

## Prudential Standard FSI 2

### Valuation of Assets, Liabilities and Eligible Own Funds

#### Objectives and Key Requirements of this Prudential Standard

*This Standard sets out the principles insurers should adopt when valuing assets and liabilities for financial soundness purposes, and determining eligible own funds. The principles set out in this Standard are supported by more detailed requirements found in FSI 2.1 (Valuation of Assets and Liabilities Other than Technical Provisions), FSI 2.2 (Valuation of Technical Provisions) and FSI 2.3 (Determination of Eligible Own Funds).*

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

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#### 1. Application

- 1.1. This Standard applies to all insurers licensed under the Insurance Act, 2017 (the Act), other than microinsurers, Lloyd's and branches of foreign reinsurers.
- 1.2. Unless otherwise indicated, all references to "insurer" in this Standard can be read as a reference to life insurers, non-life insurers and reinsurers. Similarly, a reference to "insurance" obligations/policies in this Standard can be read as a reference to "reinsurance" obligations/policies, unless otherwise specified.

#### 2. Roles and Responsibilities

- 2.1. An insurer's board of directors is ultimately responsible for ensuring that the valuation of the insurer's assets and liabilities, and the determination of eligible own funds, comply with the principles and requirements of this Standard. The board of directors must ensure that the insurer has in place appropriate systems, procedures and controls to meet the requirements of this Standard on an ongoing basis.
- 2.2. An insurer's head of actuarial function is responsible for expressing an opinion to the board of directors regarding the accuracy of the calculations and the appropriateness of the assumptions underlying the valuation of the insurer's technical provisions.
- 2.3. An insurer's auditor, appointed under section 32 of the Act, must audit the financial soundness of an insurer in accordance with its legal and regulatory obligations. The auditor must report to the board of directors and Prudential Authority any matters

identified during the performance of its responsibilities that may cause the insurer to be not financially sound.

- 2.4. The roles and responsibilities of the board of directors and the head of actuarial function are described in more detail in the Governance and Operational Standards for Insurers (GOI 3).

### 3. Commencement and Transition Provisions

- 3.1. This Standard commences on 1 July 2018.

Version Number	Commencement Date
1	1 July 2018

### 4. General Valuation Principles

- 4.1. For financial soundness purposes, the key principle that insurers should adopt when valuing assets and liabilities is to apply an economic, market-consistent approach to valuation. Consistent with an economic, market-consistent approach to valuation:
- a) Assets should be valued at the amount for which they could be exchanged between knowledgeable and willing parties in an arm's length transaction; and
  - b) Liabilities should be valued at the amount for which they could be transferred, or settled, between knowledgeable and willing parties in an arm's length transaction.
- 4.2. In many instances, assets and liabilities (other than technical provisions) valued in accordance with International Financial Reporting Standards (IFRS) will result in valuations that are consistent with an economic valuation approach. Consequently, insurers should use the value of assets and liabilities (other than technical provisions) derived under IFRS for financial soundness purposes, unless otherwise specified by the Prudential Authority or in the Financial Soundness Standards for Insurers.
- 4.3. In instances where valuation of certain assets and liabilities under IFRS can result in either a fair value or another value, the method that results in a fair value should be used.
- 4.4. Where certain assets and liabilities valued under IFRS do not result in an economic valuation, insurers may still choose to adopt the IFRS valuation unless otherwise specified by the Prudential Authority or in the Financial Soundness Standards for Insurers.
- 4.5. Assets and liabilities (other than technical provisions) that require a different valuation basis from that derived under IFRS are set out in FSI 2.1 (Valuation of Assets and Liabilities Other than Technical Provisions). FSI 2.2 (Valuation of Technical Provisions) sets out the principles and requirements for valuing an insurer's technical provisions for financial soundness purposes. In assessing whether a particular asset or liability is material for the purposes of valuation, insurers should adopt the definitions and guidance on materiality found in International Standard on Auditing 320 - Materiality In Planning And Performing An Audit as issued by International Federation of Accountants (IFAC) through the International Auditing and Assurance Standards Board (IAASB).

## **5. Hierarchy of Valuation Approaches**

- 5.1. In order to derive the economic value of assets and liabilities, insurers should adopt the following hierarchy of valuation approaches, unless otherwise specified by the Prudential Authority:
- a) In the first instance, insurers should use a mark-to-market approach to measure the economic value of assets and liabilities, i.e. using readily available prices in orderly transactions that are sourced independently (quoted market prices in active markets) to value assets and liabilities.
  - b) Where a mark-to-market approach is not possible, a mark-to-model approach should be used. Mark-to-model approaches rely on benchmarking, extrapolation or other modelling of other market inputs to derive valuations. When applying this approach, insurers should maximise the use of relevant observable market inputs and minimise the use of unobservable market inputs.

## **6. Determination of Eligible Own Funds**

- 6.1. In broad terms, own funds represents the difference between assets and liabilities adjusted for the addition of subordinated liabilities, certain regulatory adjustments, and approved ancillary own funds. Thus, the determination of own funds is largely derived from the valuation of assets and liabilities as calculated in accordance with the principles set out above.
- 6.2. Further details on the requirements associated with determining eligible own funds, including adjustments that must be made to own funds for the purposes of financial soundness, are set out in FSI 2.3 (Determination of Eligible Own Funds).