investment guidelines prescribed by the Nepal Insurance Authority (NIA) under the RBC framework?

    It is the principle of any risk-based framework to apply adequate capital charges to all direct or indirect investments made by (re)insurers.

    Even if the investments are made in accordance with investment guidelines prescribed by NIA, capital charges are applicable as per the Risk Based Capital and Solvency Directive based on the inherent risk characteristic of the investments.

11. Should the capital charge for life insurance risk be calculated by the Appointed Actuary or can this be calculated in-house?

    It is always expected that the RBC stress is calculated by a knowledgeable party who is involved in the valuation of assets and liabilities. As the life insurance risk stresses also have impact on technical provisions (including reinsurance technical provisions), it is expected that the calculation is done by the Appointed Actuary.

12. We are encountering difficulties in obtaining credit ratings for certain investments. In the absence of rating information, we request that the NIA provide an alternative method for reporting these investments.

    One of the core objectives of the RBC Framework is the assessment of different risks and adoption of sound risk management practices by the (re)insurers themselves. As a good practice, it is expected that the (re)insurers maintain proper records of their investments, including the credit ratings of all investment holdings.

    Although NIA may provide credit ratings to the insurers in the transition years, in the future it is not in the scope for NIA to compile such information for (re)insurers.

13. We have assumed the Margin for Adverse Deviation (MAD) as Margin over best estimate (MOBE) and seek clarification on the same.

    While both MAD and MOBE are margins added over the best estimate technical provisions to address the uncertainty of the technical provisions. However, there are various explicit considerations to MOBE in the Nepalese RBC Directive which differentiates MOBE to other risk margins which are set up by mere judgments.

14. How to break down the part of premiums corresponding to earthquake coverage for each line of business to compute the earthquake reserve?

    For the time being, the insurer has freedom to select the method to estimate the information related to earthquake coverage, provided the method is based on objective and robust criteria, and it is kept unless justified document reason to improve. Insurers are requested to determine the earthquake premium and earthquake risk exposure on a sound judgement basis. We recommend that the Appointed Actuary be consulted in this determination of the portion of premium allocated as earthquake premiums.

15. As per Investment directive issued by the regulator, the assets are mostly tied to time deposits with banks, which are not interest sensitive. So, in interest rate up and down scenario there is only impact of change in liability. This is creating undue capital charge as there is no movement in assets.

    Any assets whose value in case of being transferred to an independent third party depends on the level of interest rate shall be considered as interest rate sensitive and the value in stressed up and stressed down scenario differs from their value in unstressed scenario.

16. As the assets and liabilities for non-life insurers are mostly of shorter duration, is it necessary to apply interest rate risk charge?

    For non-life insurers with short-tailed business, where claim payouts are frequent, investments are usually made for shorter duration resulting in lower sensitivity of interest rate risk to assets. It should be noted that in short-tailed portfolios, similar to the assets, the liabilities also are less sensible to interest rate risks due to lower duration. However, under a risk-based framework the mismatch in assets and liabilities cannot be neglected and it is the responsibility of the insurer to address any

mismatch by setting in place a robust investment strategy, ALM framework or even shifting the concentration of portfolios.

17. Why are fixed-income time deposits with banks are considered sensitive to interest rates risk?

Any asset or liability whose market value is impacted by the changes in interest rates, having in mind both an ongoing basis and a transfer of the assets/ liabilities, are sensitive to interest rates risk. For fixed-income term deposits with banks, in a situation where the portfolio of term deposits with banks needs to be transferred to another insurer, the pricing of the portfolio transfer will not be the maturity/redemption value, even when transferring hold-to-maturity assets. Hence, medium and long-term fixed-income assets, term deposits with banks included, are interest rate sensitive.

18. What is the level of granularity required while reporting the investments in sheet 03.02?

It is expected that the level of granularity will allow for sound assessment of the market and credit (counterparty default) risks related to the investments of the insurer, rather than simply providing a highly detailed list of assets.

In instances where there are plenty of assets with very similar features from the perspective of risks (counterpart risk, market risk, contractual conditions, …), insurers may group the exposures in the same type and subtype of assets, with the same counterparty, with the same features and similar duration.

19. How to determine the future profit embedded in the valuation of technical provisions?

Expected profits in technical provisions may be determined as the difference between the valuation of the technical provision according to the provisions of the RBC-S Directive and the valuation of technical provisions applying the assumptions considered in the pricing of the contract.

Other approaches may be used to determine the expected future profits embedded in the technical provisions, such as the current value of the profit margin included in the actuarial basis when designing the insurance product.

20. Can the liquidity forecasting be carried out using linear projections?

It is expected that the forecast of cash inflows and cash outflows are consistent with the business plan and strategic plan of the insurer, rather than application of any artificial method of projection such as merely linear or other algorithmic projections. For example, premiums and expenses should be aligned with the development of

those items considered in the commercial policies and strategic plan. In the same manner, cash flows related to investment should be consistent with the investment policy approved, considering the type of insurance contracts marketed.

21. Could you please provide guidance on what confidence level Nepal RBC is calibrated at? (Like international standards, an example being Solvency II is calibrated at a 99.5% level of confidence)

    The factors and stresses set out to calculate the risk-based capital requirement under the Nepali Risk Based Framework have been based on references from other jurisdictions that are sufficiently similar to the Nepali insurance market. This approach has been considered due to the lack of adequate data availability and quality to support an actuarially robust calibration of the risks in the Nepali insurance market. The jurisdictions considered as references to design the Nepali risk-based framework have a targeted confidence level of 99.5%. Furthermore, current factors and stresses have been assessed considering the average market profile.

    Under the current market conditions, the calculation of the risk-based capital requirement is intended to achieve a Value at Risk of the Available Capital Resources of an insurer or reinsurer subject to a confidence level of 99.5% over a 1-year time horizon.

22. What is basis of determination of Min Solvency Margin Ratio of 130%?

    The Solvency Margin Ratio and supervisory control levels have been set up in line with the international practices, considering the insurance industry of Nepal and the RBC requirement under Nepalese RBC Framework.

23. What documentation is expected with the RBC filing?

    RBC Submissions from the insurer shall include the RBC QRRT and RBC Valuation Report. Any other supporting documents should also be submitted, including –

    - *Cover Letter,*
    - *Board Decision,*
    - *Data Certification,*
    - *Certification of solvency position by Appointed Actuary and countersigned by Chief Executive Officer (CEO),*
    - *Certification of solvency position by External Auditor, and*
    - *Any other documents as required by the Authority.*

24. How is the amount of credit risk reduction for reinsurance technical provisions calculated?

    The calculation of credit risk reduction shall consider the probability of default and loss given default for each reinsurance arrangement. The reinsurance sheet 04.02_Reins is provided with a default calculation according to the factors provided by NIA and assuming an average receivable period of two years. The reporting entity may change the default calculation considering their experience.

25. What is the rationale for applying a mark-to-model valuation approach to debentures that are listed on the stock exchange?

    Under the RBC-S Directive, assets shall be valued at fair value using observable market prices only where a deep, liquid, and transparent market exists. Although debentures may be listed in the stock exchange, in practice such instruments often do not trade in a market that meets these criteria. Therefore, it becomes necessary to use the mark-to-model valuation approach for valuation of debentures.

26. Why is MOBE for non-life insurance business and reinsurance business calculated at 75% confidence level?

    The Margin Over Best Estimate (MOBE) for non-life insurance and reinsurance business is calculated at a 75% confidence level to reflect an appropriate level of prudence while remaining practical for the Nepalese insurance market. This approach is consistent with the international practices, considering the shorter-term and the nature of non-life and reinsurance risks in the Nepalese insurance market.

27. Please clarify if MOBE may have different value in the Financial Statements and for solvency purposes.

    Margin Over Best Estimate (MOBE) may have different valuation in the financial statements and solvency balance sheet if appropriately justified. Among others, the difference could arise from the zeroization of negative reserves in financial statements, or from the reinsurance assets that do not qualify for solvency purpose being admissible in the financial statements.

28. Can we use MAD (Margin for Adverse Deviation) for calculating the MOBE for the Financial Statement?

The approach of using a fixed Margin for Adverse Deviations (MAD) shall be applicable for the determination of Margin Over Best Estimate (MOBE) only when it is ensured that the valuation of uncertainties is not lower than the amount derived from the confidence level prescribed in the RBC-S Directive.

29. Can separate sets of assumptions be adopted for the calculation of liabilities under the Financial Statements and the RBC framework?

    Regarding Insurance Contract liabilities under Financial Statements and under the RBC framework, the value of technical provisions shall be equal to the sum of a best estimate (Gross Premium Method, prospective valuation method) and a Margin over the best estimate to reflect the inherent uncertainty in the cash flows related to insurance obligations. The assumptions on mortality, morbidity, lapse rates, expenses, future inflation and future management actions shall be based on the insurer's experience (where available), and it is expected that these assumptions are not different merely due to the purpose of reporting. Any difference in the assumptions must be justified by the Appointed Actuary.

30. How is MOBE determined under stressed scenarios?

    When calculating the capital requirements in scenario-based modules or submodules, MOBE shall remain unchanged. Such assumption is a common practice to avoid circularity in the calculation of the capital requirement. Referring to the calculation of MOBE in unstressed scenario, since it intends to capture the market value of the unavoidable uncertainty inherent to best estimate valuation, any source of remaining uncertainty should be reflected in the MOBE valuation.

31. Does the multi-year contract in liquidity forecasting refer only to the engineering line of business?

    The RBC QRRT sheet for liquidity forecasting shall include forecast of all the future inflows and outflows of the (re)insurer.

    So, the multi-year contract refers to all the policies or contracts with contractual term of more than one year, including those that have been issued in prior years and continue to be active in the future.

32. Which claim amounts should be reported as 'Gross Cost of Claims' on the table in the left side of the templates 05.03_01 and 05.03_02?

The information on the left side of the templates 05.03_01 and 05.03_02 shall refer to all the claims that were outstanding at any point during the reporting financial year 2081-2082, regardless of when the claim was reported. This includes –

- *any claims that were outstanding at the beginning of the reporting year, regardless of whether the claims were settled during the year or are still outstanding at the end of reporting year,*
- *claims that were closed at the beginning of the reporting year and reopened during the reporting year, regardless of whether the claims were settled during the year or are still outstanding at the end of reporting year, and*
- *any claims that were reported during the year, regardless of whether the claims were settled during the year or are still outstanding at the end of reporting year.*

Here, 'settled' may mean settled with payment or settled without payment. The claim amounts for claims that are settled without payment shall be reported as zero.

33. Is RBC Valuation different from NFRS17 valuation?

It is widely recognized that Financial statements and Solvency assessment have different goals. Thus, though both are based on an economic approach and have commonalities, it is not relevant to fully identify both frameworks.

Nevertheless, the Technical Specifications of the QRRT RBC templates have tried to minimize the divergences among both valuations, or at least make the calculations carried out for the financial statements as usable as possible for the solvency assessment, with the appropriate adjustments where relevant.

34. What is the meaning of *'mark-to-model' valuation* ?

Expression 'mark-to-model' applies to the valuation of assets/liabilities without a directly observable market value and without existing any similar asset/liability with a directly observable market value to use as a valuation reference (with the appropriate amendments).

'Mark-to-model' applies financial formulas and inputs which deliver a valuation sufficiently reliable and near to what would be the market value of the asset/liability. The valuation model should benefit from general accepted recognition and back-testing on its reliability.

35. How to classify non-life liabilities among discounted and non-discounted liabilities for calculation of interest rate risk charge?

To make possible a robust economic assessment of the solvency position of an insurer it is necessary to consider the time value of money, which means to apply a discounting of cash flows appropriate to the features of the asset/liability (which is consistent with the international standards on financial statements reporting).

In some lines of non-life business, the cash flows corresponding to technical provisions are expected to occur in the short term, which means that the effect of discounting is negligible. It might also occur that the medium and long-term cash outflows are immaterial and so is the effect of discounting.

However, where the discounting has a material impact it is expected that insurers will value the technical provisions applying the relevant discounting and calculate the capital requirement for interest rates risk with the upwards and downwards scenarios set out in RBC-S Directive.

36. Why are future profits deducted from Tier 1 capital while determining the Available Capital Resources?

Tier 1 capital must be of the highest quality - permanent, fully loss-absorbing, and available at all times. Future profits depend on assumptions about future business performance and can disappear in adverse scenarios. Future profits are deducted from Tier 1 capital when determining Available Capital Resources because they are uncertain, not yet realized, and not immediately available to absorb losses under stress.

37. Is it necessary to separate IBN(E)R for direct insurance and accepted reinsurance?

It is expected that the calculation of the IBNR and IBNER is separate for direct insurance and accepted reinsurance, since both types of business are expected to present materially different patterns.

In the exceptional cases where that is not the case (e.g. due to the immateriality of the accepted reinsurance), the insurer shall apply an allocation of the total IBNR or IBNER among direct insurance and accepted reinsurance. That allocation shall be based on objective and reasonable criteria which shall be kept unless justified document reason to improve the criteria.

38. Why is it necessary to calculate IBNER separately?

As part of good risk management of claims, both its handling and its valuation process, insurers should monitor the deviations in the cost initially estimated when the claim is declared and the final cost to settle the claim. It is expected that the insurer shall also monitor the reasons underlying such deviation. The aim is

monitoring the existence of unfavorable deviations and adopting the appropriate corrective measures to prevent such deviations in the future.

39. What does 'Loss Absorbing Capacity' mean?

Loss Absorbing Capacity refers to the capability of insurance policies, particularly those offering participating (PAR) benefits, to adjust non-guaranteed benefits based on the performance of the underlying business.

40. Is loss-absorbing capacity of technical provisions allowed in the calculation of RBC requirement?

In the meantime that most of participants in the Nepali insurance sector achieve the capability for an appropriate calculation of the FDB, NIA has opted for a prudent softening of the calibration of the life underwriting risk stresses as a means for an implicit allowance of the loss absorbing capacity of the FDB. Therefore, NIA will not allow for any further reduction of the solvency capital requirement based on the loss-absorbing capacity of the technical provisions.

41. Why is Loss Absorbing Capacity of the FDB provision not allowed under the Nepalese RBC Framework?

The allowance for Loss absorbing capacity in FDB is a major change both in methodological and operational terms. Currently, simplistic approach is being used by the insurers to calculate the FDB provision. Appropriate implementation of the loss absorbing capacity requires a major change in the methodology used to calculate the FDB provision in stressed scenarios, to the modular approach of the risk-based capital requirement, and a re-calibration of the capital charges of some risk modules or submodules. Hence, for the time being, loss absorbing capacity of the FDB provision under simplistic approach is not allowed.

42. Why is future Bonus included in Best Estimate of Future Discretionary Benefits?

For solvency purposes, the IAIS Core Principles set out:

14.8.8 When establishing the future cash flows to include in the determination of technical provisions for solvency purposes,consideration should therefore be given to all payments whether or not these payments are contractually guaranteed under an insurance contract. For example,

future discretionary bonuses which the insurer expects to make should be included.

In the case this provision is considered as an estimate of the future payments to policyholders derived from the contractual provisions/expectations of the insurance contracts, its nature is that of FDB.

Any contingent obligation of the insurer towards policy holders or beneficiaries of insurance contracts that meets the definition of the Risk-Based Capital and Solvency Directive should be reported separately within the provision corresponding future discretionary benefits.

43. Can the stresses prescribed for the calculation of risk-based capital requirement be used in the calculation of MOBE?

MOBE has a different foundation than RBC stresses. While MOBE tries to capture the market valuation of uncertainty, RBC stresses try to assess the solvency position of the insurer in extreme adverse circumstances.
Therefore, it lacks sense to use RBC stresses as a reference to quantify MOBE (e.g. to cap MOBE with the underwriting RBC stresses).

44. What does 'Total Balance sheet approach' mean when calculating RBC requirement under stressed scenarios?

'Total balance sheet approach' means that all assets and liabilities of the solvency balance sheet should be revalued under stressed scenarios when the RBC for a risk is calculated by applying scenarios.
This conceptual approach is compatible with the practical expedient of not revaluing certain items of the asset or liability side when:

- *either the stress has no effect (e.g. a mortality stress and the impact on equities) or*
- *where that impact is reasonably immaterial (ignoring the impact does not change the solvency position of the insurer in a way that a third party might reach a different opinion about the soundness of the insurer).*

45. Are the risk-free rates published by NIA zero coupon spot rates?

Considering the methodology applied and the fact that rates used for calculating Nepalese RFR rates are zero coupon spot rates, the Nepali interest rates published by NIA are zero coupon spot rates.

46. What if the market value of an asset cannot be determined directly?

According to the Risk Management Guidelines for Insurance Company, (2076), an insurer or reinsurer should only buy those assets whose risks the entity is able to identify, measure, monitor, mitigate and report. In the case of assets not traded in deep, liquid and transparent markets, the NIA expects that the insurer or reinsurer is able, among other conditions, to measure the market value of the asset, and to monitor the changes of such market value according to the evolution of the financial environment.

If the market value is not directly observable, then market value of similar assets, or the mark-to-model valuation approach may be used to determine the market value.

47. Is it mandatory to use mark to model when the asset is not traded in a deep, liquid and transparent market?

When the asset is not traded in a deep liquid and transparent market, the market value of the asset in such market cannot be accepted as a reliable market price. In such cases, another appropriate method to determine the market value shall be used. This includes market value of similar assets, or the mark-to-model valuation approach.

48. Can value of investments according to NFRS be used for solvency purposes?

The valuation of investments applied in NFRS is acceptable as the market valuation required for the purposes of the solvency assessment and reporting ***only*** *where the investment is valued in NFRS at fair value.*

In no case the 'amortized cost' shall be considered compliant with the Risk Based Capital and Solvency Directive.

49. Should reinsurers report the information required in the life insurance technical provisions sheets 06.01-06.07 when the reinsurance arrangements are short-term (1 year) contracts renewed yearly?

In a risk-based framework it makes sense to report insurance and reinsurance business consistently and according to their nature.

Therefore, the approach of QRRT RBC is to report all life insurance and reinsurance contracts corresponding to life insurance in life insurance templates. It also applies to both the direct and the accepted life reinsurance business on a yearly renewal basis.

50. What is the confidence level for the calculation of life accepted reinsurance?

MOBE for life accepted reinsurance shall be quantified with the same confidence level as for similar life direct insurance, according to the Risk Based Capital and Solvency Directive.

51. What should be reported as Reinsurance UPR and Reinsurance OCR?

Projected cash flows within the reinsurance contract boundaries related to claims occurred before or at the valuation date, belong to the reinsurance OCR,

Projected cash flows within the reinsurance contract boundaries not related to claims occurred before or at the valuation date, belong to the Unearned Premium Reserve (UPR).

Any cash flow out of the reinsurance contract boundaries cannot be considered as an asset or liability of the solvency balance sheet.

52. How to determine the solvency valuation of assets with a variable interest rate return?

For this type of assets it is expected that their solvency valuation shall be consistent with the fair value of NFRS, having in mind that the fair value NFRS shall be assessed applying financial methodologies that produce quite similar valuations to those observed in the trading of the assets or of sufficient similar assets.

53. Is it necessary to maintain Earthquake Reserves if the insurer has secured CAT reinsurance arrangement?

Under a risk-based framework a separate treatment of direct insurance and ceded reinsurance is considered necessary to provide an appropriate solvency valuation, and treatment of risks in the solvency assessment.

Therefore, the adjustment of CAT reinsurance arrangements in earthquake reserves shall not be considered, and the reinsurance assets arising due to the CAT reinsurance arrangement shall be reported separately.

54. Is it required to discount the non-life insurance liabilities?

In a sound risk-based approach, where the effect is material, the discount of non-life liabilities is necessary. It may be acceptable to report undiscounted non-life technical provisions beyond 1-year time horizon derived of non-life technical provisions only where the effect of discounting is negligible.

55. Why is it necessary to consider premium reserves in the calculation of MOBE for Non-life insurers?

The reference measure to determine the MOBE under the simplified approach for non-life insurance portfolios should capture any source of uncertainty. This is necessary because the future cash flows corresponding to the non-life technical reserves are uncertain either in timing and/or amount.

Thus, it is not consistent with the definition of MOBE (inline with IAIS) to exclude any of the technical provisions, premium reserves included, because uncertainty is inherent to all of them.

56. What does "look-through approach" of Collective Investment Undertakings mean?

The look-through approach is applicable to indirect investments such as unleveraged mutual funds, other collective investment vehicles, etc. to identify all underlying exposures embedded in such investments, including all indirect holdings that may artificially inflate the qualifying capital resources of a (re)insurer.

57. Why should spreads be added to the risk-free rates while determining the economic valuation of assets?

Such an addition is necessary to achieve an economic valuation of the assets whose market value depends on the time value of money and on the credit quality of the counterpart. Therefore, the referred addition can be seen as neither

an overlap nor an excessive level of prudence. It is just a necessary consequence of the economic approach of a risk-based framework.

58. Can reinsurance technical provisions have negative value?

In a risk-based framework the solvency valuation of technical provisions for direct insurance may result in a negative amount (a negative liability = asset). In fact, if theoretically we would value technical provisions at the very first moment of an insurance contract marketed on a profit basis (the moment before receiving the premium), negative technical provisions would be the general case.

Based on a similar rationale, the technical provisions of a ceded reinsurance contract may be negative as well (a negative asset = liability).

59. How to distinguish between 'Contracts with options or guarantees' and 'Contracts without options or guarantees'?

'Contracts with options or guarantees' shall include contracts that have either financial guarantees, contractual options, or both as far as the technical provision calculation should reflect the existence of those financial guarantees or contractual options.

'Contracts without options and guarantees' shall include the amounts related to contracts without any financial guarantees or contractual options, meaning that the technical provision calculation does not reflect the amount of any financial guarantees or contractual options.

Note that Financial guarantees are connected with investment results and not with reimbursement for an insured event.