

SOLVENCY REGIME UNDER INSURANCE ACT, 2006, ACT 724.

Background

The current solvency regime requires the assets of Non-Life insurance companies at any point in time, to exceed their liabilities by at least 10% of net premium income in order to be technically solvent. In the case of Life companies, assets must at least equal liabilities.

In both cases, whilst all the liabilities on the Balance Sheet are taken into consideration, the assets are weighted according to some prescribed criteria to emphasize liquidity, safety and availability.

The above regime has been criticised as not being suitable for the current relatively stable macro economic environment with low interest rates.

Again, it has been difficult for some industry practitioners to fully understand the current guidelines especially the weighting factors and procedures. There have therefore been calls for a review of the current regime.

The NIC, in response to the above set up an industry committee to review the guidelines. The report of the committee was rendered obsolete by further changes in the country's economic situation and international regulatory standards.

In a related development, the 2008 National budget indicated the need for a review of the regulatory framework to enable insurance companies restructure their investment portfolios to reflect the current economic environment.

Based on the above considerations, the following Solvency guidelines have been issued by the National Insurance Commission to govern the investments of insurance companies in Ghana.

Objectives

The objectives of the solvency guidelines are as follows;

- i. To ensure appropriate asset spread, good yield, and safety of the investments of insurance companies as well as appropriate asset liability matching.
- ii. To ensure that Ghana's solvency regime complies with international standards and best practice.
- iii. To enhance the contribution of insurance companies to the country's economic development.

Scope

This document covers the following subjects;

- i. The solvency margin
- ii. Solvency control levels
- iii. Investment mix requirements
- iv. Investment to total asset ratio
- v. Valuation rules
- vi. Effective Date and Transitional arrangements

The Solvency margin

The International Association of Insurance Supervisors' (IAIS) standard on solvency requires a solvency margin to be set to provide a safety buffer against events that may occur that are outside the expected range of events for which risk reduction measures have been taken. This margin is also meant to serve as a buffer for assets whose full values may not be realised due to impairment or some factors which may not have been identified at Balance Sheet dates. The margin also reflects risks not taken into account in valuing liabilities including off-balance sheet exposures.

Both Life and Non-Life insurance companies are therefore required to have a financial solvency margin of 50% or the minimum capital which ever is higher. This means that at any point in time, an insurance company's assets must be at least 150% of its liabilities **or** its Net Assets must be at least equal to the minimum capital requirement in order to be solvent.

Please note that the solvency margin shall in no case be less than the minimum capital requirement.

Solvency control levels

The following control levels have been put in place to enable the NIC take a proactive approach of dealing with emerging insolvencies at the initial stages before they degenerate into crises. The solvency control levels and their consequent corrective actions are as follows;

Level	Margin	Corrective Action
Green	If assets are 150% or more of liabilities	Routine Monitoring
Amber	If assets are more than 125% of liabilities but less than 150% thereof	Restructure investments
Red	If assets are at least equal to liabilities but less than 125% of liabilities	Enforcement Action/capital injection
Black	If liabilities are more than assets	Suspend licence with the possibility of final licence withdrawal and liquidation

Investment Mix

Since this solvency regime mainly dwells on financial solvency, there is the need to ensure that investments of insurance companies are adequately spread. The investment portfolio of insurance companies is therefore required to comply with the following investment mix under the new solvency regime;

Investment	Proportion of Investment Portfolio	
	Life	Non-Life
Government securities, cash and deposits (excluding Statutory Deposit)	At least 35%	At least 35%
Statutory Deposit	At least 10% of minimum capital	At least 10% of minimum capital
Listed Stocks	0 – 30%	0 – 30%
Unlisted Stocks	0 – 20%	0 – 10%
Mutual Funds	0 – 20%	0 – 20%
Investment Properties	10 – 30%	0 – 20%
Other investments approved by the NIC	0 – 10%	0 – 10%

Investments to Total Assets ratio

In addition to the investment mix, it is required that at any point in time, the ratio of investments to total assets should not be less than 55%. That is, at least 55% of the total assets of the company must be in direct investments. Direct investments are defined as assets that directly earn cash income or appreciate in value (capital appreciation) over time.

Valuation Rules

Valuation rules for both financial reporting and solvency assessments will be as prescribed by International Financial Reporting Standards (IFRS). Effective implementation of and compliance with IFRS by all insurance companies will provide an ideal condition for the solvency regime. This is because IFRS has clear and appropriate valuation rules on both assets and liabilities.

The NIC is in the process of procuring a consultant to develop an accounting manual which is IFRS compliant for the insurance companies and also provide training on IFRS for the insurance industry. It is expected that this will enhance the financial

reporting capacity under IFRS and provide the necessary guidelines needed for the effective implementation of the solvency guidelines.

There will also be provisions in the Regulations to the Insurance Act, 2006 on related party transactions and assets.

Again, both the IAIS and the IASB are considering special valuation rules for insurance assets and liabilities. The final results of their discussion will be incorporated into the manual.

Effective Date and Transitional Arrangements

These Solvency guidelines take effect in January 2008. This means that the 2008 annual returns and subsequent quarterly and annual returns will be assessed under the new regime.

However, a two year transitional period will be allowed within which all insurance companies will be expected to comply fully with the new solvency margins.

All insurance companies will be expected to have a solvency margin of at least 30% or Minimum Capital, whichever is higher by 31st December 2008, at least 40% margin by 31st December, 2009 and at least 50% margin by 31st December 2010 and thereafter.