Review of Risk-Based Capital

Public consultation document

23 July 2025

Comments due by 23 August 2025

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Section 1: Introduction

1.1 Solvency Margin (Risk-based Capital) Rules, 2015 ("**RBC Rules**", "**Rules**", "**framework**") were issued by Insurance Regulatory Commission of Sri Lanka ("**IRCSL**", "**Commission**") under section 105 read with section 26(1) of the Regulation of Insurance Industry Act, No. 43 of 2000 ("RII Act") and implemented with effect from 1 January 2016. These Rules focused on ensuring adequate liability and capital assessments by insurers in Sri Lanka, reflective of risks undertaken by life and general insurers. Since the implementation of the Rules, there have been evolving asset markets, dynamic economic conditions of Sri Lanka and developments by global regulatory forums (Risk-based Global Insurance Capital Standard, issued by International Association of Insurance Supervisors). These factors have led IRCSL to initiate a holistic review of current Rules to ensure that the Rules remain relevant to reflect tthe current Sri Lankan Market conditions and consistent to global standards.

1.2 The purpose of this consulting document is to:

a. provide an opportunity to interested parties to share their views, concerns, and expertise regarding the proposed changes

b. enable the industry to familiarize itself with these proposals;

c. ensure that the future framework reflects the unique features of Sri Lankan market;

d. built on existing arrangements to ensure a healthy and thriving industry as well as build trust within the proposed solutions; and

e. identify additional targeted improvements or solutions to existing improvements which haven't been considered as part of the consultative process so far.

We have provided a number of questions corresponding to our proposals to facilitate respondents to provide feedback on the improvements identified under the current Rules and proposed approach(es).

1.3 It must be emphasized that the move towards revisions to existing RBC framework does not necessarily imply a need to increase or decrease capital for individual insurers. The framework seeks to, be consistent with international practice, make capital requirements more sensitive to the level of risk that insurers are bearing.

1.4 IRCSL invites interested parties to provide their views and comments on the proposed RBC consultation including issues or areas to be clarified or elaborated further and any alternative proposal that IRCSL should consider. Please be informed that written comments should be submitted in response template (as also provided in Annexure A), under the title "Public consultation comments on proposed changes to Solvency Margin (Risk-based Capital) Rules, 2015", on or before 23 August 2025 by e-mail or registered post to:

Insurance Regulatory Commission of Sri Lanka
Level 11, East Tower, World Trade Centre, Colombo 1
Telephone: 011 2396184 - 9 (General) | Fax: 011 2396190
e-mail: rbc.consultation@ircsl.gov.lk

1.5 In the course of preparing your feedback, you may direct any queries to the actuarial unit of IRCSL via email on rbc.consultation@ircsl.gov.lk .

1.6 Please note that all submissions received may be made public unless confidentiality is specifically requested for the whole or part of the submission. Please keep in mind that Commission may have to disregard confidential submissions that in fairness should be made available to others for further comment. For that reason, please avoid confidential submissions if possible, or keep them short.

Approach for revision in the Rules

1.7 IRCSL issued a consultation form to both long term insurers and general insurers in Sri Lanka, to gather industry insights on targeted improvements required in the Rules. Further, discussions were undertaken within the IRCSL, including self-assessments and a review conducted of existing rules against global standards. Collectively, this provided a list of targeted improvement to the existing Rules.

1.8 IRCSL setup an RBC task-force with representatives from Insurance Association of Sri Lanka (IASL), Actuarial Association of Sri Lanka (AASL), insurance companies, National Insurance Trust Fund (NITF) and IRCSL, to leverage industry knowledge and actuarial experience and work collectively to identify changes for proposed targeted improvement areas, pros and cons of various options identified to tackle improvement areas, and analyse possible implementation approach for each improvement.

1.9 The RBC task-force had regular discussions on identified improvement areas, internally amongst the task-force members and subsequently with IRCSL to present with proposed solution(s) of the improvement area and additional industry insights (additionally gathered by the task-force members via discussion with industry stakeholders who are not a part of the task-force).

1.10 The RBC task-force has summarised the discussions as part of a formal report, detailing the current approach, proposed outcome, benchmarking against global standards, considerations from Sri Lanka perspective and the proposed outcome post the discussion. This report can be assessed through:

https://ircsl.gov.lk/bfd_download/public-consultation-revision-to-solvency-margin-risk-based-capital-rules-2015/

Next steps

1.11 IRCSL will carefully consider the comments received through the public consultation and will include the comments in the technical specification for Quantitative Impact Study (QIS), where appropriate.

1.12 IRCSL will analyse impacts observed as part of the QIS performed by the insurance companies.

1.13 Recommendations and conclusions will be drawn based on the results through concurrent discussions with the industry. Subsequently, revised Solvency Margin (Risk-based Capital) Rules will be finalised by IRCSL.

1.14 Proposed timelines for each of the above phases and implementation of revised rules shall be updated timely by IRCSL.

How to read the document

1.15 This document has been setup to provide a comparison of the current Solvency Margin (Risk-based Capital) Rules, 2015 against the expected revised Rules based on the proposed revisions following the consultative process. This comparison is provided in Section 2 of this document.

1.16 Please be advised that the revised Rules provided in Section 2 are for illustrative purposes only. They are indicative changes and do not represent the final form of the revised Rules.

1.17 Revisions highlighted as part of this document reflect targeted improvement areas which were discussed within the task force and subsequently with IRCSL. For areas where multiple viable options were identified, all such options have been included in this public consultation document to gather additional feedback.

1.18 Further insights into the analysis undertaken by IRCSL to identify potential solution(s) for each targeted improvement can be found in the report submitted by the RBC task-force to IRCSL.

1.19 Participants are advised to thoroughly review the entire public consultation document prior to submitting their responses, in order to gain a comprehensive understanding of the potential changes associated with each proposed targeted improvement. An overview of the consultation questions, categorized by each proposed improvement, is included in the Excel workbook provided in Annexure A.

1.20 The general convention to read the proposed Rules in Section 2 of this report are as follows:

a. Text in **[black]** represents the current Rules.

b. Text in **[red]** represents omissions in the revised Rules. Where entire paragraph is to be omitted, this is marked as **[Deleted]**

c. Text in **[dark purple]** represents proposed revisions to the Rules.

d. Text in **[green]** represents revisions with multiple proposed solutions for a single improvement for participant to share the feedback for a preferred approach, along with the rationale.

1.21 Subsequent to change in Section 3 of RII Act, “Insurance Board of Sri Lanka” and “Board” is now referred to as “Insurance Regulatory Commission of Sri Lanka” and “Commission” respectively. All instances of “Board” are replaced with “Commission” in the revised Rules.

1.22 For each change, consultation questions have been included at the end of each paragraph/section where a change is proposed.

1.23 Consultation questions have also been summarised as part of the template accessible through the following link which should be filled by the participants and shared electronically via the email mentioned above.

Section 2: Proposed revised Rules

Part I – Application

1. These Rules may be cited as the Solvency Margin (Risk Based Capital) Rules, **[year of implementation]**.
2. These rules shall apply to every insurer registered **and licensed** under the RII Act, with effect from **date of implementation.**

Part II – Required Financial Resources

3. Every insurer shall, with effect from **the date of the implementation,** maintain a Capital Adequacy Ratio (hereinafter referred to as the "CAR") of a minimum of 120%.
4. Every insurer shall, with effect from **the date of implementation**, maintain a Total Available Capital (hereinafter referred to as "TAC") of a minimum of rupees Five Hundred million.
5. (1) Every insurer shall, taking into consideration the nature, size, and complexity of its insurance business and the risk to which it is exposed, without prejudice to rule 3 and 4 maintain a prudent CAR and adequate TAC.

   (2) Every insurer shall have, in order to comply with the provision of paragraph (1), adequate risk management systems with strategies, processes, and reporting procedures appropriate to identify, measure, monitor, and report, on a continuous basis, the risks to which the insurer is or could be exposed, and their interdependencies.
6. (1) Every insurer shall, taking into consideration the nature, size, and complexity of its insurance business, and the risks to which it is exposed, value its assets and liabilities including policy liabilities under these rules at least quarterly during the year.

   (2) Every insurer shall inform the Commission the basis of, and justification for, material discretionary decisions taken by the insurer under these rules, including decision on assumptions, adjustments, internal models, time periods, methods and techniques, either in notes to its quarterly reports, or otherwise, within a reasonable period after the decision has been taken.
7. (1) Every insurer shall inform the Commission of its compliance with these rules, in the form, manner and during such period as the Commission may specify in that behalf.

   (2) The Commission may require such insurer to provide supporting documents on the compliance **with a** certification from an independent actuary or other skilled person, whose qualifications may be specified by the Commission, at the cost of the insurer.
8. (1) Where an insurer has reasonable reasons to believe that such insurer is or is likely to be, in breach of rule 3, 4 or 5, such insurer shall report the breach or likely breach to its board of directors and to the Commission as soon as possible.

   (2) Where in the opinion of the Commission, an insurer has failed, or is likely to fail, to comply with rule 3, 4 and 5 as aforesaid the Commission may require such insurer to provide a plan to restore its financial position, in the form and manner that the Commission may specify in that behalf.

(3) The Commission may require the insurer to provide a supporting opinion on the plan from an independent actuary or other skilled person, whose qualifications may be specified by the Commission, at the cost of such insurer.

No revisions have been proposed to Part II of the current Rules with respect minimum Total Available Capital and minimum Capital Adequacy Ratio.

Question 1

Please provide with rationale, if there are additional considerations with respect to Part II - Required Financial Resources of the current Rules, which are required to be considered as part of the revision to the Rules.

Part III – Determination of TAC and CAR

9. Subject to the provisions of rule 13, TAC is the total of Tier 1 and Tier 2 capital of an insurer, minus the deductions required by rule 12.

10. Tier 1 capital comprises:

    a. issued and fully paid up ordinary shares and share premiums;

    b. capital reserves;

    c. paid up non-cumulative irredeemable preference shares;

    d. adjusted retained earnings or accumulated losses taking into account;

        i. adjustments for available for sale reserves that may be required or permitted under Sri Lanka Accounting Standards (adjusted for fair value losses)

        ii. adjustments for differences in asset or liability values between the values calculated under these Rules and those calculated under Sri Lanka Accounting Standards (whether positive or negative);

        iii. any other fair value losses (not already captured in (i) and (ii) above);

    e. unallocated valuation surplus in the long term insurance fund, that is, surplus that has not yet been allocated between policyholders and shareholders; and

    f. [Deleted]

    [Explanation: It is proposed to revise the methodology used for valuation of participating business liabilities to be based on a single market consistent liability value, including future discretionary benefits discounted at the risk-free interest rate yield curve. Hence, additional credit to the extent of the difference between GBL and TBL as calculated under the Rules will no longer be applicable. Details on assessment of policyholder liabilities for participating business is further elaborated in Part V.]

    g. **In the case of long term insurance business, 100% of Reserve Floor Adjustment determined with respect to negative reserves.**

    [Explanation: The current RBC framework allows for negative liabilities, which is balanced by the application of the SVCC in the RCR calculation. However, with the proposal to remove SVCC, this balance is disrupted. It is therefore proposed that companies may calculate a Reserve Floor Adjustment, to the extent of amount of the negative reserve, at a level of granularity that deems fit to the Actuary, and include such adjustment in liabilities; and credit to the extent of the amount of such adjustment can be taken in calculation of Total Available Capital.]

Question 2

a. Please share your comments on the proposed approach of holding Reserve Floor Adjustment within mathematical reserves, equal to the amount of negative reserves, with allowance of taking 100% credit of such adjustment as part of the Total Available Capital. Please include any alternative approach with rationale.
b. Please share your comments on level of granularity on which such Reserve Floor Adjustment should be determined with respect to negative mathematical reserves (policy level, product level, line of business level, company level, or any other granularity).

11. Tier 2 capital comprises:

    a. cumulative irredeemable preference shares;

    b. redeemable preference shares;

    c. mandatory capital loan stock and other similar capital instruments;

    d. revaluation reserves for self-occupied properties and other property investments;

    e. revenue reserves, excluding retained earnings;

    f. irredeemable subordinated debt; and

    g. subordinated debt that:

        i. has a minimum five-year term,

        ii. is unsecured; and

        iii. is subject to a lock-in clause precluding payment of either interest or principal (even at maturity) if the payment would cause the insurer's CAR to fall, or remain, below capital adequacy ratio specified in rule 3 (hereinafter referred to as "RCAR").

12. In determining TAC, insurers shall deduct from the total of Tier 1 capital and Tier 2 capital :-

    a. goodwill and other intangible assets, including capitalised expenditure ;

    b. inadmissible land, building, other immovable property, plant, and equipment ;

    c. inadmissible loans and advances, except agent balances and staff loans ;

    d. deferred income tax assets ;

    e. prepayments ;

    f. inventory ;

    g. tax receivables ;

    h. assets pledged to support credit facilities ;

    i. claims receivable under policies held by an insurer for its own benefit (except reinsurance policies) ;

    j. claims receivable under contract of co-insurance **overdue for more than nine months or twelve months**;

    [Explanation – It is noted that co-insurance in Sri Lanka operates on a similar model as re-insurance, wherein an insurer first sells a policy and then finds another insurer to co-insure the risks. It is therefore proposed, to treat the co-insurance receivables similar to net reinsurance receivables while calculating the inadmissible assets under TAC. Further, as per risk rating of the co-insurer, for each co-insurance contract, any co-insurance balance within the above specified period shall attract risk capital charge identical to reinsurance risk capital.]

    k. investments in shares that do not fall within category of asset listed in Column 1 of Table 1;

    l. investments in related parties that are prudentially regulated financial institutions;

    m. investments in related parties that are not listed on a licensed stock exchange;

    n. positive net amounts receivable from a reinsurer, overdue for more than [six months] **nine months or twelve months** after setting off against any amounts due to the reinsurer; and

[Explanation – it is proposed to consider a longer period for claim receivables from reinsurers for admissibility of asset due to operational complexities, evaluation of similar rule in other regions and overall time taken by reinsurers to settle claims]

o. inadmissible mortgage loans in the case of General Insurance Business.

13. In determining TAC, Tier 2 capital shall not exceed 50% of Tier 1 capital

14. Every insurer shall determine CAR using the following formula:

$$CAR = (TAC/RCR) \times 100$$

Where RCR is determined in accordance with the rules in Part VII.

Question 3

Please share your comments on the proposed treatment of co-insurance receivables as:
a. allowing co-insurance receivables to be admissible upto a certain outstanding duration.
b. determining capital on co-insurance balances within the above specified period, identical to approach and charges for calculation of re-insurance risk capital.

Please include any alternative approach along with the rationale.

Question 4

Please share the average time taken by your organisation to get reinsurance receivables settled. Please comment on whether these are driven by the nature of the process for admitting such claims by reinsurers or any delay is driven by operational delays of the insurer or reinsurer?

Question 5

Please indicate whether your company is considering the issuance of any new capital instruments that are not listed under paragraphs 10 and 11. If yes, please provide details of the instruments, the rationale for their issuance and the proposed classification of these instruments under the RBC framework

Question 6

Please share your comments on the items that are affected by the difference in valuation basis between SLFRS 17 and the current RBC Rules. Please provide details of the affected items and suggestions on how these items could be adjusted under revised RBC Rules.

Question 7

Are there any other comments regarding determination of TAC and CAR that the Commission shall consider in the development of revised Rules? If “yes”, please explain with sufficient details and rationale.

Part IV – Admissible assets, asset limits, and asset valuation

15. (1) For the purpose of determining CAR, the assets in the categories listed in the first column of table 1 are permitted (hereinafter referred to as "admissible assets") up to the maximum percentage limit of the total value of an insurer's admissible assets (including admissible assets in shareholders' funds), and subject to any overall-or sub-limits, specified in the second column.

(2) Subject to the provisions of paragraph (3) and notwithstanding the provisions of paragraph (1); if

a. debt securities

b. corporate debt issued by a bank ;

c. corporate debt issued by a company ;

d. asset backed securities ; or

e. interest bearing deposits with a bank or finance company

were issued,

A. outside Sri Lanka or by an entity established outside Sri Lanka, the assets are admissible only if the asset or entity, as the case may be, carries a credit rating (hereinafter referred to as the "Investment grade rating") assigned in the eighteen-month period preceding the valuation date, that is not lower than:

i. the rating specified for the related credit rating agency in Part A of the Schedule hereto; or

ii. an equivalent rating from a credit rating agency approved by the Commission; or

B. in Sri Lanka or by a company, established in Sri Lanka the assets are admissible only if the asset or company, as the case may be, carries an investment grade rating, assigned in the eighteen-month period preceding the valuation date, that is no lower than:

i. the rating specified for the related credit rating agency in Part B of the Schedule hereto; or

ii. an equivalent rating from credit rating agency registered under the Securities and Exchange Commission of Sri Lanka Act, No. ~~36~~**19** of ~~1987~~**2021.**

(3) The provisions of paragraph (2) do not apply to investments in related parties, or to unlisted equity and corporate debt held in shareholders' funds.

Table 1: Admissible assets and limits

Admissible asset category	Maximum percentage
(a) i. Government securities issued by Central Bank of Sri Lanka ii. Debt Securities fully guaranteed by Government of Sri Lanka	100%
(b) Debt securities: i. issued or fully guaranteed by a foreign government or a central bank of a foreign country, and ii. carrying an investment grade rating to the instrument	20%
(c) Ordinary shares of a company (that is not a related party) listed on a licensed stock exchange	For general insurance business, 30% For long term insurance business 40%
(d) Corporate debt (including bonds, debentures, commercial papers and similar financial instruments) issued by a licensed	For general insurance business, 60%, subject to an overall limit of 60% for

Admissible asset category	Maximum percentage
commercial bank or a licensed specialised bank (that is not a related party) and i. carrying an investment grade rating to the instrument, or ii. Backed by guarantee issued by a licensed commercial bank or a licensed specialized bank carrying an investment grade rating (that is not a related party), or iii. Backed by a guarantee issued by a multilateral agency	corporate debt in(d), (e), (f), and (g) of Table 1 For long term insurance business, 50%subject to an overall limit of 50% for corporate debt in (d), (e), (f) and (g) of Table 1
(e) Corporate debt (that is not related party debt) (including bonds, debentures, commercial papers, and similar financial instruments) listed on licensed stock exchange	10%, subject to an overall limit of 60% or 50%, as the case may be, for corporate debt in (d), (e), (f), and (g) of Table 1
(f) Corporate debt (that is not related party debt) (including bonds, debentures, commercial papers, and similar financial instruments) i. issued by a company; and ii. carrying an investment grade rating to the instrument	10%, subject to an overall limit of 60% or 50%, as the case may be, for corporate debt in (d), (e), (f), and (g) of Table 1
(g) Asset backed securities (except securities issued or guaranteed by a related party) ; i. where the capital and interest or the maturity value, as the case may be, is fully guaranteed by a licensed commercial bank or a licensed specialised bank carrying an investment grade rating ; or ii. that are issued by a company listed on a licensed stock exchange, and carrying an investment grade rating to the instrument.	10%, subject to an overall limit of 60% or 50%, as the case may be, for corporate debt in (d), (e), (f), and (g) of Table 1
(h) Interest bearing deposits with a licensed commercial bank or a licensed specialised bank carrying an investment grade rating	40%, subject to an overall limit of 40% for interest bearing deposits in (h) and (i) of Table 1
(i) Interest bearing deposits with a licensed finance company. i. listed on a licensed stock exchange; and ii. carrying and investment grade rating	10%, subject to an overall limit of 40% for interest bearing deposits in (h) and (i) of Table 1
(j) Other cash and cash equivalents, not included in other asset categories in this Table, subject to any restrictions that may be imposed by the Commission	4%
(k) Freehold land and buildings occupied by the insurer	For general insurance business, 10% For long term insurance business, 15%
(l) Freehold land and buildings held for investment purposes	For general insurance business, 10% For long term insurance business, 15%
Long term leasehold land and building **(Insurers may seek case-by-case clarification / approval from the Commission on treatment of leasehold land and building constructed by lessee on leasehold land, with such assessment typically based on factors such as the nature of the underlying lease, terms and conditions, the fair value of the construction, etc)**	**The maximum admissible limit shall be:** **For general insurance business, 10%** **For long term insurance business, 15%** **subject to an overall limit of 10% or 15%,** **as the case may be, for freehold land and building in (k), (l) and this section of Table 1**
(m) Investments in related parties, which parties are listed on a licensed stock exchange, except prudentially regulated financial institutions	7.5% But no single exposure may exceed 5%
(n) Unlisted shares and corporate debt investments (except investments in related parties) - held in shareholders' funds	5%

Admissible asset category	Maximum percentage
(o) Unrated corporate debt investments - held in shareholders' funds	5%
(p) Unit trusts and mutual funds	25%
(q) Gold kept in safe custody in a licensed commercial bank or a licensed specialised bank	20%
(r) Positive net amounts receivable from reinsurers for no longer than **[6] 9 or 12** months, after setting-off amounts due from the insurer to the reinsurer	100%
For general insurance business, positive net amounts receivable from the co-insurer for no longer than 9 or 12 months, after setting-off amounts due to the co-insurer	**100%**
(s) For long term insurance business, outstanding policy loans that do not exceed the surrender value of the policy	100%
(t) For long term insurance business, accrued premium (or premium instalment) outstanding for no longer than the shorter of thirty days or the period within which the premium shall be paid under the policy	100%
(u) For general insurance business, accrued premium outstanding for no longer than sixty days from the inception of the policy **(u)** **1. For general insurance business written with respect to travel insurance, marine insurance, title insurance and bonds issued by insurance companies - accrued premiums outstanding for no longer than fifteen days if collected via brokers (i.e. two weeks of credit as per Section 89 of the RII Act).** **2. For general insurance business written with respect to motor insurance, accrued premiums outstanding for no longer than thirty days (collected via all other means except via brokers) no longer than forty five days if collected via brokers (i.e. thirty days plus two weeks of credit as per Section 89 of the RII Act). With effect from 1 January 2028, accrued premiums outstanding for no longer than fifteen days if collected via brokers (i.e. two weeks of credit as per Section 89 of the RII Act).** **3. For all other general insurance business, accrued premiums outstanding for no longer than thirty days (collected via all other means except via brokers) no longer than forty five days if collected via brokers (i.e. thirty days plus two weeks of credit as per Section 89 of the RII Act). With effect from 1 January 2028, accrued premiums outstanding for no longer than fifteen days if collected via brokers (i.e. two weeks of credit as per Section 89 of the RII Act).** ***[refer to explanation for further change intended to be made for this item]***	100%
(v) For general insurance business, mortgage loans on immovable property approved by the Commission as at 31.12.2010	20%, but no single exposure may exceed 80% of the value of the security, based on strict valuation rules (and any excess shall be deducted from TAC)

[Explanation – Noting short term nature of general insurance business, the Commission intends to drive the general insurance business towards "cash before cover" model with effect from 1 January 2028, as is discussed in General Insurers CEO forum. For travel insurance, marine insurance, title insurance and bonds issued by insurance companies, Circular #1 of 2023 does not provide any credit on premium payment.

For all other general insurance business, it is proposed to reduce period of admissibility for accrued premiums from 60 days to 30 days (collected via all other means except via brokers) and additional 2 weeks of credit as per Section 89 of the RII Act for premium collected via brokers. With effect from 1 January 2028, no policy shall be issued without collection of premium, and hence any accrued premium will be treated as inadmissible, except where collected via brokers for which 15 day credit will be given.]

Question 8

A discussion for consideration of long-term leasehold land and building constructed on leasehold land by the lessee as admissible assets for solvency calculation was undertaken within the task force. One of the factors for an asset to be considered as admissible for solvency purposes is the ability to transfer the asset at a realisable value. Hence, it was proposed to consider such assets as admissible if the terms and conditions of the lease allows a transfer of lease in exchange for a consideration, subject to the approval from the Commission based on the application made by the insurer.

a. Please share your comments on proposal of case-by-case assessment of asset admissibility of long -term leases by the Commission, based on the application made by an insurer
b. Please share your comments with respect to perceived difference between the long term lease taken from a private institution vis-à-vis, taken from the government which can impact the admissibility and transferability of such leases.
c. Please share any other considerations to be assessed by the Commission while assessing asset admissibility of long-term leases

Question 9

Please share your comments on the proposed approach for admissibility of accrued premium for general insurance business, particularly the intention to move towards "cash before cover" model?

Please include any alternative approach along with the rationale.

16. If all the assets in a particular asset category in column 1 of Table 1, taken together exceed the related admissibility limits in Column 2, insurers shall ;

    (a) unless the provisions of paragraph (b) apply, progressively exclude the assets with the lowest credit rating until the limit is reached ; or

    (b) in an asset category where the assets are not rated, progressively exclude the assets with the highest risk profile, and the excluded assets, or part assets, are not admissible assets.

17. Notwithstanding the provisions of rule 15(2), assets located outside Sri Lanka are not admissible assets unless the insurer has obtained the permission of the Commission under Section 25(3) of the RII Act.

18. Encumbered assets are not admissible and the corresponding liabilities with regard to encumbered assets shall not be taken into account in calculating CAR.

19. (1) Subject to the provisions of paragraph (2), for the purpose of calculating CAR, insurers shall value admissible assets in the categories listed in Column 1 of the Table 2 using a market consistent approach in accordance with the related valuation principles in Column 2.

(2) Every insurer shall value assets that are not in a category listed in Column I of Table 2 using a market consistent approach or, if a market consistent approach cannot reasonably be applied, using Sri Lanka Accounting Standards.

Table 2: Valuation of Assets

Admissible asset category	Maximum percentage
(a) Government securities issued by Central Bank of Sri Lanka and Debt Securities fully guaranteed by Government of Sri Lanka	1. Most recent average buying price quoted by primary market dealers provided in the weekly economic indicators published by the Central Bank of Sri Lanka. 2. If the most recent market price in not available, the estimated realizable value.
(b) Debt securities	Most recent published buying price certified and issued by the issuer or guarantor
(c) Ordinary shares of company	Prevailing market price as per the last traded stock on the Colombo Stock Exchange
(d) Corporate debt	If quoted - prevailing market price as per the last traded stock on the Colombo Stock Exchange If unquoted - net realisable value, taking into account the prevailing interest rate scenario and expected cash flows from the debt
(e) Asset backed securities	As for other corporate debt above
(f) Interest bearing deposits	Value of the deposit including accrued interest
(g) Other cash and cash equivalents	Actual amount
(h) Freehold land and buildings	Realisable value, based on an estimate by a qualified property valuer approved by the Commission
Long term leasehold land and building	**Realisable value, based on an estimate by a qualified property valuer approved by the Commission and the value as certified by the External Auditor**
(i) Investments in related parties	If quoted - prevailing market price as per the last traded stock on the Colombo Stock Exchange. If unquoted - net realisable value, taking into account the prevailing interest rate scenario and expected cash flows from the investment.
(j) Unlisted equity and corporate debt – held in shareholders' funds	Estimated realisable value
(k) Unrated corporate debt - held in shareholders' funds	Estimated realisable value
(l) Unit trusts and mutual funds	Most recent manager's buying price quoted by the unit trust or mutual fund
(m) Gold kept in safe custody in a bank	Lower of market price and estimated realisable value
(n) Net amounts receivable from reinsurers**/co-insurers**	Net amount receivable after deducting the provision for bad and doubtful debts
(o) Outstanding policy loans	Net realisable value
(p) Premium outstanding	Actual amount
(q) Mortgage loans on immovable property	Estimated realisable value

Question 10

Please indicate whether your company is considering investing in any assets apart from those outlined in Table 1 and Table 2. Please provide details around the nature of the asset along with the necessary details such as issuing agency, listed / unlisted, rated / unrated, tenure and means to arrive at the market consistent valuation of such assets.

Question 11

Please share your comments on the appropriateness of the proposed approach for the valuation of leasehold land and building. Please include any alternative approach along with the rationale.

Question 12

Are there any other comments regarding Part IV –Admissible assets, asset limits and asset valuation, that the Commission shall consider in the development of revised Rules? If “yes”, please explain with sufficient details and rationale.

Part V – Valuation of Liabilities

20. (1) For the purpose of calculating CAR, insurers shall value insurance liabilities on a market consistent basis in accordance with the provisions of this Part.

(2) Every Insurer shall value non-insurance liabilities in accordance with Sri Lanka Accounting Standards.

21. (1) Every insurer shall value long term insurance liabilities using the following formula ;

Long term insurance liability = best estimate (BE) long term liability + risk margin for adverse deviation (RM)

(2) Every insurer shall value general insurance liabilities using the following formula:

General insurance liability = claims liability + premiums liability

Where claims liability (CL) = BE claims liability + RM claims liability

Where premium liability (PL) = Max {UPR, [BE (URR) + RM(URR)]}, and

Where UPR means unearned premium reserve and URR means unexpired risk reserve.

22. (1) Subject to the provisions of this Part, the BE liability is the present value of all future BE cash flows calculated using the risk-free interest rate yield curve required by rule 32.

(2) Subject to provisions of paragraph (3), insurers shall calculate the BE liability using a discounted cash flow approach covering all the cash in and out flows required to settle the obligations under in-force policies.

(3) Every long-term insurer shall use a discounted cash flow approach equivalent to gross premium valuation methodology to calculate the liabilities of :

i. non-participating policies ;

ii. [the guaranteed benefits of] participating policies; and

iii. the non-unit linked liabilities of unit linked long term policies

Question 13

Please share your understanding in respect of the calculation of policy liabilities for the universal life business i.e. whether policy liabilities shall be calculated using the gross premium valuation approach or shall the liability be based on fund value plus non-unit liabilities along with the rationale for the same.

23. Subject to the provisions of rule 24, relevant future cash flows include :

a. future premiums, charges and fees

b. administrative expenses, investment management expenses, commission expenses and claims management expenses ;

c. claims payments ; and

d. for long term policies, benefits payments including death, survival, critical illness and disability benefits, and benefits payable on lapse, surrender, premium discontinuance, or other contingency **– including all guaranteed and non-guaranteed future discretionary benefits;**

[Explanation –Current approach of calculating two separate liabilities (GBL and TBL) is not consistent with the market consistent principle wherein GBL though discounted using risk-free

interest rate yield curve, doesn't allow for the future discretionary benefits while TBL, though allows for all future cashflows, but is discounted using fund-based yield and not the risk-free interest rate yield curve. Hence, this leads to an inconsistency in the valuation of assets and liabilities. It is proposed to have a single market consistent liability value which includes non-guaranteed future discretionary benefits]

Question 14

Please comment if you agree with the proposed approach of having a single policy liability estimate for participating business. Please share alternative approach in sufficient detail and rationale for alternative approach in case you disagree.

24. In determining the BE of the present value of future pre-tax cash flows, insurers shall exclude :

    a. income tax payments and receipts ;

    b. cash flows arising from future policies ; and

    c. investment returns from current or future investments except returns related to long term policies linked to the performance including unit linked long term policies, universal life policies, and participating policies, where future investment returns may affect the benefits payable to policyholders.

Question 15

In your opinion, are there any other cash flows that you believe should be considered for inclusion or exclusion when calculating policy liabilities?

25. All relevant cash flows for in-force policies that are reasonably likely to occur after the valuation date shall be included on a prospective basis.

26. Every insurer shall value liabilities on a policy by policy (seriatim) basis but, to the extent that this is not reasonably possible, insurers may use reasonable approximations or groupings of data.

27. (1) Every insurer shall calculate liabilities both gross and net of reinsurance. **For general insurance business, every insurer shall calculate liabilities gross and net of reinsurance as well as co-insurance.**

    (2) For the purpose of determining liabilities, both gross and net of reinsurance **and co-insurance**, relevant future cash flows shall also be determined on a gross and net basis.

    (3) Every insurer may use reasonable approximations of the impact of non-proportional reinsurance arrangements on the BE liabilities and RMs.

Question 16

Please explain how your company currently considers co-insurance arrangements in calculation of gross and net liabilities i.e. whether gross liabilities are calculated gross of co-insurance or both gross and net liabilities are calculated net of co-insurance.

Question 17

Please share your comments on the proposed treatment of co-insurance contracts to be same as that of reinsurance contracts for valuation of liabilities and whether there are additional considerations for the Commission with respect to this change. Please include any alternative approach along with the rationale.

[Explanation – It is noted that co-insurance in Sri Lanka operates on a similar model as re-insurance, wherein an insurer first sells a policy and then finds another insurer to co-insure the risks.

Therefore, for general insurance business, gross premium and claims liability shall consider the entire liability gross of co-insurance arrangement i.e. aligned to the manner in which gross of reinsurance liabilities are determined.

Similarly, net premium and claim liability shall be calculated as net of premiums payable under co-insurance (for calculation of premium liability) and net of expected claims receivable (for calculation of claims liability). Hence, it is proposed to treat the co-insurance contract similar to that of a reinsurance contract, noting how co-insurance works in Sri Lankan market and liabilities should accordingly be calculated]

28. Every insurer shall use, in order to calculate the BE liabilities, appropriate actuarial and statistical techniques (such as analytical techniques, deterministic techniques, and simulation methods) to determine the mean of possible outcome, taking into account all relevant information about the insurer's business.

29. (1) Every insurer shall calculate the cash flows used to determine the BE liabilities on the basis of reasonable, supportable, and explicit BE assumptions to estimate the mean of possible outcomes.

(2) BE assumptions shall:

a. be made using judgment and be based on experience ;

b. take into account relevant statistical and other information ; and

c. be neither overstated nor understated.

(3) Every insurer shall use, subject to the provisions of paragraph (4), their own experience as the starting point in determining BE assumptions for future experience.

(4) If their experience is not sufficiently credible, such insurers shall use appropriate industry data, data from reinsurers, population statistics, or the assumptions used in a recent business planning exercise, to set suitable BE assumptions.

(5) Unless the nature of the liability is sufficiently simple, such insurers shall make appropriate adjustments to their BE assumptions to take into account the extent to which variations in the assumptions may be correlated with, or may influence, each other in adverse circumstances so that the BE liability reflects the mean of the distribution of potential liability outcomes.

(6) Without prejudice to the provisions of rules 30(4) and 33(4), insurers shall review all BE assumptions on a regular basis and revise them, if appropriate, before the next valuation date.

30. (1) Every insurer shall use, in order to project future cash flows to determine BE liabilities, reasonable BE assumptions for non-market risks and other inputs, including :

a. mortality and morbidity ;

b. policy discontinuances, lapses and surrenders ; and

c. expenses and expense inflation

(2) Positive or negative correlations between two or more non-market inputs shall be reflected in the calculation of the BE liabilities in a consistent manner.

(3) For disability benefits, BE assumptions shall be made for mortality and recovery rates, as well as for disability incidence rates ;

(4) Every insurer shall review the BE assumptions related to lapses and surrenders at least once annually and revise them to reflect their most recent experience, if appropriate, before the next valuation date.

(5) Every insurer must establish a board-approved crediting rate policy for its universal life business. This policy shall govern all crediting rates, including declared rates, rates guaranteed at the start of the year, and the assumptions for future crediting rates used in the calculation of policy liabilities.

[Explanation – It is proposed for insurance companies to mandatorily have a board approved crediting rate policy, which is also approved by the Actuary of the insurer. It is observed that all insurers generally have an internal mechanism to derive the declared crediting rate however, they might not have a formal board approved policy. To ensure effective governance of universal life products in respect of crediting rate declared to the policyholders as well as a consistent approach is used to derive future crediting rate assumption, it is proposed to have a board approved policy which will govern crediting rate declared historically, interim crediting rate guaranteed during the year, future crediting rate assumption under the base liability calculation as well as extent to which this assumption should change under increasing and decreasing interest rate scenario under interest risk capital charge.

This has been further elaborated under the section of interest rate risk capital calculation in Part VII of this document.]

(6) Every insurer must establish a board approved bonus policy for the participating business. This policy shall govern all bonus rates (including reversionary bonus, cash bonus and terminal bonus), including declared bonuses, and assumptions for future bonus rates used in the calculation of policy liabilities. Bonus rates used for the valuation of participating policies shall be supportable and consistent with the risk-free interest rate yield curve under Rule 32. As a transitionary measure, insurers are allowed to comply with these provisions within three years from the date of implementation of the Rules.

[Explanation – It is proposed for insurance companies to mandatorily have a board approved bonus policy, which is also approved by the Actuary of the insurer. It is observed that all insurers generally have an internal mechanism to derive the declared bonus rate however, they might not have a formal board approved policy. To ensure robust bonus declaration mechanism as well as to ensure fair treatment of policyholders, it is proposed for insurers to have a board approved policy. This policy should govern the bonus rates declared for each year, future bonus rate assumption and extent which this assumption should change under increasing and decreasing interest rate scenarios. Given that most of the insurers will require time to develop such policy, a transitionary relief is proposed for the insurers to comply with the suggested revision.

This has been further elaborated under the section of interest rate risk capital calculation in Part VII of this document.]

Question 18

Please share your comments on proposal for long term insurer to mandatorily have a board approved crediting rate policy driving future crediting rate assumption used to determine liability cashflows as well as driving change in future crediting rate assumption in calculation of liability cashflows underlying interest risk capital charge. Please provide any alternative approach with sufficient detail and rationale.

Question 19

Please share your comments on proposal of long-term insurer to mandatorily have a board approved bonus policy driving future bonus assumption used to determine liability cashflows as well as driving change in future bonus assumption in calculation of liability cashflows underlying interest risk capital charge. Please provide any alternative approach with sufficient detail and rationale.

Question 20

If your company doesn't have a board approved crediting rate policy, please share the expected methodology (including internal processes) that you will use to calculate the impact of proposed change in calculation of interest risk capital charge with respect to changing future cashflows to the extent of change in future crediting rate assumption under increasing/decreasing interest rate scenario.

Question 21

If your company doesn't have a board approved bonus policy, please share the expected methodology (including internal processes) that you will use to calculate the impact of proposed change in calculation of interest risk capital charge with respect to changing future cashflows to the extent of change in bonus rate assumption under increasing/decreasing interest rate scenario.

Question 22

Do you agree with the transitional arrangement and time provided for such arrangement in respect of valuation of participating policy liabilities. If not, please share the rationale and alternative approach.

31. (1) Subject to the provisions of paragraph (3), in calculating the BE liabilities, every insurer shall take into account the effect of any non-linear or asymmetrical distribution of outcomes by using an appropriate method to simulate the probability distribution.

    (2) Subject to the provisions of paragraph (3), if a non-liner or an asymmetrical distribution has a significant effect on the value of the cash-flows, for example in the case of policies that contain embedded options and guarantees, every insurer shall take into account the asymmetrical distribution of liability outcomes using a simulation method to calculate the BE liability as the mean of an appropriately simulated probability distribution.

    (3) If such policies represent less than 5% of the total insurance liabilities, with the approval of the Commission, insurers may use a deterministic method.

32. (1) Subject to the provisions of paragraph (2), every insurer shall use a risk-free interest rate yield curve to discount liability cash flows, **as published by the Commission**.

    (2) Every insurer may, with the approval of the Commission, use a risk-free interest rate yield curve developed using an appropriate mathematical model and consistent with current Sri Lankan Government bond rates.

(3) If the Commission has not approved an interest rate curve under paragraph (2), such insurer shall use the current risk-free interest rate yield curve published by the Commission.

(4) During periods of extreme economic volatility, the market data-based derivation of risk-free interest rate yield curve may not be reliable for solvency assessment. In such event, the Commission shall consult the insurers to collectively review and analyze the approach for overall evaluation of solvency (including derivation of risk-free interest rate yield curve, asset valuation etc.).

[Explanation – The current approach to derive risk-free interest rate yield curve assumes constant yield post 10 years. Other issues were highlighted to the Commission include negative forward rates derived from the current approach of boot-strapping based on market data.

It is proposed that the risk-free interest rate yield curve will be derived based on the three-segment approach:

Segment 1: Use of market data over period where market is sufficiently deep and liquid (last liquid point). The last liquid point shall be reviewed regularly and updated in case of any market movement.

The Commission shall consider smoothing the market rates using methodology such as fitting a Nelson-Siegel-Svensson equation on the market rates.

Segment 2: Convergence of last liquid point to ultimate forward rate using Smith-Wilson approach at convergence point i.e. 60th year. For Smith-Wilson approach alpha is set at the lowest value that produces a yield curve reaching the convergence tolerance of the LTFR by the convergence point. A lower bound for alpha is set at 0.05. The convergence tolerance is 0.1 basis point and is achieved at convergence point.

Segment 3: Post convergence point, use of Ultimate Forward Rate (UFR). UFR will be derived using medium to long term estimates of target inflation by the CBSL and expected real interest rate derived based on historic GDP growth rates for Sri Lankan market. UFR will be re-evaluated on the above parameters by the Commission at 31 December every year. The maximum year-on-year change in UFR shall be limited to 15 basis points.

For example, for 31 December 2024, the market data suggests that long term inflation targets by CBSL are 4% and expected real return based on historic GDP for Sri Lanka is 4%, implying a UFR of 8%.

The above approach takes care of current limitations in the risk-free curve as:

a. *Market data is only used till last liquid point. The Commission, though survey form issued to the industry and through discussion with RBC task-force, concluded LLP to be set as 10 years.*
b. *Nelson-Siegel-Svensson equation used to smoothen market data to avoid negative forward rates.*
c. *Use Smith Wilson approach to interpolate the risk-free interest rates between LLP and convergence point, based on thorough analysis of globally accepted practice, instead of keeping the curve unchanged beyond the LLP.*
d. *UFR derived using stable parameters to reflect market expectation of long-term yields.*

During the period of market volatility such as economic crisis where asset valuations and corresponding market yields are not reliable, it is proposed for the Commission and relevant industry representatives to collectively arrive at the approach to determine risk-free interest rates for evaluation of solvency.]

Question 23

Please share your comments on the appropriateness of the proposed approach as well as parameters used for derivation of risk-free interest rate yield curve from the Sri Lankan context including any possible alternatives for derivation of risk-free interest rate curve with rationale. Parameters include:
a. Last liquid point
b. Basis of interpolation (Smith Wilson approach), including tolerance limit
c. Convergence point
d. UFR

Question 24

Please share your comments on the proposed methodology of smoothing the market yields in the first segment using Nelson-Siegel-Svensson equation, from Sri Lankan context, to overcome the limitation in respect of negative forward rates and market volatility. Please share your comments on any alternative approach that can be used to overcome this challenge, with underlying rationale.

Question 25

Are there any other comments regarding the base yield curve methodology that the Commission shall consider in the development of revised Rules? If "yes", please explain with sufficient details and rationale.

33. (1) In determining BE assumptions for mortality and morbidity risks, unless the Commission has required the use of specified mortality or morbidity tables, long term insurers may use standard industry mortality and morbidity tables, adjusted by a suitable multiplier wherever appropriate and to remove any implicit margins.

(2) Subject to the provisions of paragraph (3), the multiplier shall be based on the insurer's recent experience, comparing actual to expected mortality and morbidity.

(3) If an insurer does not have sufficient experience, the insurer shall use industry data, data from reinsurers, population statistics, or the assumptions used in a recent business planning exercise, to set suitable BE assumptions.

(4) Every insurer shall review the BE assumptions related to mortality and morbidity at least once every three years and revise them to reflect the most recent experience before the next valuation date.

34. [Deleted]

[Explanation – Current approach of calculating two separate liabilities (GBL and TBL) is not consistent with the market consistent principle wherein GBL though discounted using risk-free rate of return, doesn't allow for the future discretionary benefits while TBL, though allows for all future cashflows, but is discounted using fund-based yield and not the risk-free rate. Hence, this leads to an inconsistency in the valuation of assets and liabilities. It is proposed to have a single market consistent liability value which includes non-guaranteed future discretionary benefits.

Question 26

Are there any other comments regarding the participating policies liability valuation that the Commission shall consider in the development of revised Rules? If "yes", please explain with sufficient details and rationale.

35. (1) Every insurer shall determine the non-unit linked liabilities of unit linked long term policies by projecting the non-unit linked and linked future cash flows to determine if the insurance fund will be sufficient to meet future obligations and, if not, shall increase the liability value to eliminate the deficit.

(2) The non-unit linked cash flows shall be discounted using the interest rate yield curve required by rule 32.

(3) When the growth of a unit linked long term fund leads to a cash inflow, insurers shall determine the cash flows by adjusting the fund growth rate assumptions (allowing for an appropriate RM) in calculating the future cash flow.

(4) The fund growth rate assumption shall be consistent with the fund experience provided by the fund manager

36. (1) Every insurer may establish negative liabilities for long term policies (and are not required to set the liabilities to zero).

Where the calculated mathematical reserve in respect of a policy is negative, a Reserve Floor Adjustment equal to the amount of the negative reserve shall be made, ensuring that the reserve held is not less than zero - at a level of granularity deemed fit by the Actuary.

[Explanation – The current RBC framework allows for negative liabilities, which is balanced by the application of the SVCC in the RCR calculation. However, with the proposal to remove SVCC, this balance is disrupted. It is therefore proposed, to hold a Reserve Floor Adjustment, with respect to negative mathematical reserves at a level of granularity as deemed fit by the Actuary's judgement; and credit to the extent of the amount of such adjustment can be taken in calculation of Total Available Capital.

Further, it was also evaluated that, if negative liabilities were allowed (in absence of any direct or indirect floors), higher surplus estimated within the policyholder fund due to negative liabilities represents surplus arising from future profitability. However, such surplus should be recognized as distributable surplus (and transferable to shareholders as dividends) if operating assumptions underlying liabilities hold true. As a result, insurance companies should re-evaluate the surplus emerging in policyholder fund after zeroisation of negative liabilities while determining surplus distributable to shareholder as dividends - to ensure that surplus created because of negative liabilities is not distributed to the shareholders till not actually realised. Commission will issue separate direction/clarification on need for dividend approval to address this concern – this direction/clarification will be treated as an additional requirement over and above the requirement proposed in #36 of the Rules and will be applicable only for the purposes of approval of dividend declaration by IRCSL. The granularity at which surplus will be re-assessed for this purpose will be evaluated at different levels during QIS.]

(2) If the surrender value of a policy is higher than the sum of the BE liability and the RM, the value of the BE liability may not be increased to the surrender value of the policy.

Question 27

For the purpose of taking IRCSL approval on the amount of the dividend payable to shareholders, please share your comments with underlying rationale, on the proposed approach of re-calculating surplus underlying policyholder fund with zeroising the negative liabilities at adequate level of granularity as will be prescribed by IRCSL in a separate direction/clarification (such as product level or line of business level) – to restrict dividend distribution attributable from surplus arising from negative liabilities?

Please include any alternative approach with rationale

37. (1) Every insurer shall identify all options and guarantees under long term policies and the value of the policy liability shall include an amount to cover the liabilities which may result from the exercise of the options and guarantees.

    (2) Every insurer shall use, subject to the provisions of paragraph (3), (4), and (5), a stochastic method to ensure the sufficiency of such policy liabilities at a 75% confidence interval.

    (3) The BE liability of policies with embedded options or guarantees may be valued using closed-form option pricing formulas or using an approach such as risk-neutral valuation.

    (4) Subjects to the provisions of paragraph (5), for long term policies with embedded options or guarantees, where a significant proportion of the total uncertainty arises from only one or a small number of risks, the remaining risks making an proportionately smaller contribution, insurers may use a valuation technique that combines a simulation approach for the primary risks along with a deterministic approach for the secondary risks.

    (5) Where the BE liability for policies with options or guarantees is expected to be less than 5% of the total long term insurance liabilities or where the options and guarantees are simple and short term, with the approval of the Commission, insurers may use a deterministic method.

38. Every insurer shall include in valuing long term insurance liabilities, appropriate determinations and values ; for

    a. the immediate payment of claims ;

    b. in the case of limited payment policies and paid-up policies, future expenses and bonuses;

    c. existing liabilities or expected future liabilities under policies that have lapsed ;

    d. disability benefits in payment ;

    e. policies kept in force where the premiums have been waived ;

    f. future benefits in the event of a life insured's disability or future waivers of premiums ;

    g. policies covering a substandard risk or a high-risk occupation ; and

    h. any other liability or contingent liability under a long-term policy not already listed

39. Every general insurer shall, using the methodology in Table 3 to calculate the UPR and the BE of URR, calculate the premiums liability for each sub-class of general insurance business using the following formula;

    Premium Liability (PL) = Max {UPR, [BE (URR) + RM (URR)]}

    Option 2: Premium Liability (PL) = (Combined Ratio – Acquisition expense ratio)*UPR + (Combined ratio – 1)*Present value of future premiums arising from within contract boundaries + RM *[Risk margin calculated as per Insurance Capital Standard prescribed methodology, as explained in Part VI shall be included in this option]*

Table 3: Calculation methodology for UPR and URR

Factor	Category	Valuation methodology
UPR	All general insurance policies except reinsurance policies	Premium adjusted for accounted commissions paid to intermediaries, not exceeding the commission required by the Commission For policies with a term of one year, an appropriate time apportionment method no less accurate than the 1/24th method ; for policies with a term longer or shorter than one year, a method that assumes a uniform spread of premiums during each month of the term of the policy
	All reinsurance policies	An appropriate time apportionment method no less accurate than the 1/8th method
BE (URR)	All policies	BE of expected future claims payments arising from future events, for risks assumed as at the valuation date, including an allowance for expected expenses incurred to settle claims, including overheads in administering the policies and settling the claims, and allowing for expected premium refunds.

[Explanation – In order to align to global forward -looking standard, it is proposed to evaluate the option of calculating premium liability and corresponding liability risk charges in line with Insurance Capital Standard. The RBC task-force indicated some inputs required for calculation approach suggested under Insurance Capital Standard may not be available with insurers, hence this approach is being evaluated as an option vis-à-vis no change.]

Question 28

Please provide your comments on the appropriateness of methodology underlying alternate proposed approach for calculating premium liability. Please provide any alternative approaches with rationale.

Question 29

Please provide your comments on the ability to calculate premium liability as per formula specified as option 2 in paragraph 39 of Part V. If a certain item is not available with the insurer, please specify with rationale.

40. (1) Every insurer shall calculate the claims liability for each sub-class of general insurance business using the following formula ;

Claims Liability (CL) = BE (Claims Liability) + Risk Margin (Claims Liability)

(2) In calculating the CL, insurers shall take into account all future payments related to claims incurred as at the valuation date, including claims incurred but not reported, claims outstanding, and expected direct and indirect claims related expenses such as investigation fees, loss adjustment fees, legal fees, medical fees, labour costs, and internal administrative costs.

(3) The BE of the CL shall reflect the statistical mean of the underlying distribution of the relevant insurance risks.

41. (1) Where policy administration expenses have not been included in the date used for determining insurance liabilities, general insurers shall make a separate provision for such expenses.

(2) When determining the BE of the CL and PL, general insurers shall make an appropriate allowance for future claims escalations caused by wage or price increases, court-awarded interest, or other environmental or economic causes.

(3) If the effect of the discounting is material and appropriate, insurers may calculate the CL and PL and on a discounted basis using the risks free interest rate yield curve required by rule 32.

Question 30

Are there any additional comment in respect of Part V- valuation of liabilities, which is currently not addressed as part of the revised Rules or in case any further clarification is needed. Please provide sufficient details outlining the concern, proposed solution and rationale for the same.

Part VI – Determination of RM

[Explanation (long term insurance) – The approach for calculation of risk margin is proposed to be aligned to the approach outlined in Insurance Capital Standard wherein risk margin is calculated as 85th percentile of a standard normal distribution characterised by mean equal to best-estimate liability net of reinsurance and liability risk capital charge represents 99.5% percentile. In mathematical term, calculation of risk margin can be defined as:

*Liability risk capital charge * 1.04/2.58; wherein 1.04 and 2.58 represent the Z-value of the standard normal cumulative distribution at 85th and 99.5th percentile*

Further, noting the current risk margin is defined as 75% confidence interval, it is proposed to evaluate risk margin on 75th and 85th percentile for long term insurance business during QIS.]

[Explanation (general insurance) – The approach for calculation of risk margin is proposed to be aligned to the approach outlined in Insurance Capital Standard wherein risk margin is calculated as 65th percentile of a normal distribution characterised by mean equal to best-estimate liability net of reinsurance and liability risk capital charge represents 99.5% percentile. Insurance Capital Standard has prescribed following MS-Excel formula for calculation of risk-margin:

*Liability risk capital charge * 0.39/2.58; wherein 0.39 and 2.58 represent the Z-value of the standard normal cumulative distribution at 65th and 99.5th percentile*

Further, noting the current risk margin is defined as 75% confidence interval, it is proposed to evaluate risk margin on 65th and 75th percentile for general insurance business during QIS.

Feedback received from RBC task-force suggests evaluating two options:

a. no change in approach and factors to calculate risk margin and liability risk capital charge (noting relatively complex methodology prescribed in Insurance Capital Standard)

b. the overall impact on risk margin and liability risk capital charge to be aligned to Insurance Capital Standard. For avoidance of confusion, the liability risk charge used in prescribed formula mentioned above, shall be evaluated based on ICS prescribed liability risk charge factors and methodology; to evaluate a holistic impact of approach specified in Insurance Capital Standard .]

42. (1) Every **long term** insurer shall determine a RM so that the sum of the BE liability and the RM represents a **75% or 85%** confidence interval with respect to the underlying probability distribution of the possible outcomes.

Every **general** insurer shall determine a RM so that the sum of the BE liability and the RM represents a **65% or 75%** confidence interval with respect to the underlying probability distribution of the possible outcomes.

(2) In determining the RM, insurers shall take into account the impact of the provisions of the insurer's reinsurance contracts (such as retention limits or quota share percentages) **and co-insurance contracts** on the determination of the present value of reinsurance/ **co-insurance** recoverable under the stress scenarios or on the application of the RM factors to the BE liabilities.

43. (1) If an insurer has sufficiently credible experience, with the approval of the Commission, the insurer may use an internal model to determine appropriate RMs so that the sum of the BE liability and the RM achieves the required **75% or 85% confidence interval for long term insurance and 65% or 75% confidence interval for general insurance**.

(2) The RMs determined using an internal model may apply at the product level rather than to each sub-class and, if an insurer has sufficiently credible experience to determine such an assumption, the model may include an assumption for risk diversification.

(3) As at each valuation date, insurers shall be able to demonstrate that the sum of the BE liability and RM in each case achieves the **75% or 85% confidence interval for long term insurance and 65% or 75% confidence interval for general insurance** .

44. (1) If the Commission has not approved an internal model under rule 43, long term insurers shall [use the default RMs specified in Table 4] **use the default approach specified in this paragraph.**

(2) [Deleted]

(3) [Deleted]

(4) [Deleted]

Risk margin for long term insurers will be calculated as 75th or 85th percentile of the normal distribution characterized by:

a. **A mean equal to the best-estimate liability, net of reinsurance for long-term insurance, calculated subject to provisions of Part V – Valuation of Liabilities; and**

b. **A 99.5% percentile equal to the liability risk capital charge for long-term insurance, calculated subject to provisions of paragraph 59 of Part VII – Determination of Risk Capital Required (RCR).**

45. (1) If the Commission has not approved an internal model under rule 43, general insurers shall use the default RMs specified in Table 5.

(2) The RMs for the URR and CL shall be calculated by multiplying the BE liability by the relevant RM factor in Table 5.

(3) When the RMs are calculated using Table 5, no additional credit for diversification may be taken.

Table 5: Default RMs for general insurance liabilities

Business category	URR RM as % of BE	CL RM as % of BE
A. High volatility		
Liability insurance (such as public, product, employers, Professional Indemnity)	19%	16%
Aviation and marine hull		
Other liability (except motor)		
B. Medium volatility		
Cargo	14%	12%
Engineering		
Motor Liability		
Workers' compensation		
C. Low volatility		
Fire	10%	8%
Motor damage or loss		
Personal accident		
Health		
Other (non-liability)		

[Option-2] - the risk margin for general insurers shall be calculated as 65th or 75th percentile of the normal distribution characterized by:

a. **A mean equal to best-estimate liability, net of reinsurance for general insurance, calculated subject to provisions of Part V – Valuation of Liabilities; and**

b. **A 99.5% percentile equal to the liability risk capital charge for general insurance, calculated subject to provisions of paragraph 59 of Part VII – Determination of Risk Capital Required (RCR).**

Question 31

Please share your comments on the proposed methodology for calculation of risk margin for long term insurance business. Please include any alternative approach along with the rationale.

Question 32

Please share with rationale the preferred approach for the calculation of risk margins for general insurance business. Please include any alternative approach along with the rationale.

Question 33

Please share your comments on the choice of confidence interval for calculation of risk margin for long term/general insurance along with the rationale.

Question 34

Are there any other comments regarding the risk margin methodology that the Commission shall consider in the development of revised Rules? If “yes”, please explain with sufficient details and rationale.

Part VII – Determination of Risk Capital Required (RCR)

46. (1) Subject to the provisions of paragraph (2), every insurer shall make the calculations required in this Part for each risk charge, applied to the total of insurance funds and shareholders' funds, then add the resulting amounts to arrive at the total RCR, using the following formulas:

a. for general insurance business :

RCR = √[(credit risk capital charge + concentration risk capital charge + reinsurance risk capital charge + market risk capital charge)^2 + liability risk capital charge^2 + operational risk capital charge^2 **+ catastrophe risk capital charge^2**]; and

b. for long term insurance business :

RCR = max {(SVCC, √[(credit risk capital charge + concentration risk capital charge + reinsurance risk capital charge + market risk capital charge)^2 + liability risk capital charge^2 + operational risk capital charge^2 **+ catastrophe risk capital charge^2**]

[Explanation: Catastrophe risk capital charge is integrated within entity-level diversified risk capital (similar treatment as market risk, operational risk) to be consistent with the Insurance Capital Standard prescribed approach]

Question 35

Please share your comments on treating catastrophe risk charge similar to other risk charges as market risk charge, operational risk charge etc. (vis-à-vis including within liability risk charge). Please include any alternative approach along with the rationale.

(2) Except for operational risk under rule 61, risk charge do not apply to assets required to be deducted from TAC under rule 12.

(3) Subject to provisions of paragraph 52 (1) for long term insurance business, an insurer can take credit of change in the liability cashflows for future discretionary benefits in calculation of interest rate risk capital charge. The overall reduction in RCR driven by revision of future discretionary benefits should be limited to the extent of present value of all future discretionary benefits allowed in the calculation of base liabilities.

[Explanation – It is proposed to allow long term insurance companies to reflect the change in the future discretionary benefits under the stress scenarios to the extent of future actions that are contractually enforceable, are assumed to be enacted by the insurers under such stress event and are in line with their board approved policies on management of such products(including, but not limited to, board approved bonus philosophy, crediting rate philosophy). The maximum permissible reduction in RCR due to alteration of future discretionary benefits is restrict to the extent of the future discretionary benefits allowed for in the base liabilities i.e. RCR without revision of future discretionary benefits less RCR with revision to future discretionary benefits is less than or equal to the present value of future discretionary benefits under best-estimate liability.

Hence, insurer shall calculate the extent of future discretionary benefits allowed for in the base liabilities by setting future discretionary benefits to nil and compare those with the impact of change in the RCR due to change in the future discretionary benefits. Any reduction is RCR in excess of future discretionary benefits under base liabilities shall be zeroised]

Question 36

Please share your comments on the proposed approach for implementing a ceiling on the maximum benefit that can be availed by an insurer, with respect to change in future discretionary benefits allowed in calculation of RCR. Please also include alternative approach with rationale, if any.

Question 37

Please share any operational or modelling complexities envisaged by insurers to implement the calculation underlying

a) change in liability cashflows (to the extent of expect change in future discretionary benefits) within interest risk charge calculation
b) calculation of overall entity level RCR, taking into consideration maximum permissible benefit of such change in future discretionary benefit liability cashflows to be limited to future discretionary benefits allowed for in the base liabilities

Question 38

Are there any further comment that the Commission shall consider while defining the ceiling on benefits due to change in future discretionary benefits. Please share your comments along with the rationale.

47. (1) As required in paragraph (2) and (3), every insurer shall determine a credit risk capital charge by adding together each credit risk exposure multiplied by the credit risk factor, for that exposure, the credit risk exposure being the market consistent value of the financial instrument.

(2) Every insurer shall apply subject to the provisions of rule 48, apply the credit risk capital factors specified in Column 2 of Table 6 to the market consistent value of the related fixed income assets in the categories of admissible asset listed in Column 1 of Table 6, except investment in related parties (to which rule 54 applies).

(3) Every Insurer shall :

a. use the most recent credit rating for each counterparty or financial instrument, as the case may be, assigned by a credit rating agency falling within rule 15(2)(A) or (B); or

b. treat the asset as unrated.

Table 6: Credit Risk Capital Factors for Fixed Income Assets

Category of asset	Risk capital factor	
Government securities issued by Central Bank of Sri Lanka and Debt Securities / Deposits fully guaranteed by Government of Sri Lanka		0%
AAA rated debt securities issued or fully guaranteed by a foreign Government or a Central Bank of a foreign country		0%
Debt securities issued or fully guaranteed by a foreign government or a central bank of a foreign country (except AAA rated debt securities above)		
	Above AA-	1.6%
	A+ to A-	4.0%
	BBB + to BB-	8.0%
	Below BB-	12.0%
Corporate debt including bonds, debentures, commercial papers, and similar financial instruments and asset backed securities (except debt instruments with a term of less than 1 year)		

Category of asset	Risk capital factor	
	AAA to AA-	1.6%
	A+ to A-	4.0%
	BBB + to BB-	8.0%
	Below BB-	12.0%
	Unrated	16.0%
Corporate debt with a term of less than 1 year		
	A1/P1	1.6%
	A2/P2	4.0%
	A3/P3	8.0%
	Unrated	12.0%
Deposits with a licensed commercial bank or licensed specialised bank, or a licensed finance company		
	AAA to AA-	1.6%
	A+ to A-	4.0%
	BBB + to BB-	8.0%
	Below BB-	12.0%
Other admissible assets		
	Cash and cash equivalents	0%
	Policy loans	0%
	Premium outstanding	0%
	Mortgage secured by residential property	2.8%
	Mortgages secured by commercial property	8.0%

48. (1) Every insurer may, subject to the provisions of paragraph (2), apply a lower credit risk capital factor to a debt (except mortgage debt and debt to which a risk factor of 0% already applies) if the debt is guaranteed by a recognized guarantor (a risk mitigation instrument)

(2) If an insurer holds a risk mitigation instrument, the insurer may :

a. apply the higher of the risk factor applicable to the guarantor or 1.6% to the portion of the debt that is guaranteed; and

b. apply the risk factor applicable to the issuer to the portion of the debt that is not guaranteed.

Every insurer may apply a lower credit risk capital factor on credit risk exposure under green bonds listed a stock exchange. For such green bonds, the credit risk capital factor associated with corporate bonds of an equivalent rating shall be reduced by a haircut which will be assessed as part of the QIS.

[Explanation – Green bonds listed on a stock exchange are expected to have a sound governance structure around its use including a monitoring mechanism. Further, in order to promote investment in such bonds, it is proposed to include a haircut on the credit risk capital charge for such bonds]

Question 39

a. Please share your comments on the proposed preferential treatment of green bonds while calculation of credit risk capital charges with rationale. Please include any alternative approach along with the rationale.

b. Please share your comments on the quantum of relief/haircut on the credit risk capital charges for green bonds along with the rationale. Please provide a numeric response to this question.

Question 40

a. Please confirm if your organisation has exposure to such bonds or if planning to invest in such bonds in near future.

b. Please share your comments on the expected riskiness of green bonds vis-à-vis a corporate debt based on the expected listing requirements, governance framework, expected rating criteria etc.

49. Every insurer shall:

a. apply a concentration risk capital factor of 100% to the value of the assets that are not admissible assets and that are not required to be deducted from TAC under rule 12; and

b. aggregate the resulting amounts to form the concentration risk capital charge.

50. (1) Every insurer shall calculate a reinsurance **and co-insurance** risk capital charge for each reinsurance**/co-insurance** counterparty using the following formula:

Reinsurance **and Co-insurance** risk capital charge = Reinsurance **/ Co-insurance** risk exposure x Counterparty credit risk factor; where the reinsurance risk exposure the sum of :

a. admissible amounts due from the reinsurance**/co-insurance** counterparty, including claims recoverable and ceding commissions.

b. Reinsurance**/co-insurance** recoveries in respect of claims incurred including ceded claims liabilities;

c. for long term insurance business, the difference between the value of the gross liabilities and the net liabilities of the insurer in respect of its participating policies, non-participating policies, and unit linked long term policies due to reinsurance ceded to the reinsurer; and

d. for general insurance business, the difference between the gross premiums **and claims** liability and the net premiums **and claims** liability of the insurer due to reinsurance**/co-insurance** ceded to the reinsurer **and co-insurance arrangement**.

e. **Amount of reinsurance credit taken in the calculation of catastrophe risk capital for both life and general insurance business**.

[Explanation – Insurers are allowed to take reinsurance credit of catastrophe reinsurance in place while calculating the capital for catastrophe risk. Hence, appropriate reinsurance capital risk charge is applied to the extent of reinsurance credit taken.

Further noting consistent approach proposed for treatment of co-insurance and re-insurance, it is proposed that co-insurance risk capital is calculated in the same manner as re-insurance risk capital. Accordingly, re-insurance risk capital is re-named as "re-insurance and co-insurance risk capital".]

(2) The counterparty credit risk capital factors are specified in Table 7, except that, in the case of reinsurance ceded to the National Insurance Trust Fund Board of Sri Lanka the credit risk capital factor is 0%.

(3) Every insurer shall aggregate the risk capital charges calculated for each reinsurance **and co-insurance** counterparty to form the reinsurance risk capital charge.

Question 41

Please share your comments on additional reinsurance risk capital charge calculated on credit of reinsurance taken in calculation of catastrophe risk capital charge.

Question 42

Please share your comments on treatment of co-insurance arrangement same as that for reinsurance arrangement, including the use identical risk factors while arriving at the reinsurance risk capital charge.

Question 43

Please share any additional considerations in respect of the reinsurance risk capital charge which shall be addressed as part of revision to the Rules with sufficient detail and rationale.

Table 7: Reinsurance / co-insurance credit risk factors

Credit rating of reinsurer (rated by a credit rating agency listed in Part A of the Schedule)	Risk factor
AAA to AA -	1.6%
A+ to A -	4.0%
BBB + to BB -	8.0%
Below BB -	12.0%
Unrated	16.0%

[new section inserted]

For long term insurance business, every insurer shall calculate a catastrophe risk capital charge using the following approach:

a. **Value of change in liabilities by applying an additive mortality stress of 0.15% p.a. on the mortality rate for the next 12 months from the valuation date i.e. an absolute increase of 0.15% in the annual mortality rate over the next 12 months from the valuation date.**

b. **An insurer shall apply catastrophe risk capital charge only on products exposed to mortality risk.**

c. **An insurer can consider the effect of reinsurance, including any catastrophe reinsurance, wherever applicable provided there is no double counting of the effect of the reinsurance contract. If catastrophe reinsurance treaty excludes select catastrophe events (for which the underlying insurer is liable to policyholders), the Appointed Actuary should justify the rationale of treatment of such reinsurance cover**

in calculation of catastrophe risk capital charge and seek appropriate clarifications from the Commission.

d. **The value of catastrophe risk capital charge, net of reinsurance shall be floored to zero.**

Question 44

Please share your comments on the proposed approach of inclusion of catastrophe risk in the RCR calculation for long term insurance business including the proposed quantum of the stress. Please share the alternative approach or stress quantum and rationale for the same.

Question 45

a. Please confirm if the hospitalisation benefit riders/ disability riders/ any base product offering hospitalization and disability benefits sold by your company are exposed to pandemic risks and cover a payment to the policyholder in case of a pandemic.
b. Please provide the current exposure (SA or benefit offered) of your products which are covering pandemic risk (as at 31 March 2025) as proportion to the total exposure to health riders ((irrespective of pandemic risk covered or not).

Question 46

Are there any further comment that the Commission shall consider while determining the catastrophe risk capital charge for long term insurance business. If “yes”, please explain with sufficient detail and rationale.

[new section inserted]

For general insurance business,

a. **Natural perils – floods: Risk capital for flood peril for business written within Sri Lanka shall be calculated using either of below methods:**

- **Insurers can use internally developed catastrophe model, by taking the difference between the 99.5th percentile and the mean of the total annual net losses derived from the catastrophe model. Such model should be approved by the Actuary of the insurer and submitted to the Commission for approval.**

i. **Apply factor of 0.05% with the sum insured/covered for products that are exposed to flood peril.**

b. **Natural perils – others: Risk capital for natural catastrophe perils shall be calculated by multiplying the below factors for each peril with the maximum amount of gross loss covered by a licensed person over a one-year period (net of reinsurance)**

Peril	Factor
Earthquake	5.0%
Windstorm	2.0%
Other perils (including flood peril in relation to business outside Sri Lanka)	1.0%

The calculation of catastrophe risk capital charge for man-made perils shall be determined using the following approach (based on the specific exposure):

c. **Man-made perils – Terrorism: Risk charge is calculated as total loss of property; including building, motor or any other property or insurance contracts arising from**

loss of property. This is assessed via scenario testing of five-tonne bomb blast for the largest geographical risk concentration partly or fully located within a radius of 500 metres. For property damage, including insured properties and related covers, the following assumptions are made:

i. **100% damage ratio within a circular zone of a 200-metre radius;**

ii. **25% damage ratio for the next circular zone up to a 400-metre radius; and**

iii. **10% damage ratio between 400 and 500 metres.**

For disabilities, the following assumptions are made:

i. **20% disability rate within a circular zone of a 200-metre radius; and**

ii. **10% fatality rate between 200 and 500 metres.**

d. **Man-made perils – Mortgage insurance: Risk capital is determined as aggregate loss amount resulting from an increase in frequency and severity due to 25% decline in home prices, assumed to persist for one-year time period. The total loss amount includes the impact of both an increase in frequency of delinquency and defaults and an increased loss severity that results from the decline in home prices.**

e. **Man-made perils – Trade credit: The trade credit coverage indemnifies the policyholder for bad debt losses incurred due to a customer's inability to pay. Risk capital amount for this risk is based on total loss due to policyholder's inability to pay, indicated by both an increase in both the probability of default and the loss given default. This is calculated based on aggregate net earned premium for trade credit, split by external credit rating category: investment grade vs. non-investment grade. Credit stress factor of 80% is applied on investment grade and 200% is applied on non-investment grade.**

f. **Man-made perils – Surety: A surety bond indemnifies the policyholder from the principal's inability to perform its contractual obligation. The risk capital is defined as a total net potential loss amount based on the penal sum of the surety bond. Net potential loss amount for a principal is calculated using the gross exposure of the principal. Loss severity model 95% probable maximum loss (PML) is applied to the gross exposure. The loss amount is then adjusted for any co-surety arrangements, acceptable cash collateral and any reinsurance arrangements. Such calculations are performed on the largest net potential losses for its ten largest exposures to surety counterparties, with the capital amount based on the amount of two largest net losses.**

All catastrophe scenarios are aggregated as follows:

$$\text{Risk Capital}_{Cat} = \sqrt{RC^2_{Nat\ Cat} + RC^2_{Terror} + RC^2_{Pandemic} + RC^2_{Credit\ and\ Surety}}$$

[Explanation – Current Rules didn't allow for risk capital requirements for catastrophe risks. However, risk-based capital approach should address and allow for all relevant and material risks in valuations and / or regulatory capital requirement. In order to accommodate all relevant risks, it is proposed to introduce catastrophe risk for both life and general insurance business.

For general insurance business, the feedback received from task-force indicates limited availability of data to calibrate stress factors, hence a mix of Insurance Capital Standard prescribed risk charges and risk charges applicable in other regulatory regimes have been leveraged and adjusted to account for natural perils prone in Sri Lanka.]

Question 47

Please comment on additional natural or man-made perils which are relevant from Sri Lankan context and hence should be allowed for in the calculation of catastrophe risk capital charge for general insurance business. Please provide a list of amendments including a definition of the peril to include along with any other specific details to support the suggestion.

Question 48

Is the approach proposed adequate to account for diversification effects between Catastrophe risks? If "no", please provide a more appropriate alternative suggestion including rationale.

Question 49

Are there any further consideration for the Commission while determining the catastrophe risk capital charge for general insurance business. If "yes", please explain with sufficient detail and rationale.

51. Every insurer shall determine a market risk capital charge as follows:

Market risk capital charge = Interest rate risk charge + Credit spread risk charge + Equity risk charge + property risk charge + Gold risk charge + Unit trust and mutual fund risk charge, calculated in accordance with rules 52 to 57.

52. (1) Subject to the provisions of paragraphs (4) and (5), insurers shall calculate the interest rate risk charge as follows :

a. compute the present value of the net guaranteed liabilities and the interest rate sensitive asset exposures under the base scenario, referred to as V0 and A0, respectively, where (in the manner required by paragraph 22 of Parts 5V and 6) V0 is the value of the guaranteed insurance liabilities, which ~~includes~~ **excludes** RM and is discounted using the risk-free interest rate yield curve;

b. re-compute the present value of the net guaranteed liabilities and the interest rate sensitive asset exposures under the increasing interest rate scenario, referred as to V1 and A1, respectively;

c. recompute the present value of the net guaranteed liabilities and the interest rate sensitive asset exposures under the decreasing interest rate scenario, referred to as V2 and A2, respectively;

Insurers can re-calculate liabilities cashflows underlying discretionary future benefits, under increasing and decreasing interest rate scenario, to the extent of:

i. **change in the liability cashflows for universal life and non-unit component of unit linked products to the extent of change in the underlying crediting rate and unit fund growth assumption respectively under the interest rate scenario.**

ii. **change in liability cashflows for the participating business to the extent of expected change in the future discretionary benefits under different interest rate scenarios.**

[Explanation: The calculation of surplus under base as well as interest rate scenario shall based on the BE cashflows and shall exclude the risk margin. Risk margin represents the compensation payable for risk undertaken while writing the insurance business and doesn't represent any additional prudence. Thus, it is proposed to calculate the risk capital based on best estimate liability excluding RM.

For participating business, since future discretionary benefits in the liability cashflows are consistent and supportable with underlying discount rate and in line with the board approved bonus policy, it is proposed to allow the long term insurance companies to alter the liability cashflows representing future discretionary benefits, to the extent of change of future bonus rates being dependent on the prevailing increasing/decreasing interest rate scenario and as permissible as per board approved bonus policy.

Similarly, for universal life and unit linked business, the insurance companies are allowed to alter liability cashflows representing future discretionary benefits under universal life business, as well as other liability cashflows which may be impacted by change in the interest rate such as non-unit cashflows for unit-linked business - to the extent of change of future crediting rate/fund-growth rate being dependent on the prevailing increasing/decreasing interest rate scenario and as permissible as per board approved crediting rate for universal life business.

It is further proposed to include the stressed crediting rate, stressed bonus rates and unit fund growth rate under both interest up and interest down scenario as part of the annual or quarterly RBC reports (whichever relevant) along with the methodology of deriving the same.]

a. compute the value of the surplus under each scenario as the difference between the present value of the assets and liabilities; and

b. determine the reduction in surplus under the increasing and decreasing interest rate scenarios

Question 50

Please share your comments on the proposed approach to calculate the value of surplus as per paragraph 52 (1d) as the difference between present value of interest sensitive asset cashflows and present value of best estimate net of reinsurance liability cashflows **excluding** risk margin. Please include any alternative approach with rationale.

Question 51

Please share your comment on the appropriateness of the proposed revision including challenges foreseen allowing insurers to change liability cashflows to the extent of expected change in the future discretionary benefit due to change in interest rate scenario.

(2) Subject to the provisions of paragraph (3), the interest rate risk charge is the greater of the reduction in surplus under the increasing and decreasing interest rate scenarios.

(3) If there is an increase in surplus under both shock scenarios, then the risk charge is zero.

(4) Cash flows for assets and liabilities that are not sensitive to interest rates, such as floating rate bonds, **and** equities, and non-guaranteed liabilities are not included in the calculation of the interest rate risk charge.

(5) Subject to the provisions of paragraph (6), (7), and (8) a standard up-shock and down- Shock methodology shall be applied to the risk-free interest rate yield curve to arrive at the increasing and decreasing interest rate scenarios.

(6) The shocked term structures shall be derived by multiplying the risk-free interest rate yield curve **till last liquid point** by $(1+S_{up})$ and $(1-S_{down})$, where the upward stress factors $S_{up}(t)$ and the downward stress factors $S_{down}(t)$ are those specified for each maturity "t" in Table 8. **The factors in Table 8 shall be used only for the market derived yields and UFR.**

Stressed risk-free interest rate yield curves between last liquid point and convergence point shall be derived using the Smith Wilson approach with parameters used for deriving base curve.

[Explanation: The shocked risk-free interest rate yield curve is derived using the approach identical to the derivation of base risk-free interest rate yield curve. Hence, shock factors are only applied on inputs used to derive risk free interest rate yield curve i.e. market yields till last liquid point and ultimate forward rate. The curve between these two points is interpolated using the Smith Wilson methodology. A lower shock factor is proposed for ultimate forward rate due to low volatility expected in long term yield estimates. The factors in Table 8 shall be used only for the market derived yields.

The risk-free interest rate yield curve derived for increasing and decreasing interest rate scenario will be published by Commission, along with base risk-free interest rate yield curve.]

(7) [Deleted]

(8) [Deleted]

Question 52

Please share your comments on the proposed approach for derivation of shocked yield curves to be consistent with the approach used for derivation of base yield curve. Please share the rationale and alternative approach in case you disagree with the proposed approach.

Question 53

Please share your comment on the proposed lower risk charge applicable to the ultimate risk forward rate. Please include any alternative approach and rationale for the same.

Question 54

Are there any further comment that the Commission shall consider while determining the shocked yield curve for calculation of interest rate risk capital. If "yes", please explain with sufficient detail and rationale.

Table 8: Risk free interest rate curve shock factors

Maturity t (years)	Shock up(t) factor	Shock down(t) factor
0.25	70%	75%
0.5	70%	75%
1	70%	75%
2	70%	65%
3	64%	56%
4	59%	50%
5	55%	46%

Maturity t (years)	Shock up(t) factor	Shock down(t) factor
6	52%	42%
7	49%	39%
8	47%	36%
9	44%	33%
10	42%	31%
11	39%	30%
12	37%	29%
13	35%	28%
14	34%	28%
15	33%	27%
16	31%	28%
17	30%	28%
18	29%	28%
19	27%	29%
20	26%	29%
21	26%	29%
22	26%	30%
23	26%	30%
24	26%	30%
25 – 29	26%	30%
30 and above	25%	30%
UFR	**10%**	**10%**

Factors for terms to maturity greater than LLP shall be ignored and shall be referred to in case of change in the LLP only.

53. (1) Every insurer shall determine a credit spread risk charge for interest rate sensitive assets that are also subject to credit risk as follows:

(2) Subject to the provisions of paragraph (7) every insurer shall first determine an average credit spread in excess of the risk-free interest rates for the interest rate sensitive and credit risk bearing assets, taken together , by weighting the current yields on the assets in proportion to their value as at the valuation date.

(3) Every insurer shall then determine a “risky” yield curve by adding the average credit spread determined under paragraph (2) to the risk-free interest rate yield curve required by rule 32

(4) Every insurer shall then calculate the differences between the present value of the net liability cash flows for guaranteed liabilities and the present value of the cash flows for interest rate sensitive assets, under an increasing interest rate scenario and under a decreasing interest rate scenario, where the cash flows for the credit risk bearing assets are discounted using the “risky” yield curve, and the cash flows for the liabilities and the non -credit risk bearing assets are discounted using the risk free interest rate yield curve.

(5) The increasing and decreasing rate scenarios shall be determined by shocking both the “risky” yield curve and the risk-free interest rate yield curve using **implied shock factors derived from the stresses applied on the base curve.**

[Explanation – It is proposed to calculate the stressed “risky” yield curve by multiplying the “risky” yield curve as per sub-section (3) above by the implied stressed factors derived from the base

interest rate yield curve and stressed interest rate yield curves. Implied stress factors will be published by the Commission along with the base yield curve and shall be used by the insurers in the RBC template to derive shocked "risky" yield curve.]

Question 55

Please share your comments with rationale on the proposed approach for calculation of stressed "risky" yield curve. Please include any alternative approach for the calculation of stressed curve along with the technical specifications and other necessary details.

(6) The credit spread risk amount is the greater of the reduction in surplus under the increasing and decreasing rate scenarios.

(7) Alternatively, every insurer may calculate the present value of the asset cash flows for the credit risk bearing assets by determining the credit spread for each asset separately and, for each asset, using the above method, determining a risky yield curve, shocking it to determine the increasing and decreasing rate scenarios, discounting the cash flows, and adding the resulting amounts.

(8) The credit spread risk charge is the higher of zero and the difference between the interest rate risk charge calculated under rule 52 and the total of the credit spread risk amounts.

54. (1) Every insurer shall calculate an equity risk charge by applying the equity risk factors to the value of the admissible assets as specified in Table 9 and aggregating the resulting amounts.

(2) Investments in related parties shall be treated as equity investments for the purpose of calculating the equity risk charge

Table 9: Equity risk factors

Shares listed on a licensed stock exchange	35%
Investments in related parties listed on a licensed stock exchange	35%
Unlisted private equity	45%

55. (1) Every insurer shall calculate a property risk charge applicable to admissible assets whose value is sensitive to the volatility of market prices of property.

(2) For the purpose of paragraph (1), the following assets shall be treated as property:

a. land, buildings, and other immovable property rights; and

b. direct or indirect participations in real estate companies that generate periodic income from property holdings,

unless the asset is subject to a risk charge under another rule, except rule 61 (operational risk capital charge)

(3) Every insurer shall apply a property risk factor of 25% to the value of property and aggregate the resulting amounts to form the property risk charge.

(4) **Every insurer shall apply a property risk factor of 30% to the realisable value of leasehold land and building constructed on leasehold land by the lessee under a long-term lease agreement, if such asset is considered admissible.**

[Explanation – Leasehold land and building with a realisable value shall attract a property risk charge in line with freehold property]

Question 56

Please share your comments on the proposed approach of keeping the risk charges for leasehold land and building constructed on leasehold land by the lessee identical to that of freehold property.

Please share your comments if you expect the level of riskiness for a leasehold land and building to vary when compared with freehold land and hence shall have a differential risk charge. Please provide sufficient details and rationale.

56. Every insurer shall apply a gold risk factor of 15% to the total value of their admissible gold assets to determine the gold risk charge.

57. (1) Every insurer shall apply the risk factors to the underlying assets of the fund, or part fund, as specified in Table 10, for admissible mutual funds and unit trusts.

(2) The value of the underlying assets shall be determined as at the valuation date based on the market values provided by the fund manager.

(3) Every insurer shall aggregate the resulting amounts for each unit trust and mutual fund to form the unit trust and mutual fund risk charge.

Table 10: Risk factors for unit trusts and mutual funds

Asset category	Risk factor
Government securities and Debt Securities/Deposits guaranteed by Government	0.0%
Money market instruments, including cash	1.6%
Ordinary shares	35.0%
Debt Securities & corporate debt	4.0%
Property (as defined in rule 55)	25.0%
Other	15.0%

58. (1) General insurers shall calculate a liability risk capital charge by aggregating the risk charges for claims liability and premiums liability as follows.

(2) Every general insurer shall determine premiums liability risk charges for each sub-class of general insurance business separately, [by multiplying the net unexpired risk reserve (URR), determined at a 75% confidence interval, by the corresponding premiums liability risk factor specified in column 2 of Table 11] **using the following formula:**

Premium liability risk charge = Max [0, (URR X premium liability risk charge) – 50%* (Premium liability – URR)]; where

URR = BE (URR) + RM (URR); net of reinsurance

Premium liability risk charge is determined based on risk factor specified in column 2 of Table 11

[Explanation: Current Rules don't provide the insurer any benefit of holding a higher liability (to the extent of difference in UPR and URR (determined at a 75% confidence interval) in TAC or premium liability risk charge. It is proposed to provide partial credit of such higher liability held, to the extent of 50% of difference in premium liability and URR.]

Question 57

Please comment on the appropriateness of the proposed approach with respect to additional credit in the calculation of premium liability risk charge for the general insurance business.

(3) Every general insurer shall determine claims liability risk charges for each sub-class of general insurance business, separately, by multiplying the net claims liability by the corresponding claims liability risk factor specified in column 3 of Table 11.

Table 11: Risk factors for premiums liability and claims liability risk charges

Business category	Premiums liability risk factor	Claims liability risk factor
A. High volatility		
Liability insurance (such as public, product, employers, Professional Indemnity)	36%	30%
Aviation and marine hull		
Other liability (except motor)		
B. Medium volatility		
Cargo	30%	25%
Engineering		
Motor Liability		
Workers' compensation		
C. Low volatility		
Fire	24%	20%
Motor damage or loss		
Personal accident		
Health		
Other (non-liability)		

Option 2:

General insurers shall calculate a liability risk capital charge by aggregating the risk charges for claims liability and premiums liability as follows:

a. **Every general insurer shall determine premiums liability risk charges for each sub-class of general insurance business , by multiplying the corresponding premium liability risk factor by higher of:**

   i. **Net earned premium – Premium net of ceded reinsurance, earned in the latest one year preceding valuation date.**

   ii. **Net premium to be earned: Premium net of ceded reinsurance to be earned in next one year post valuation date, including such premium from business already written and business expected to be written by insurer**

   iii. **Net written premium – Premium net of ceded reinsurance, earned in the latest one year preceding valuation date. If net earned premium is not reported by insurer, net written premium shall be used as proxy. If net earned premium is reported, then this item shall not be used.**

b. **Every general insurer shall determine claims liability risk charges for each sub-class of general insurance business, separately, by multiplying the net claims liability by the corresponding claims liability risk factor.**

c. **Risk charges applicable to premium and claims liability are as follows:**

Business segment	Category	Premium risk factor	Claims risk factor
Motor	Motor-like	35%	25%
Property damage	Property-like	35%	30%
Accident, protection & health	Other	35%	30%
Short tail medical expenses	Other	35%	25%
Other short tail	Other	35%	30%
Marine, Air, Transport (MAT)	Property-like	35%	35%
Workers' compensation	Liability-like	45%	36%
Public liability	Liability-like	45%	36%
Product liability	Liability-like	45%	47%
Professional indemnity	Liability-like	45%	35%
Other liability and other long tail	Liability-like	45%	36%
Non-proportional motor, property damage, APH and MAT	Property-like	50%	45%
Catastrophe reinsurance	Property-like	50%	45%
Non proportional liability	Liability-like	50%	48%
Non-proportional professional indemnity	Liability-like	50%	45%
Mortgage insurance	Mortgage	50%	40%
Commercial credit insurance	Credit	50%	40%
Other medium term	Other	55%	40%

d. **Diversification benefit shall be applied at the below level, to determine overall liability risk capital charge:**

i. **25% correlation factor is applied between the premium and claims liability risk charges for all sub-classes of general insurance business.**

ii. **Mortgage and credit business is excluded to aggregate with property risk and credit risk respectively.**

iii. **Second layer of diversification is applied across segments of a given category:**

Categories	Correlation factor between segments within the category
Liability-like	50%
Motor-like	75%
Property-like	50%
Others	25%

iv. **Third layer of diversification is applied using 50% correlation factor between categories: liability-like, motor-like, property-like and others.**

[Explanation – it is proposed to assess the impact of Insurance Capital Standard prescribed approach for the calculation of liability risk capital charges for general insurance business. Hence, if PL is calculated in line with the Insurance Capital Standard prescribed methodology, corresponding premium liability risk charge shall also be assessed based on the alternative approach to ensure consistency in the calculation of liabilities, RM and RCR. As part of QIS, the Commission intends to evaluate the impact of overall alignment of liabilities and RCR to Insurance Capital Standard prescribed methodology and calibrated factors. Description of each product to be included within each business segment can be found in Section 15 of RBC report submitted by RBC task-force and provided in section 1 of this consultation.]

Question 58

Please provide your comments on the methodology and risk charge factors underlying premium and claims liability risk charges as prescribed by Insurance Capital Standard. Please provide any other alternative if considered more appropriate for the calculation of risk capital with sufficient detail.

Question 59

Are there any further comment that the Commission shall consider while determining the liability risk capital charges for general insurance business. If "yes", please explain with sufficient detail and rationale.

59. [Deleted]

(1) An insurer shall calculate liability risk capital charge for long term insurance business by aggregating the risk capital for each of the following sub-risks using correlation matrix as specified in paragraph (7):

a. **Mortality risk**

b. **Longevity risk**

c. **Morbidity risk**

d. **Lapse risk**

e. **Expense risk**

(2) Subject to the provisions of paragraphs (3), (4), (5), (6) and (7), long term insurers shall calculate risk capital charges as the higher of:

a. **Difference between the Net Asset Value under the base and stressed scenario. Net Asset Value shall be calculated as the difference between value of asset and value of liability (excluding risk margin); or**

b. **Zero**

(3) For the purposes of paragraph (2), an insurer must determine value of liability for long term insurance business in the following manner:

a. **For participating and non-participating business, including universal life business, insurer must determine the liability in the same manner in which liability (net of reinsurance) is determined in accordance with Part V of the Rules;**

b. **For unit-linked policy, the value of liability shall exclude unit fund value.**

(4) Risk capital assessment and direction of onerousness for lapse risk shall be assessed at

a. **Product level; or**

b. **Homogenous risk group (HRG) level. HRG encompasses a collection of policies with similar risk characteristics, which remain stable over time; and have similar underwriting policies, claims patterns, risk profiles, product features, future management actions. HRG shall include a minimum of participating, non-participating endowment, non-participating term, universal life, unit-linked, annuity, and health business.**

(5) An insurer shall calculate risk capital for each sub-risk (excluding lapse risk) as:

Risk category	Stress factor
Mortality	12.5% increase in the best estimate mortality rate for policies exposed to mortality risk
Longevity	17.5% decrease in the best estimate mortality rate for policies exposed to longevity risk
Morbidity	*Refer to table below*
Expense	8% increase in the best estimate expense assumption Absolute increase of 3% in year 1 to 10, 2% for year 11 to 20 and 1% thereafter from the valuation date in expense inflation

For determination of risk capital under morbidity stress, risks were categorised as below,

	Medical expenses	Lump-sum in case of health event	Short term recurring payment	Long-term recurring payment
Categorisation	Providing fixed or reimbursable compensation for medical expenses	Single payment at the occurrence of a specified health event/accidence causing disability.	Recurring compensation for a period based on time spent in a given temporary health status	Fixed annuity in case of long-term/permanently deteriorated health status
Indicative product examples [provided for reference during QIS]	Medical expense / supplemental medical contracts providing benefits for practitioner fees, medication fees, vision and dental expenses etc.	Accident, critical illness, and permanent disability policies that provide a lump sum payment on occurrence of a claim, accidental death and dismemberment policies.	Hospital indemnity, personal accident / loss of income policy, short-term disability income protection (generally in the context of group insurance).	Personal or group policies for permanent disability and long-term care
Stress factor – short term*	20%	25%	20%	Inception rate + 25% Recovery rate – 20%

Stress factor – long term*	**8%**	**20%**	**12%**	**Inception rate: +20%** **Recovery rate: -20%**
Calculation approach	**Where benefits modelled using inception rates/recovery rates, stress is applied to inception rates (if only recovery rates modelled, decrease in recovery rate assumed).** **Where no explicit inception rates/recovery rates, stress directly applied to medical claim payment amounts.**			**Maximum of inception rate risk charge or recovery rate risk charge.**

(6) Risk capital for lapse risk shall be calculated at the level as defined in paragraph (4), as the maximum reduction in NAV after applying following shock factors:

a. **Reduction in NAV after applying a shock of increase of 50% to the best estimate lapse rates,**

b. **Reduction in NAV after applying a shock of decrease of 50% to the best estimate lapse rates,**

c. **Reduction in NAV after applying a mass lapse stress as an instantaneous increase as at valuation date, in the best estimate surrender rates by an additive stress of 30% for individual business and 50% increase for group business, subject to a maximum of 100% stress.**

d. **zero**

[Explanation – Mass lapse scenario is applied as an instantaneous surrender equal to the prescribed stress factor. Thus, the corresponding surrender rate for the policy year is replaced with the mass lapse stress factor. However, noting high surrender rates observed in the Sri Lankan market, it was proposed to introduce mass lapse as an additive stress. Further, no mass lapse event was observed in Sri Lankan to calibrate the quantum of stress. Hence, the stress factor has been based on the Insurance Capital Standard prescribed stress]

(7) Liability risk capital charge for long term insurers shall be aggregated using the below correlation matrix, where, life risk capital would be calculated as:

$$\sqrt{\sum_{m,n} correlation\ matrix_{m,n} * risk\ capital\ amount_m * risk\ capital\ amount_n}$$

Where m, n represents corresponding sub risks in the above correlation matrix.

	Mortality	Longevity	Morbidity	Lapse	Expense
Mortality	100%	-25%	25%	0%	25%
Longevity	-25%	100%	0%	25%	25%
Morbidity	25%	0%	100%	0%	50%
Lapse	0%	25%	0	100%	50%
Expense	25%	25%	50%	50%	100%

[Explanation: While the Commission intended to calibrate liability risk capital charges for Sri Lankan insurance market, there were concerns raised on data credibility, heterogeneity and

inconsistency. Accordingly, noting Insurance Capital Standard has calibrated risk charges specific to different regions, it is proposed to align the calculation of liability risk capital charge to Insurance Capital Standard, including use of Insurance Capital Standard prescribed stress factors and correlation matrix for long term insurance businesses.

Risk capital in respect of each of the stress shall be calculated as the difference between net asset values where the asset values are expected to remain unchanged while the liability would be stressed. The liability value used for the calculation of stress impact shall be the best estimate liability net of reinsurance and excluding the risk margin. Risk margin represents the compensation payable for risk undertaken while writing the insurance business and is not intended to represent any additional prudence. Thus, it is proposed to calculate the risk capital based on best estimate liability excluding RM.

Currently, the liability risk capital charge is calculated using a combined stress scenario as per the current Rules. However, this scenario doesn't adequately allow for a diversification benefit across products and across risks. Hence, it is proposed to introduce a correlation matrix to aggregate sub-risk level risk capital.]

Question 60

Please share your comments on the proposed approach of calculation of risk capital as the difference in net asset value wherein liabilities exclude risk margin. Please provide any other alternatives with rationale.

Question 61

Please share your comments on the proposed quantum of risk charge applicable on each stress. Please share any alternative risk charge factors along with underlying source and rationale.

Question 62

Please share your comments on the level at which the onerous of lapse stresses shall be assessed including the choice of level and any alternative approach with necessary details and rationale.

Question 63

a. Please share your comments on the proposed approach for inclusion of mass lapse risk capital in the lapse module.
b. Please comment on the proposed approach of considering mass lapse stress as additive stress from Sri Lankan perspective including the quantum of the proposed stress.
c. Please share your comments and rationale with alternative approach in case you disagree.

Question 64

Please share your comments on the proposed approach of aggregating the risk capital using the correlation matrix instead of performing a combined stress as per the current Rules. Please include any alternative approach with adequate details, specifications and rationale.

Question 65

Please share your comments on the challenges foreseen in calculation of liability risk capital charge for long term insurer along with the rationale and alternative approach for the Commission's consideration.

Question 66

Are there any further comment that the Commission shall consider while determining the liability risk capital charges for long term insurer. If "yes", please explain with sufficient detail and rationale.

60. [Deleted]

[Explanation: It is proposed to remove the SVCC flooring from calculation of RCR and instead consider a mass lapse stress within lapse risk capital under liability risk capital charge. This is expected to better represent the risk faced by long term insurers in respect of mass surrenders.]

Question 67

a. Please share your comments on removal of Surrender Value Capital Charge floor from the calculation of RCR.
b. In your view, please share (with rationale) if current approach or proposed approach is more suitable from the Sri Lankan context.

61. Every insurer shall calculate an operational risk capital charge of 1% of the value of all assets of the insurer, whether admissible or not, and whether held inside or outside an insurance fund or shareholders' fund, including assets by reference to the value of which linked long term liabilities are to be determined.

Question 68

Are there any additional comment in respect of Part VII- determination of risk capital required (RCR), which is currently not addressed as part of the revised Rules or in case any further clarification is needed. Please provide sufficient details outlining the concern, proposed solution and rationale for the same.

62. **Every insurer shall calculate an additional risk capital for all additional risks they are exposed to adequately reflect the full range of risks to which they are exposed. Insurers must ensure that the level of capital held is commensurate with the nature, scale, and complexity of their business and risk profile, even where explicit methodologies are not prescribed.**

63. **Every insurer may, with the approval of the Commission, use an alternative method for calculation of the risk capital charge, provided that the method is robust, appropriately reflects the insurer's risk exposure, is based on sound actuarial and risk management principles, and results in a level of capital that is not lower than that required under the standard approach.**

Question 69

Please share any other comments/feedback on the amendment of current Rules that the participant would like to share,

Part VIII – General

64. Unless the context otherwise requires:

"RII Act" means the Regulation of Insurance Industry Act, No. 43 of 2000

"asset backed securities" means securities that are primarily serviced by cash flows from a discrete pool of receivables or other financial assets, either fixed or revolving, that by their terms convert into cash within a definite period, with any rights or other assets designed to ensure the servicing or timely distribution of proceeds to the security holders;

"BE" means best estimate;

"Commission" means the Insurance Regulatory Commission of Sri Lanka established under section 2 of the RII Act;

"Capital adequacy ratio" means the capital adequacy ratio of an insurer, that is, the ratio of TAC to RCR expressed as a percentage.

"CL" means the claims liability;

"co-insurer" means any insurance company registered and licensed under the RII Act

"company" means a company incorporated under the Companies Act, No. 7 of 2007;

"Future discretionary benefits" means any non-guaranteed amount payable to policyholders which is linked to contractual or legal obligations of the insurers to distribute a portion of the insurer's investment or underwriting profit;

"inadmissible assets" means the assets which are not admissible;

"licensed finance company" means a company licensed under Finance Business Act, No. 42 of 2011, to carry on finance business within the meaning of that Act;

"licensed specialised bank" means an institution licensed as a specialised bank under the Banking Act, No. 30 of 1988;

"Long term insurance fund" means the insurance fund maintained under section 38 of the RII Act;

"MCR" means the minimum capital required by rule 4;

"market consistent valuation" means a valuation of assets or liabilities at marked value ('mark to market') or, where a market value cannot reasonably be ascertained, a valuation using 'mark to model' approach;

"multilateral agency" means the International Finance Corporation or other similar institution approved by the Commission

"mutual fund" means a professionally managed and regulated open-ended collective investment vehicle (that is not a hedge fund or unit trust) that pools money from many investors to purchase securities;

"NAV" means the net asset value calculated as the difference between the value of assets and the best-estimate value of liabilities, net of reinsurance (excluding risk-margin);

"PL" means the premiums liability;

"RCR" means the total amount of risk capital charges, valued and determined in accordance with these Rules; "RCAR" means the CAR required by rule 3;

"recognised guarantor" means the Government of Sri Lanka, the Central Bank of Sri Lanka, the central Bank of a foreign country carrying an investment grade rating, a multilateral agency, or an institution carrying an investment grade rating approved by the Commission;

"related party" shall have the same meaning as in the Sri Lanka Accounting Standards;

"RM" means risk margin for adverse deviation;

"shareholders' funds" means:

issued and fully paid ordinary share capital;

share premium arising out of (a), and

reserves with retained profits attributable to shareholders (except non-distributable or restricted reserves);

"Solvency Margin (Long Term Insurance) Rules 2002" means the Solvency Margin (Long Term Insurance) Rules, 2002, published in Gazette Extraordinary No. 1255/12 of September 24, 2002;

"Solvency Margin (General Insurance) Rules, 2004" mean the Solvency Margin (General Insurance) Rules, 2004, published in Gazette Extraordinary No. 1341/8 of May 17, 2004;

"Sri Lanka Accounting Standards" means the accounting standards adopted under the Sri Lanka Accounting and Auditing standards Act, No. 15 of 1995, which comprise Accounting Standards prefixed both SLFRS and LKAS (SLFRS refers to Sri Lanka Accounting Standards corresponding to IFRS (International Financial Reporting Standards) and LKAS refers to Sri Lanka Accounting Standards corresponding to IAS (International Accounting Standards):

"Total available capital" (TAC) means the total available capital held by an insurer, valued and determined in accordance with rules 9 to 13, available to cover RCR and MCR;

"Tier 1 capital" means permanent capital that is fully available to cover the losses of an insurer at all times on both a going concern and a winding up basis, as specified in rule 10;

"Tier 2 capital" means capital that lacks some of the absorbency characteristics of the Tier 1 capital, but nevertheless provides some loss absorbency during ongoing operations or on winding up as specified in rule 11;

"unit trust" means a unit trust within the meaning of the Securities and Exchange Commission of Sri Lanka Act, No. ~~36~~**19** of ~~1987~~**2021**, managed by a company licensed under that Act, or a unit trust outside Sri Lanka approved by the Commission;

"UPR" means the unearned premium reserve; and "URR" means the unexpired risk reserve.

65. The Solvency Margin (Long Term Insurance) Rules, 2002 Solvency Margin (General Insurance) Rules, 2004 are rescinded with effect from December 31, 2015.

The Solvency Margin (Risked Based Capital) Rules, 2015 issued in respect of Long term Insurance and General Insurance are rescinded with effect from date of implementation.

SCHEDULE

Part A

Credit rating agency	Minimum international rating of entity or security	Minimum international rating of short term (less than one year) security
(1) Moody's Investor Services	Baa 3	P3
(2) Standard and Poor's Corp	BBB-	A3
(3) Fitch Ratings	BBB-	F3
(4) A. M. Best Company	bbb-	AMB - 3

Part B

Credit rating agency	Minimum rating of entity or security	Minimum rating of short term (less than one year) security
(1) Fitch Ratings (Lanka) Ltd	BBB-(lka)	F3 (lka)

Appendix A: Template for consultation feedback

Participants are required to provide the feedback to consultation questions raised via the attached response template. Any person submitting comments on behalf of any organization is requested to provide details of the organization they represent.