# PRA RULEBOOK: NON-SOLVENCY II FIRMS REGIME INSTRUMENT 2015

## Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (The PRA's general rules);
(2) section 137T (General supplementary powers);
(3) section 340(1) and (4) (Appointment: requirements on firms);
(4) section 340(3A) (Appointment: requirements as to co-operation); and
(5) section 340(6) and (7) (Appointment: qualifications of actuaries).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

## Pre-conditions to making

C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

## PRA Rulebook: Non-Solvency II Firms Regime Instrument 2015

D. The PRA makes the rules in the Annexes to this instrument.
E. Annexes A to P, R and S are part of the Non-Solvency II Firms Sector of the PRA Rulebook.
F. The Non-Solvency II Firms – Actuarial Requirements Part (set out in Annex Q of this instrument) is part of the Non-Solvency II Firms Sector and Non-authorised Persons Sector of the PRA Rulebook.

## Commencement

G. Annexes A to N and P to S of this instrument come into force on 1 January 2016.
H. The Non-Solvency II Firms – Governance Part (set out in Annex O of this instrument) comes into force as follows:

(1) except as set out in (2), on 1 January 2016; and
(2) Rule 3.2(3) and Chapters 8, 9 and 10, on 7 March 2016.

From 1 January 2016 to 6 March 2016, rule 3.2(3) and Chapters 8, 9 and 10 of the Non-Solvency II Firms – Governance Part shall read "[Not currently used]".

## Citation

I. This instrument may be cited as the Non-Solvency II Firms Regime Instrument 2015.

**By order of the Board of the Prudential Regulation Authority**

12 November 2015

**Annex A**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - OVERALL RESOURCES AND VALUATION

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *non-directive insurer* other than a *non-directive friendly society*; and

(2) a *Swiss general insurer*.

1.2 In this Part, the following definitions shall apply:

*business risk*

means any risk to a *firm* arising from changes in its business, including:

(1) the risk that the *firm* may not be able to carry out its business plan and its desired strategy; and

(2) risks arising from a *firm's remuneration* policy.

*exposure*

means the maximum loss which a *firm* might suffer if:

(1) a *counterparty* or a group of connected *counterparties* fail to meet their obligations; or

(2) the *firm* realises assets or off-balance sheet positions.

*liquidity risk*

means the risk that a *firm*, although solvent, either does not have available sufficient financial resources to enable it to meet its obligations as they fall due, or can secure such resources only at excessive cost.

*mark to market*

means valuation at readily available close out prices from independent sources.

*mark to model*

means any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input.

*pension obligation risk*

means the risk:

(1) to a *firm* caused by its contractual or other liabilities to or with respect to a *pension scheme* (whether established for its *employees* or otherwise); and

(2) that the *firm* will make payments or other contribution to or with respect to a *pension scheme* because of a moral obligation or because the *firm* considers that it needs to do so for some other reason.

*regulatory surplus value*

means the sum of:

(1) the *total capital after deductions* of the *undertaking*; less

(2) the *individual capital resources requirement* of the *undertaking*,

where:

(a) only the proportion of the total number of *shares* issued by the *undertaking* held, directly or indirectly, by the *firm* is to be taken into account, or

(b) if the *individual capital resources requirement* of an *undertaking* that:

(i) has a *Part 4A permission*; and

(ii) is a *subsidiary*

exceeds *total capital after deductions*, then the full amount of the items referred to in (1) and (2) must be taken into account.

*residual risk*

means the risk that credit risk mitigation techniques used by the *firm* prove less effective than expected.

*restricted assets*

means assets of the *undertaking* which are subject to a legal restriction or other requirement having the effect that those assets cannot be transferred or otherwise made available to the *firm* for the purposes of the *firm* meeting its *CR Requirement* without causing a breach of that legal restriction or requirement.

*securitisation risk*

includes the risk that the *capital resources* held by a *firm* in respect of assets which it has *securitised* are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.

*specific valuation rule*

means any rule in the Non-Solvency II Firms Sector of the *PRA* Rulebook that provides in particular circumstances for a particular method of recognition or valuation.

## 2 ADEQUATE FINANCIAL RESOURCES

2.1 This Chapter does not apply to a *Swiss general insurer.*

2.2 If a *firm* carries on *long-term insurance business* and *general insurance business* the rules in this Chapter apply separately to each type of business.

2.3 A *firm* must at all times maintain overall financial resources, including *capital resources* and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.

2.4 A *firm* must have in place sound, effective and complete processes, strategies and systems to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources and *capital resources* that it considers adequate to cover:

(1) the nature and level of the risks to which it is or might be exposed;

(2) the risk that its liabilities cannot be met as they fall due; and

(3) the risk that the *firm* might not be able to meet its *CR Requirement* in the future.

2.5 The processes, strategies and systems required by 2.4 must enable a *firm* to identify and manage the major sources of risks referred to in 2.4, including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale of its business:

(1) credit risk;

(2) *market risk*;

(3) *liquidity risk*;

(4) *operational risk*;

(5) insurance risk;

(6) concentration risk;

(7) *residual risk*;

(8) *securitisation risk*;

(9) *business risk*;

(10) interest rate risk;

(11) *pension obligation risk*; and

(12) group risk.

2.6 A *firm* must identify separately the amount of *tier one capital*, tier two capital, other capital eligible to form part of its *capital resources* and each category of capital (if any) that is not eligible to form part of its *capital resources* which it considers adequate for the purposes described in 2.4.

2.7 The processes and systems required by 2.4 must:

(1) include an assessment of how the *firm* intends to deal with each of the major sources of risk identified in accordance with 2.5;

(2) take into account the impact of diversification effects and how such effects are factored into the *firm's* systems for measuring and managing risks; and

(3) include an assessment of the *firm*-wide impact of the risks identified in accordance with 2.4, to which end a *firm* must aggregate the risks across its various business lines and units, making appropriate allowance for the correlation between risks.

2.8 A *firm* must carry out assessments of the processes, strategies and systems required by 2.4 to ensure that they remain compliant with this Chapter.

2.9 A *firm* must carry out the assessments required by 2.4 and 2.8:

(1) annually; and

(2) whenever changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate.

2.10 A *firm* must make and retain for at least three years a written record of the assessments required under this Chapter, including a written record of:

(1) the major sources of risk identified in accordance with 2.5; and

(2) how it intends to deal with those risks.

## 3 VALUATION

3.1 Subject to 3.2 to 3.5, 8.1 and any *specific valuation rule*, whenever a rule refers to an asset, liability, *exposure*, equity or income statement item, a *firm* must, for the purpose of that rule, recognise the asset, liability, *exposure*, equity or income statement item and measure its value in accordance with the *accounting principles*.

3.2 Except where a *specific valuation rule* provides otherwise:

(1) when a *firm*, upon initial recognition, designates its liabilities as at fair value through profit or loss, it must always adjust any value calculated in accordance with 3.1 by subtracting any unrealised gains or adding back in any unrealised losses which are not attributable to changes in a benchmark interest rate; and

(2) in respect of a *defined benefit occupational pension scheme*:

(a) a *firm* must derecognise any *defined benefit asset*; and

(b) a *firm* may elect to substitute for a *defined benefit liability* the *firm's deficit reduction amount*.

An election made under (2)(b) must be applied consistently for the purposes of all applicable rules in respect of any one *financial year*.

3.3 Except where a *specific valuation rule* provides otherwise a *firm* must comply with 4 to 7:

(1) subject to 3.4, to account for

(a) investments that are, or amounts owed arising from the disposal of:

(i) *debt securities*, bonds and other money- and capital-market instruments;

(ii) loans;

(iii) *shares* and other variable yield participations;

(iv) *units* in any *collective investment scheme* falling within Insurance Company – Capital Resources 13.1(1)(d)(iv); and

(b) *derivatives* and *quasi-derivatives*; and

(2) to any balance sheet position not falling within (1) that is measured at market value or fair value.

3.4 3.3 does not apply to *shares* in an *affiliated company* that is:

(1) an *undertaking* with a *Part 4A permission*;

(2) an *ancillary services undertaking*; or

(3) any other *subsidiary*, the *shares* of which a *firm* elects to value in accordance with 8.1.

3.5 A *firm* must not place any value on amounts recoverable from an *ISPV* for the purposes of any rule.

## 4 MARKING TO MARKET

4.1 Wherever possible, a *firm* must use *mark to market* in order to measure the value of investments and positions.

4.2 Subject to 4.3, when *marking to market*, a *firm* must use the more prudent side of bid/offer unless the *firm* is a significant market maker in a particular position type and it can close out at the mid-market price, in which case the *firm* can use the mid-market price.

4.3 When calculating the current *exposure* value of a credit risk *exposure* to a *counterparty*:

(1) a *firm* must select as a basis of valuation either:

(a) the more prudent side of bid/offer; or

(b) the mid-market price;

(2) the *firm* must be consistent in the basis of valuation it applies under (1) both between counterparties and year-on-year; and

(3) where the difference between the more prudent side of bid/offer and the mid-market price is material, the *firm* must consider making adjustments or establishing reserves.

## 5 MARKING TO MODEL

5.1 Where *marking to market* is not possible, a *firm* must use *mark to model* in order to measure the value of the investments and positions.

5.2 When the model used is developed by the *firm*, that model must be:

(1) based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process; and

(2) independently tested, including validation of the mathematics, assumptions, and software implementation.

5.3 A *firm* must ensure that its senior management are aware of the positions which are subject to *mark to model* and understand the materiality of the uncertainty this creates in the reporting of the performance of the business of the *firm* and the risks to which it is subject.

5.4 A *firm* must source market inputs in line with market prices so far as possible and assess the appropriateness of the market inputs for the position being valued and the parameters of the model on a frequent basis.

5.5 A *firm* must use generally accepted valuation methodologies for particular products where these are available.

5.6 A *firm* must establish formal change control procedures, hold a secure copy of the model, and periodically use that model to check valuations.

5.7 A *firm* must ensure that its risk management functions are aware of the weaknesses of the models used and how best to reflect those in the valuation output.

5.8 A *firm* must periodically review the model to determine the accuracy of its performance.

## 6 INDEPENDENT PRICE VALUATION

6.1 In addition to *marking to market* or *marking to model*, a *firm* must regularly verify market prices and model inputs for accuracy and independence.

## 7 VALUATION ADJUSTMENTS

7.1 The recognition of any gains or losses arising from valuations subject to 3.3 must be recognised for the purpose of calculating *capital resources* in accordance with 4 to 7, unless a rule provides for another treatment of such gains or losses, in which case that other treatment must be applied.

7.2 A *firm* using third-party valuations, or *marking to model*, must consider whether valuation adjustments are necessary.

7.3 A *firm* must consider the need for making adjustments or establishing reserves for less liquid positions (including those arising from both market events and institution-related situations, including concentration positions and/or stale positions) and, on an ongoing basis, review their continued appropriateness in accordance with 7.5.

7.4 A *firm* must consider adjustments or reserves in respect of unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where appropriate, model risk.

7.5 A *firm* must consider at least the following factors when determining whether a valuation adjustment or reserve is necessary for less liquid positions:

(1) the amount of time it would take to hedge out the position/risks within the position;

(2) the average and volatility of bid/offer spreads;

(3) the availability of market quotes (number and identity of market makers);

(4) the average and volatility of trading volumes;

(5) market concentrations;

(6) the ageing of positions;

(7) the extent to which valuation relies on *marking to model*; and

(8) the impact of other model risks.

7.6 If the result of making adjustments or establishing reserves under 7.1 to 7.5 is a valuation which differs from the fair value determined in accordance with 3.1, a *firm* must reconcile the two valuations.

## 8 AFFILIATED COMPANY VALUATION

8.1 Except where the contrary is expressly stated in this Part, whenever a rule refers to *shares* held in an *affiliated company* referred to in 3.4(1) or (3), a *firm* must value the *shares* held as the sum of:

(1) the *regulatory surplus value* of that *undertaking*; less

(2) the sum of:

(a) the book value of the investments by the *firm* and its *affiliated companies* in the *tier two capital resources* of the *undertaking*; and

(b) if the *undertaking* is an *insurance undertaking*, any *restricted assets* of the *undertaking*.

8.2 A *firm* must value shares held in an *ancillary services undertaking* in accordance with 3.1.

**Annex B**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - TECHNICAL PROVISIONS

**Chapter content**



**Links**

## 1 APPLICATION

1.1 Unless otherwise stated, this Part applies to:

(1) a *non-directive insurer*, other than a *non-directive friendly society*; and

(2) subject to 1.2, a *Swiss general insurer*.

1.2 This Part only applies to a *Swiss general insurer* in respect of the activities of the *firm* carried on from a *branch* in the *UK*.

1.3 This Part applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.

1.4 Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this Part applies separately to each type of business.

## 2 ESTABLISHING TECHNICAL PROVISIONS

2.1 For *general insurance business*, a *firm* must establish adequate *technical provisions* in accordance with Insurance Company – Overall Resources and Valuation 3.1.

2.2 For *long-term insurance business*, a *firm* must establish adequate *technical provisions* in respect of its *contracts of long-term insurance* as follows:

(1) for liabilities in respect of such contracts that have fallen due, in accordance with Insurance Company – Overall Resources and Valuation 3.1;

(2) otherwise, *mathematical reserves* in accordance with the Insurance Company – Mathematical Reserves Part of the *PRA* Rulebook and with due regard to generally accepted actuarial practice.

## 3 RISK TRANSFER PRINCIPLE

3.1 A *firm* may only take credit for *reinsurance* (including all contracts of *reinsurance* with an *ISPV* and *analogous non-reinsurance financing agreements*) if and to the extent that there has been an effective transfer of risk from the *firm* to a third party that is effective in all circumstances in which the *firm* may wish to rely upon the transfer.

## 4 ASSETS OF A VALUE SUFFICIENT TO COVER TECHNICAL PROVISIONS AND OTHER LIABILITIES

4.1 Subject to 4.3, a *firm* (other than a *composite firm*) must hold *admissible assets* of a value at least equal to the amount of:

(1) the *technical provisions* that it is required to establish under:

(a) 2.1; or

(b) 2.2; and

(2) its other:

(a) *general insurance liabilities*; or

(b) *long-term insurance liabilities*.

4.2 Subject to 4.3, a *composite firm* must ensure that it holds;

(1) *admissible assets* separately identified in accordance with Insurance Company – Internal Contagion Risk 4.1 of a value at least equal to 4.1(1)(a) and 4.1(2)(a); and

(2) other *admissible assets* (other than those excluded under 4.3) of a value at least equal to 4.1(1)(b) and 4.1(2)(b).

4.3 For the purposes of 4.1 and 4.2, a *firm* (other than a *pure reinsurer*) must exclude *property-linked liabilities* and *index-linked liabilities* and the assets held to cover them under Insurance Company – Risk Management 4.

4.4 For the purpose of determining the value of assets available to meet *technical provisions* and other *long-term insurance liabilities* in accordance with 4.1, 4.2 and Non-Solvency II Firms - With-Profits 2.1, to the extent already offset in the calculation of *technical provisions,* no value is to be attributed to:

(1) debts owed by *reinsurers*;

(2) a claim under a *contract of insurance*;

(3) tax recoveries; or

(4) claims against *compensation funds*.

## 5 LOCALISATION

5.1 This Chapter does not apply:

(1) to a *Swiss general insurer;*

(2) in respect of debts owed by *reinsurers*;

(3) in respect of *insurance business* carried on by a *UK firm* outside an *EEA State*; or

(4) in respect of *general insurance business class* groups 3 (Marine Transport) and 4 (Aviation) of Part II of Annex 11.2 to IPRU(INS) of the *PRA Handbook* as at 31 December 2015.

5.2 In accordance with 5.3, a *firm* must hold *admissible assets* held pursuant to Insurance Company – Risk Management 3.2:

(1) (where the *admissible assets* cover *technical provisions* in *UK* sterling), in any *EEA State*; and

(2) (where the *admissible assets* cover *technical provisions* in any currency other than *UK* sterling), in any *EEA State* or in the country of that currency.

5.3 For the purposes of 5.2:

(1) a tangible asset is to be treated as held in the country or territory where it is situated;

(2) an *admissible asset* consisting of a claim against a debtor is to be treated as held in any country or territory where it can be enforced by legal action;

(3) a *security* which is *listed* is to be treated as held in any country or territory where there is a *regulated market* on which the *security* is dealt; and

(4) a *security* which is not *listed* is to be treated as held in the country or territory in which the *issuer* has its head office.

## 6 MATCHING OF ASSETS AND LIABILITIES

6.1 This Chapter does not apply:

(1) to a *pure reinsurer*; or

(2) in respect of assets held to cover *index-linked liabilities* or *property-linked liabilities*, except that, where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, this Chapter will nevertheless apply to assets held to cover that guaranteed element.

6.2 Assets held by a *firm* to cover its *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities* must:

(1) have characteristics of safety, yield and marketability which are appropriate to the type of business carried on by the *firm*;

(2) be diversified and adequately spread; and

(3) in accordance with 6.3, be of a sufficient amount, and of an appropriate currency and term, to ensure that the cash inflows from those assets will meet the expected cash outflows from the *firm's* insurance liabilities as they become due.

6.3 For the purpose of 6.2(3), in determining expected cash outflows, a *firm* must take into consideration any options which exist in the *firm's contracts of insurance*.

## 7 PREMIUMS FOR NEW BUSINESS

7.1 A *firm* must not enter into a *contract of long-term insurance* unless it is satisfied on reasonable actuarial assumptions that:

(1) the *premiums* receivable and the investment income expected to be earned from those *premiums*; and

(2) the *reinsurance* arrangements made in respect of the risk or risks covered by that new contract;

are sufficient to enable it, when taken together with the *firm's* other resources, to meet the requirements in 7.2.

7.2 The requirements referred to in 7.1 are, to:

(1) establish adequate *technical provisions* as required by 2.2;

(2) hold *admissible assets* of a value at least equal to the amount of the *technical provisions* and other *long-term insurance liabilities* as required by 4; and

(3) maintain adequate overall financial resources as required by Insurance Company - Overall Resources and Valuation 2.3.

**Annex C**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - MATHEMATICAL RESERVES

**Chapter content**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer* which carries on *long-term insurance business,* other than a *non-directive friendly society.*

1.2 Except for 16.3(1) this Part does not apply to *final bonuses*.

1.3 In this Part, the following definitions shall apply:

*benefits payable*

means benefits payable under a *long-term insurance contract*, including:

(1) all guaranteed benefits including guaranteed *surrender values* and paid-up values;

(2) vested, declared and allotted bonuses to which the *policyholder* is entitled;

(3) all options available to the *policyholder* under the terms of the contract; and

(4) discretionary benefits payable in accordance with any relevant provisions of the *FCA Handbook*.

*dividend yield*

has the meaning given in 9.6(1).

*earnings yield*

has the meaning given in 9.6(2).

*future premium*

means the value attributed to a *premium* due in any future *financial year*.

*internal rate of return*

has the meaning given in 9.7.

*non-attributable expenses*

means expenses which are not directly attributable to a particular *contract of long-term insurance*.

*recoverable acquisition expenses*

means the amount of expenses, after allowing for the effects of taxation, which it is reasonable to expect will be recovered from *future premiums* payable under the contract.

*risk-adjusted yield*

means the risk-adjusted yield calculated in accordance with 9 and 10.

*running yield*

has the meaning given in 9.5.

## 2 BASIC VALUATION METHOD

2.1 (1) Subject to (2), a *firm* must establish its *mathematical reserves* using a prospective actuarial valuation on prudent assumptions of all future cash flows expected to arise under, or in respect of, each of its *contracts of long-term insurance*.

(2) A *firm* may use a retrospective actuarial valuation where:

(a) a prospective method cannot be applied to a particular type of contract; or

(b) the *firm* can demonstrate that the resulting amount of the *mathematical reserves* would be no lower than would be required by a prudent prospective actuarial valuation.

## 3 METHODS AND ASSUMPTIONS

3.1 In the actuarial valuation under 2.1, a *firm* must use methods and prudent assumptions which:

(1) are appropriate to the business of the *firm*;

(2) are consistent from year to year without arbitrary changes;

(3) are consistent with the method of valuing assets;

(4) include appropriate margins for adverse deviation of relevant factors which are sufficiently prudent to ensure that there is no significant foreseeable risk that liabilities to *policyholders* in respect of *contracts of long-term insurance* will not be met as they fall due;

(5) recognise the distribution of profits (that is, emerging surplus) in an appropriate way over the duration of each *contract of insurance*;

(6) take into account its regulatory duty to treat its customers fairly under any relevant provision of the *FCA Handbook*; and

(7) are in accordance with generally accepted actuarial practice.

## 4 VALUATION OF INDIVIDUAL CONTRACTS

4.1 (1) Subject to (2) and (3), a *firm* must determine the amount of the *mathematical reserves* separately for each *contract of long-term insurance*.

(2) Approximations or generalisations may be made:

(a) in the case of *non-attributable expenses*, in relation to a group of contracts with the same or similar expense risk characteristics, provided that the *mathematical reserves* in respect of such expenses established by the *firm* in relation to that group of contracts have a minimum value of at least zero; and

(b) in any other case, where they are likely to provide the same, or a higher, result than a determination made in accordance with (1).

(3) A *firm* must set up additional *mathematical reserves* on an aggregated basis for general risks that are not specific to individual contracts.

## 5 NEGATIVE MATHEMATICAL RESERVES

5.1 A *firm* may calculate a negative value for the *mathematical reserves* in respect of a *contract of long-term insurance* provided that:

(1) this is based on assumptions which meet the general requirements for prudent assumptions as set out in 3.1;

(2) the contract does not have a *surrender value* which at the *actuarial valuation date* is guaranteed; and

(3) the total *mathematical reserves* established by the *firm* have a minimum value of at least:

(a) where the *firm's contracts of long-term insurance* include *linked long-term contracts of insurance*, the sum of the surrender values of all its *linked long-term contracts of insurance* at the *actuarial valuation date*; and

(b) in any other case, zero.

## 6 AVOIDANCE OF FUTURE VALUATION STRAIN

6.1 (1) A *firm* must establish *mathematical reserves* for a *contract of insurance* which are sufficient to ensure that, at any subsequent date, the *mathematical reserves* then required are covered solely by:

(a) the assets covering the current *mathematical reserves*; and

(b) the resources arising from those assets and from the contract itself.

(2) For the purposes of (1), the *firm* must assume that:

(a) the assumptions adopted for the current valuation of liabilities remain unaltered and are met; and

(b) discretionary benefits and charges will be set so as to fulfil its regulatory duty to treat its customers fairly under any relevant provision of the *FCA Handbook*.

(3) Subject to (4), the requirements in (1) may be applied to a group of similar contracts instead of to the individual contracts within that group.

(4) The requirements in (1) must be applied to a group of contracts in relation to which *mathematical reserves* in respect of *non-attributable expenses* are established for that group of contracts in accordance with 4.1(2)(a), instead of to the individual contracts within that group.

## 7 CASH FLOWS TO BE VALUED

7.1 In a prospective valuation, a *firm* must:

(1) include in the cash flows to be valued, the following:

(a) *future premiums*;

(b) expenses, including commissions;

(c) *benefits payable*; and

(d) subject to (2), amounts to be received or paid in respect of *contracts of long-term insurance* under contracts of *reinsurance* or *analogous non-reinsurance financing agreements*; but

(2) exclude from those cash flows amounts recoverable from an *ISPV*.

## 8 VALUATION RATES OF INTEREST

8.1 In calculating the present value of future net cash flows, a *firm* must determine the rates of interest to be used in accordance with 8.2, 9 and 10.

8.2 (1) The rates of interest required by 8.1 to be used by a *firm* for the calculation of the present value of a *long-term insurance liability* must not exceed 97.5% of the *risk-adjusted yield* that is expected to be achieved on:

(a) the assets allocated to cover that liability;

(b) the reinvestment of sums expected to be received from those assets; and

(c) the investment of future *premium* receipts.

(2) The requirements in (1) do not apply to a *contract of long-term insurance* in respect of which the *firm* has calculated a negative value for the *mathematical reserves* in accordance with 5.1.

(3) For the purposes of (1), the rates of interest assumed must allow appropriately for the rates of tax that apply to the investment return on *policyholder* assets.

(4) For the purposes of (3), the rates of tax assumed must be such that the *firm's* total implied liability for tax arising from the allocation of assets to liabilities is not less than the *firm's* actual expected liability for tax for the period in respect of which tax is to be assessed.

## 9 RISK-ADJUSTED YIELD

9.1 A *risk-adjusted yield* on an asset must be calculated by:

(1) taking the asset together with any covering *derivatives*, forward transactions and *quasi-derivatives*;

(2) assuming that the factors which affect the yield will remain unchanged after the valuation date;

(3) valuing the asset (together with any *offsetting transaction*) in accordance with Insurance Company – Overall Resources and Valuation 3 to 8;

(4) making reasonable assumptions as to whether, and if so when, any options or other rights embedded in the asset (or in any *offsetting transaction*) will be exercised.

9.2 For the purpose of 9.1(2), the factors that affect yield should be ascertained as at the valuation date (that is, the date to which present values of cash flows are being calculated). All changes known to have occurred by that date must be taken into account including:

(1) changes in the rental income from *real estate*;

(2) changes in dividends or audited profit on equities;

(3) known or forecast changes in dividends which have been publicly announced by the *issuer* by the valuation date;

(4) known or forecast changes in earnings which have been publicly announced by the *issuer* by the valuation date;

(5) alterations in capital structure; and

(6) the value (at the most recent date at or before the valuation date for which it is known) of any determinant of the amount of any future interest or capital payment.

9.3 The *risk-adjusted yield* is either:

(1) for equities and *real estate*, a *running yield*; or

(2) for all other assets, the *internal rate of return*.

9.4 The *risk-adjusted yield* on a basket of assets is the arithmetic mean of the *risk-adjusted yield* on each asset weighted by that asset's *market value*.

9.5 The *running yield*:

(1) for *real estate*, is the ratio of:

(a) the rental income arising from the *real estate* over the previous 12 *months*; to

(b) the *market value* of the *real estate*.

(2) for equities, is:

(a) the *dividend yield*, if the *dividend yield* is more than the *earnings yield*;

(b) otherwise, the sum of the *dividend yield* and the *earnings yield*, divided by two.

9.6 For the purposes of 9.5(2):

(1) the *dividend yield* is the ratio (expressed as a percentage) of dividend income over the previous 12 *months* from the equities for which the *running yield* is being calculated ("the relevant equities") to the *market value* of those equities;

(2) the *earnings yield* is the ratio (expressed as a percentage) of the audited profit (including exceptional items and extraordinary items) for the preceding *financial year* of the *issuer* of the relevant equities to the *market value* of those equities;

(3) the *earnings yield* must be calculated in accordance with whichever is most appropriate (to the *issuer* of the relevant equities) of *UK*, US or international generally accepted accounting practice.

9.7 The *internal rate of return* on an asset is the annual rate of interest which, if used to calculate the present value of future income (before deduction of tax) and of repayments of capital (before deduction of tax) would result in the sum of those amounts being equal to the *market value* of the asset.

9.8 In both the *running yield* and *internal rate of return* the yield must be reduced to exclude that part of the yield that represents compensation for credit risk arising from the asset.

9.9 Provision for credit risk for securities that are not credit-rated must be made on principles at least as prudent as those adopted for credit-rated securities.

## 10 INVESTMENT AND REINVESTMENT

10.1 The *risk-adjusted yield* assumed for the investment or reinvestment of sterling sums (other than sums expected to be received within the next three years) must not exceed the lowest of:

(1) the higher of:

(a) the long-term gilt yield; and

(b) the greater of:

(i) the forward gilts yield; and

(ii) the forward rate on sterling interest rate swaps, reduced to exclude that part of the rate that represents compensation for credit risk;

where the forward yields and forward rates corresponding to the time when the sums are expected to be received are weighted so as to reflect the investment and reinvestment characteristics of the liabilities covered;

(2) 3% per annum, increased by two thirds of the excess, if any, of the percentage in (1) over 3% per annum; and

(3) 6.5% per annum.

10.2 The *risk-adjusted yield* assumed for the investment or reinvestment of those sterling sums expected to be received within the next three years must not exceed the *risk-adjusted yield* on the assets actually held adjusted linearly over the three-year period to the *risk-adjusted yield* determined under 10.1.

10.3 The *risk-adjusted yield* assumed for the investment or reinvestment of sums denominated in a currency other than sterling must be at least as prudent as in 10.1 and 10.2 taking into account the yields on government securities denominated in that currency.

10.4 For the purpose of 10.3 the yields on the government securities must be reduced to exclude that part of the yield that represents compensation for credit risk unless, in relation to the *issuer* of those securities, a credit rating is available from at least one of the following rating agencies in the corresponding rating categories;

(1) for A.M. Best Company, ‘aaa’ or ‘aa’;

(2) for Fitch Ratings, ‘AAA’ or ‘AA’;

(3) for Moody's Investors Service ‘Aaa’ or ‘Aa’; or

(4) for Standard & Poor's Corporation ‘AAA’ or ‘AA’.

## 11 FUTURE PREMIUMS

11.1 This Chapter applies to *with-profits policies,* except *accumulating with-profits policies* written on a recurring single premium basis.

11.2 A *future premium* must not exceed the lower of the value of:

(1) the actual *premium* payable under the contract; and

(2) the *net premium*, which may be increased for *deferred acquisition costs* in accordance with 12.1.

11.3 Where the terms of a *contract of insurance* have changed since it was first entered into, a *firm* must, in determining the *net premium* for the purpose of 11.2(2), treat that change as if either:

(1) it had been included in the original contract but came into effect from the time the change became effective; or

(2) the original contract were cancelled and replaced by a new contract (with an initial *premium* paid on the new contract equal to the liability under the original contract immediately prior to the change); or

(3) subject to 11.4, it gave rise to two separate contracts where:

(a) all *premiums* are payable under the first contract and that contract provides only for such benefits as those *premiums* could have purchased from the *firm* at the date the change became effective; and

(b) no *premiums* are payable under the second contract and that contract provides for all the other benefits.

11.4 For the purposes of 11.3(3), a *firm* must not treat the change referred to in 11.3 as giving rise to two separate contracts unless a meaningful comparison can be made between the terms of the contract (as changed) and the terms upon which the *firm* was newly *effecting contracts of insurance* at the time the contract was changed.

## 12 FUTURE PREMIUMS: ADJUSTMENT FOR DEFERRED ACQUISITION COSTS

12.1 (1) The amount of any increase to the *net premium* for *deferred acquisition costs* must not exceed the equivalent of the *recoverable acquisition expenses* spread over the period of *premium* payments and calculated in accordance with the rates of interest, mortality and morbidity assumed in calculating the *mathematical reserves*.

(2) The *recoverable acquisition expenses* in (1) must not exceed the lower of:

(a) the value of the excess of actual *premiums* over *net premiums*; and

(b) 3.5% of the *relevant capital sum*.

(3) *Recoverable acquisition expenses* may be calculated as the average for a group of similar contracts weighted by the *relevant capital sum* for each contract.

## 13 FUTURE PREMIUMS: ACCUMULATING WITH-PROFITS POLICIES

13.1 This Chapter applies to *accumulating with-profits policies* written on a recurring single *premium* basis.

13.2 (1) A *firm* must not attribute any value to a *future premium* under the contract.

(2) Any liability arising only upon the payment of that *premium* may be ignored except to the extent that the value of that liability upon payment would exceed the amount of that *premium*.

## 14 EXPENSES

14.1 (1) A *firm* must make provision for expenses, either implicitly or explicitly, in its *mathematical reserves* of an amount which is not less than the amount expected, on prudent assumptions, to be incurred in fulfilling its *contracts of long-term insurance*.

(2) For the purpose of (1), expenses must be valued:

(a) after taking account of the effect of taxation;

(b) having regard to the *firm's* actual expenses in the last 12 *months* before the *actuarial valuation date* and any increases in expenses expected to occur in the future;

(c) after making prudent assumptions as to the effects of inflation on future increases in prices and earnings; and

(d) at no less than the level that would be incurred if the *firm* were to cease to transact new business 12 *months* after the *actuarial valuation date*.

(3) A *firm* must not rely upon an implicit provision arising from the method of valuing *future premiums* except to the extent that:

(a) it is reasonable to assume that expenses will be recoverable from *future premiums*; and

(b) the expenses would only arise if the *future premiums* were received.

14.2 The provisions for expenses (whether implicit or explicit) required by 14.1 must be sufficient to cover all the expenses of running off the *firm's* existing *long-term insurance business* including:

(1) all discontinuance costs (for example, redundancy costs and closure costs) that would arise if the *firm* were to cease transacting new business 12 *months* after the *actuarial valuation date* in circumstances where (and to the extent that) the discontinuance costs exceed the projected surplus available to meet such costs;

(2) all costs of continuing to service the existing business taking into account the loss of economies of scale from, and any other likely consequences of, ceasing to transact new business at that time; and

(3) the lower of:

(a) any projected valuation strain from writing new business for the 12 *months* following the *actuarial valuation date* to the extent the actual amount of that strain exceeds the projected surplus on prudent assumptions from existing business in the 12 *months* following the *actuarial valuation date*; and

(b) any projected new business expense overrun from writing new business for the 12 *months* following the *actuarial valuation date* to the extent the projected expenses exceed the expenses that the new business can support on a prudent basis.

## 15 MORTALITY AND MORBIDITY

15.1 A *firm* must set the assumptions for mortality and morbidity using prudent rates of mortality and morbidity that are appropriate to the country or territory of residence of the person whose life or health is insured.

## 16 OPTIONS

16.1 (1) When a *firm* establishes its *mathematical reserves* in respect of a *contract of long-term insurance*, the *firm* must include an amount to cover any increase in liabilities which might be the direct result of its *policyholder* exercising an option under, or by virtue of, that *contract of insurance*.

(2) Where the *surrender value* of a contract is guaranteed, the amount of the *mathematical reserves* for that contract at any time must be at least as great as the value guaranteed at that time.

16.2 (1) Where a *policyholder* may opt to be paid a cash amount or a series of cash payments (including the amount or amounts likely to be paid on a voluntary discontinuance), the *mathematical reserves* for the *contract of insurance* established under 2.1 must be sufficient to ensure that the payment or payments could be made solely from:

(a) the assets covering those *mathematical reserves*; and

(b) the resources arising from those assets and from the contract itself.

(2) For the purposes of (1), the *firm* must assume that:

(a) the assumptions adopted for the current valuation remain unaltered and are met; and

(b) discretionary benefits and charges will be set so as to fulfil the *firm's* regulatory duty to treat its customers fairly under any relevant provision of the *FCA Handbook*.

(3) (1) may be applied to a group of similar contracts instead of to the individual contracts within that group, except where the cash amount or series of cash payments is the amount or amounts likely to be paid on a voluntary discontinuance.

16.3 For the purposes of 16.2, a *firm* must assume that the amount of a cash payment secured by the exercise of an option is:

(1) in the case of an *accumulating with-profits policy*, the lower of:

(a) the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm* and including any expectations of a *final bonus*; and

(b) that amount, disregarding all discretionary adjustments;

(2) in the case of any other *policy*, the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus*.

## 17 PERSISTENCY ASSUMPTIONS

17.1 A *firm* must, when making assumptions about voluntary discontinuance rates in the calculation of the *mathematical reserves,* ensure that those assumptions meet the general requirements for prudent assumptions as set out in 3.1.

## 18 REINSURANCE

18.1 In this Chapter, references to:

(1) *reinsurance* and contracts of *reinsurance* include *analogous non-reinsurance financing agreements*;

(2) reinsured risks, in relation to a contract of *reinsurance* entered into by a *firm*, means that part of:

(a) the risks insured by the *firm* under *contracts of long-term insurance* entered into by it; and

(b) the other risks arising directly from the *firm's long-term insurance business*;

that have been transferred to the *reinsurer* under that contract of *reinsurance*; and

(3) *reinsurance* cash outflows include any reduction in *policy* liabilities recognised as covered under a contract of *reinsurance* or any reduction of any debt to the *firm* under or in respect of a contract of *reinsurance*.

18.2 A *firm* must value *reinsurance* cash flows using methods and assumptions which are at least as prudent as the methods and assumptions used to value the underlying *contracts of insurance* which have been reinsured.

18.3 For purposes of 18.2:

(1) *reinsurance* recoveries must not be recognised unless the underlying liabilities to which they relate have also been recognised;

(2) *reinsurance* cash outflows need not to be valued provided that:

(a) in accordance with 18.5 and 18.6, they are unambiguously linked to the emergence as surplus of margins included in the valuation of existing *contracts of insurance* or to the exercise by a *reinsurer* of its rights under a termination clause; and

(b) the conditions in 18.4 are satisfied;

(3) *reinsurance* cash inflows that are contingent on factors or conditions other than the reinsured risks must not be valued.

18.4 The conditions referred to in 18.3(2)(b) are that:

(1) the *reinsurance* is not connected with any other transaction, which, when taken together with the *reinsurance*, could result in the requirements set out in 18.3(2) no longer being satisfied or in the risk transferred under the *reinsurance* being undermined; and

(2) the present value of the future *reinsurance* cash outflows that may be disregarded under 18.3(2) must not at any time exceed the value of the aggregate net cash

inflows that have already been received by the *firm* under the contract of *reinsurance* accumulated at an assumed rate of LIBOR + 6% per annum.

18.5 For the purposes of 18.3(2), the "link" must be such that a contingent liability to pay or repay the amount to the *reinsurer* could not arise except when, and to the extent that, the margins in the valuation of the existing *contracts of insurance* emerge as surplus, or the *reinsurer* exercises its rights under a termination clause in the contract of *reinsurance* as a result of:

(1) fraudulent conduct by the *firm* under or in relation to the contract of *reinsurance*; or

(2) a representation as to the existence, at or before the time the contract of *reinsurance* is entered into, of a state of affairs which is within the knowledge or control of the *firm* and which is material to the *reinsurer's* decision to enter into the contract being discovered to be false; or

(3) the non-payment of *reinsurance premiums* by the *firm*; or

(4) a transfer by the *firm* of the whole or a specified part of its business without the agreement of the *reinsurer*, except where that agreement has been unreasonably withheld.

18.6 (1) Subject to (2), for the purposes of 18.3(2) and 18.5, future surplus may only be offset against future *reinsurance* cash outflow in respect of surplus on *non-profit policies* and the charges or shareholder transfers arising as surplus from *with-profits policies*.

(2) Such charges and transfers may only be allowed for to the extent consistent with the regulatory duty of the *firm* to treat its customers fairly under any relevant provision of the *FCA Handbook*.

## 19 RECORD KEEPING

19.1 A *firm* must make, and retain for an appropriate period, a record of:

(1) the methods and assumptions used in establishing its *mathematical reserves*, including the margins for adverse deviation, and the reasons for their use; and

(2) the nature of, reasons for, and effect of, any change in approach, including the amount by which the change in approach increases or decreases its *mathematical reserves*.

**Annex D**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY – CAPITAL RESOURCES REQUIREMENTS

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer* other than a *non-directive friendly society*.

1.2 If a *firm* carries on *long-term insurance business* and *general insurance business*, except where a particular provision provides otherwise, the rules in this Part apply separately to each type of business.

1.3 In this Part, the following definitions shall apply:

*adjusted mathematical reserves*

has the meaning given in 19.1.

*administrative expenses*

has the meaning set out in the *insurance accounts rules*.

*base capital resources requirement*

has the meaning given in 6.1.

*defined benefits pension scheme*

means a *pension policy* under which the only *money-purchase benefits* are benefits ancillary to other benefits which are not *money-purchase benefits*.

*equity market adjustment ratio*

means:

(1) if the ratio calculated in (a) and (b) lies between 75% and 100%, the result of 100% less the ratio (expressed as a percentage) of:

(a) the current value of the FTSE Actuaries All Share Index; to

(b) the average value of the FTSE Actuaries All Share Index over the preceding 90 calendar days;

(2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and

(3) 25%, if the ratio calculated in (1)(a) and (b) is less than 75%,

where the average value of the FTSE Actuaries All Share Index over any period of 90 calendar days is the arithmetic mean based on levels at the close of business on each of the days in that period on which the London Stock Exchange was open for trading.

*gross adjusted claims amount*

has the meaning given in 9.2 to 9.5.

*gross adjusted premiums amount*

has the meaning given in 8.2.

*life protection reinsurance business*

means *reinsurance* acceptances which are *contracts of insurance*:

(1) falling within *long-term insurance business class* I; or

(2) falling within *long-term insurance business class* III and providing *index-linked benefits*;

that are not:

(3) *with-profits policies*;

(4) *whole life assurances*;

(5) contracts to pay annuities on human life; or

(6) contracts which pay a sum of money on the survival of the life assured to a specific date or on his earlier death.

*long-term gilt yield*

means the annualised equivalent of the 15 year gilt yield for the *UK* Government fixed-interest *securities* index jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries.

*mixed insurer*

means an *insurer* (other than a *pure reinsurer*) which carries on *reinsurance* business and where one or more of the following conditions is met in respect of its *reinsurance* acceptances:

(1) the *premiums* collected in respect of those acceptances during the previous *financial year* exceeded 10% of its total *premiums* collected during that year; and

(2) the *technical provisions* in respect of those acceptances at the end of the previous *financial year* exceeded 10% of its total *technical provisions* at the end of that year.

*money-purchase benefits*

means benefits, the rate or amount of which are calculated by reference to a payment or payments made by a member of the scheme.

*permanent health reinsurance business*

means *reinsurance* acceptances which are *contracts of insurance* falling within *long-term insurance business class* IV.

*real estate market adjustment ratio*

means:

(1) if the ratio calculated in (a) and (b) lies between 90% and 100%, the result of 100% less the ratio (expressed as a percentage) of:

(a) the current value of the real estate index; to

(b) the average value of that real estate index over the three preceding *financial years*;

(2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and

(3) 10%, if the ratio calculated in (1)(a) and (b) is less than 90%.

*reinsurance ratio*

has the meaning given in 11.1.

*relevant assets*

means a range of assets which must be selected by the *firm* pursuant to 20.2 from the assets specified in (1) and (2) in the order specified:

(1) its *long-term insurance assets*; and

(2) only where the *firm* has selected all the assets within (1), its shareholder assets, other than assets of an amount and kind required:

(a) to cover its liabilities arising outside its *long-term insurance funds*; or

(b) to meet any regulatory capital requirements in respect of business written outside its *long-term insurance funds*.

*significant territory*

means any country or territory in which more than 2.5% of a *firm's long-term insurance assets* (by *market value*), excluding assets held to cover *index-linked liabilities* or *property-linked liabilities*, are invested and for these purposes the member states of the *EU* which have adopted the Euro as the official currency may be treated as a single territory.

*whole life assurance*

means a *contract of insurance* which, disregarding any benefit payable on surrender, secures a capital sum only on death or either on death or on disability, but does not include a term assurance.

## 2 RESOURCES MONITORING

2.1 A *firm* must at all times monitor whether it is complying with 3.1 and be able to demonstrate that it knows at all times whether it is complying with that rule.

2.2 A *firm* must notify the *PRA* immediately in accordance with Notifications 2 of any breach, or expected breach, of 3.1.

## 3 CAPITAL RESOURCES REQUIREMENT

3.1 A *firm* must maintain at all times *capital resources* equal to or in excess of its *CR Requirement.*

3.2 A *firm* that carries on both *long-term insurance business* and *general insurance business* must comply with 3.1, and apply 4.2 and 4.3, separately in respect of both its *long-term insurance business* and its *general insurance business,* unless it is a *pure reinsurer* which has a single *CR Requirement* in respect of its entire business in accordance with 5.2 and 5.3.

## 4 CALCULATION OF THE CR REQUIREMENT

4.1 This Chapter does not apply to a *pure reinsurer*.

4.2 The *CR Requirement* for a *firm* carrying on *general insurance business* is equal to the higher of:

(1) the *base capital resources requirement* for *general insurance business* applicable to that *firm*; and

(2) the *general insurance capital requirement*.

4.3 The *CR Requirement* for a *firm* carrying on *long-term insurance business* is equal to the higher of:

(1) the *base capital resources requirement* for *long-term insurance business* applicable to that *firm*; and

(2) the *long-term insurance capital requirement.*

## 5 CALCULATION OF THE CR REQUIREMENT – PURE REINSURERS

5.1 This Chapter only applies to a *pure reinsurer*.

5.2 Subject to 5.3, for a *pure reinsurer*:

(1) the *CR Requirement* in respect of its *general insurance business* is the *general insurance capital requirement*; and

(2) the *CR Requirement* in respect of its *long-term insurance business* is the *long-term insurance capital requirement*.

5.3 If the sum of:

(1) the *general insurance capital requirement*; and

(2) the *long-term insurance capital requirement*,

is lower than the *base capital resources requirement*, the *firm* has a single *CR Requirement* in respect of its entire business equal to the *base capital resources requirement*.

## 6 BASE CAPITAL RESOURCES REQUIREMENT

6.1 The amount of a *firm's base capital resources requirement* is:

| ***Firm* category** | | **Amount** |
|---|---|---|
| General insurance business | | |
| Liability *insurer* (*classes* 10-15) | A *mutual* that is a *Solvency I firm* | £2.25 million |
| | An *insurer* that is a *non-Solvency I firm* | £280,000 |
| | Other (including *mixed insurer* but excluding *pure reinsurer*) | £3.00 million |
| Other *insurer* | A *mutual* that is a *Solvency I firm* | £1.5 million |
| | An *insurer* that is a *non-Solvency I firm* (*classes* 1 to 8, 16 or 18) | £210,000 |
| | An *insurer* that is a *non-Solvency I firm* (*classes* 9 or 17) | £140,000 |
| | *Mixed insurer* | £3.00 million |
| | Other (excluding *pure reinsurer*) | £2.00 million |
| *Long-term insurance business* | | |
| *Mutual* | A *mutual* that is a *Solvency I firm* | £2.25 million |
| | A *mutual* that is a *non-Solvency I firm* | £560,000 |
| Any other *insurer* (including a *mixed insurer* but excluding a *pure reinsurer*) | | £3.00 million |
| All business (*general insurance business* and *long-term insurance business*) | | |
| *Pure reinsurer* | | £3.00 million |

6.2 If a *firm* falls within one or more of the descriptions of type of *firm* set out in 6.1, its *base capital resources requirement* is the highest amount set out against the different types of *firm* within whose description it falls.

## 7 GENERAL INSURANCE CAPITAL REQUIREMENT

7.1 A *firm* carrying on *general insurance business* must calculate its *general insurance capital requirement* as the highest of:

(1) the *premiums amount*;

(2) the *claims amount*; and

(3) the *brought forward amount*.

## 8 THE PREMIUMS AMOUNT

8.1 The *premiums amount* is:

(1) 18% of the *gross adjusted premiums amount*; multiplied by

(2) the *reinsurance ratio*.

8.2 For the purpose of 8.1, the *gross adjusted premiums amount* is the higher of the *gross written premiums* and *gross earned premiums* (as adjusted in accordance with 12.1) for the *financial year* in question, adjusted by:

(1) except for a *pure reinsurer* which ceased to conduct new *reinsurance contracts* before 31 December 2006, increasing the amount included in respect of the *premiums* for *general insurance business classes* 11, 12 and 13 by 50%;

(2) deducting 66.7% of the *premiums* for *actuarial health insurance* that meets the conditions set out in 13.1; and

(3) multiplying the resulting figure by 12 and dividing by the number of *months* in the *financial year*. For the purposes of this calculation, the number of *months* in the *financial year* is the number of complete calendar *months* in the *financial year* plus any fractions of a *month* at the beginning and the end of the *financial year*.

## 9 THE CLAIMS AMOUNT

9.1 The *claims amount* is:

(1) 26% of the *gross adjusted claims amount*; multiplied by

(2) the *reinsurance ratio*.

9.2 For the purpose of 9.1 and subject to 9.3, the *gross adjusted claims amount* is the amount of gross claims incurred (as determined in accordance with 12.1) over the reference period and adjusted by:

(1) except for a for a *pure reinsurer* which ceased to conduct new *reinsurance contracts* before 31 December 2006, increasing by 50% the amount included in respect of the *claims* incurred for 11, 12 and 13;

(2) deducting 66.7% of the *claims* for *actuarial health insurance* that meets the conditions set out in 13.1; and

(3) multiplying the resulting figure by 12 and dividing by the number of *months* in the reference period. For the purposes of this calculation, the number of *months* in the reference period is the number of complete calendar *months* in the reference period plus any fractions of a *month* at the beginning and the end of the reference period.

9.3 For the purposes of 9.1, in relation to *general insurance business class* 18, the amount of *claims* incurred used to calculate the *gross adjusted claims amount* must be the amount of costs recorded in the *firm's* books in the reference period as borne by the *firm* (whether or not borne in the reference period) in respect of the assistance given.

9.4 Except in those cases where 9.5 applies, the reference period to be used in 9.2 and 9.3 must be:

(1) the *financial year* in question and the two previous *financial years*; or

(2) the period the *firm* had been in existence at the end of the *financial year* in question, if shorter.

9.5 In the case of a *firm* which underwrites only one or more of the *general insurance business* risks of credit (as included in *general insurance business class* 14), storm (as included in *general insurance business class* 8), hail or frost (as included in *general insurance business class* 9 and including other business written in connection with such risks), the reference period to be used must be:

(1) the *financial year* in question and the six previous *financial years*; or

(2) the period for which the *firm* had been in existence at the end of the *financial year* in question, if shorter.

## 10 THE BROUGHT FORWARD AMOUNT

10.1 Subject to 10.2 and 10.3, the *brought forward amount* is the *general insurance capital requirement* for the prior *financial year*, multiplied, if the ratio is less than one, by the ratio (expressed as a percentage) of:

(1) the *technical provisions* (calculated net of *reinsurance*) for claims outstanding at the end of the prior *financial year*; to

(2) the *technical provisions* (calculated net of *reinsurance*) for claims outstanding at the beginning of the prior *financial year*.

10.2 If the amount of the *technical provisions* (calculated net of *reinsurance*) in 10.1(1) and (2) is in both cases zero, the *brought forward amount* is the *general insurance capital requirement* for the prior *financial year*, multiplied, if the ratio is less than one, by the ratio (expressed as a percentage) of:

(1) the *technical provisions* (calculated gross of *reinsurance*) for claims outstanding at the end of the prior *financial year*; to

(2) the *technical provisions* (calculated gross of *reinsurance*) for claims outstanding at the beginning of the prior *financial year*.

10.3 If the amount of the *technical provisions* (calculated gross of *reinsurance*) in 10.2(1) and (2) is in both cases zero, the *brought forward amount* is the *general insurance capital requirement* for the prior *financial year*.

## 11 REINSURANCE RATIO

11.1 The *reinsurance ratio* is:

(1) if the ratio calculated in (a) and (b) lies between 50% and 100%, the ratio (expressed as a percentage) of:

(a) the claims incurred (net of *reinsurance*) in the *financial year* in question and the two previous *financial years*; to

(b) the gross claims incurred in that three-year period;

(2) 50%, if the ratio calculated in (1)(a) and (b) is 50% or less; and

(3) 100%, if the ratio calculated in (1)(a) and (b) is 100% or more.

## 12 ACCOUNTING FOR PREMIUMS AND CLAIMS

12.1 For the purposes of 8.2, 9.2, 9.3, 10.1, 10.2 and 11.1, amounts of *premiums* and claims must be:

(1) determined in accordance with the *insurance accounts rules*; and

(2) adjusted for transfers that were approved by the authority with responsibility for the approval of transfers of portfolios of *contracts of insurance* at the relevant time (or became effective where approval by an authority was not required) before the end of the *financial year* in question:

(a) to exclude any amount included in, or adjustment made to, *premiums* and claims to reflect the consideration for a transfer of *contracts of insurance* to or from the *firm*;

(b) to exclude *premiums* and claims (including amounts that arose in the *financial year* in question or previous *financial years*) which arose from *contracts of insurance* that have been transferred by the *firm* to another body; and

(c) to account for *premiums* and claims which arose from *contracts of insurance* that have been transferred to the *firm* from another body as if they were receivable by or payable by the *firm* (including where they arose prior to the date of transfer and were, in fact, receivable by or payable by the other body).

12.2 For both transfers to and from the *firm*, the consideration receivable or payable in respect of the transfer is excluded from *premiums* and claims in order to avoid double counting.

12.3 Where there has been a significant change in the business portfolio of the *firm* since the end of the *financial year* in question, the *gross adjusted premiums amount* and the *gross adjusted claims amount* must both be recalculated to take into account the impact of this change. The recalculation must take into account the requirements of the *insurance accounts rules*.

## 13 ACTUARIAL HEALTH INSURANCE

13.1 The conditions referred to in 8.2(2) and 9.2(2) are that:

(1) the health insurance is underwritten on a similar technical basis to that of life insurance;

(2) the *premiums* paid are calculated on the basis of sickness tables according to the mathematical method applied in insurance;

(3) a provision is set up for increasing age;

(4) an additional *premium* is collected in order to set up a safety margin of an appropriate amount;

(5) it is not possible for the *firm* to cancel the contract after the end of the third year of insurance; and

(6) the contract provides for the possibility of increasing *premiums* or reducing payments even for current contracts.

## 14 LONG-TERM INSURANCE CAPITAL REQUIREMENT

14.1 A *firm* carrying on *long-term insurance business* must calculate its *long-term insurance capital requirement* as the sum of:

(1) the *insurance death risk capital component*;

(2) the *insurance health risk and life protection reinsurance capital component*;

(3) the *insurance expense risk capital component*;

(4) the *insurance market risk capital component*; and

(5) the *resilience capital requirement*.

## 15 INSURANCE DEATH RISK CAPITAL COMPONENT

15.1 This Chapter does not apply to:

(1) a *pure reinsurer*; or

(2) a *mixed insurer*;

in respect of *life protection reinsurance business*.

15.2 The *insurance death risk capital component* is the aggregate of the amounts which represent the fractions specified by 15.3 of the capital at risk, defined in 15.4, for *contracts of insurance* which fall within *long-term insurance business classes* I, II, III, VII, VIII or IX, in respect of those contracts where the capital at risk is not a negative figure, multiplied by the higher of:

(1) 50%; and

(2) the ratio as at the end of the *financial year* in question of:

(a) the aggregate capital at risk in respect of that category of contracts net of *reinsurance* cessions; to

(b) the aggregate capital at risk in respect of that category of contracts gross of *reinsurance* cessions.

15.3 For the purpose of 15.2, the fraction is:

(1) for *long-term insurance business classes* I, II and IX, except for a *pure reinsurer*:

(a) 0.1% for temporary insurance on death where the original term of the contract is three years or less;

(b) 0.15% for temporary insurance on death where the original term of the contract is five years or less but more than three years; and

(c) 0.3% in any other case;

(2) 0.3% for *long-term insurance business classes* III, VII and VIII, except for a *pure reinsurer*; and

(3) 0.1% for a *pure reinsurer*.

15.4 For the purpose of 15.2, the capital at risk is:

(1) where the benefit under a *contract of insurance* payable as a result of death includes periodic or deferred payments, the present value of the benefits payable; and

(2) in any other case, the amount payable as a result of death,

less, in either case, the *mathematical reserves* for the contract.

## 16 INSURANCE HEALTH RISK AND LIFE PROTECTION REINSURANCE CAPITAL COMPONENT

16.1 Subject to 16.2 the *insurance health risk and life protection reinsurance capital component* is the highest of:

(1) the *premiums amount*;

(2) the *claims amount*; and

(3) the *brought forward amount.*

16.2 16.1 only applies in respect of:

(1) *contracts of insurance* falling in *long-term insurance business class* IV (and subject to the conditions set out in 13.1 as modified by 16.3);

(2) risks falling in *general insurance business classes* 1 or 2 that are written as part of a *contract of long-term insurance*; and

(3) in the case of a *pure reinsurer* or a *mixed insurer*, *life protection reinsurance business*.

16.3 For the purposes of 16.2, 13.1(3) is replaced with: "either the reserves include a provision for increasing age, or the business is conducted on a group basis."

## 17 INSURANCE EXPENSE RISK CAPITAL COMPONENT

17.1 This Chapter does not apply to:

(1) a *pure reinsurer*; or

(2) a *mixed insurer*;

in respect of *life protection reinsurance business* or *permanent health reinsurance business*.

17.2 The *insurance expense risk capital component* is:

(1) in respect of *long-term insurance business classes* III, VII and VIII, an amount equivalent to 25% of the net *administrative expenses* in the *financial year* in question relevant to the business of each of those *classes*, in so far as the *firm* bears no investment risk and the allocation to cover *management expenses* in the *contract of insurance* does not have a fixed upper limit which is effective as a limit for a period exceeding five years from the commencement of the contract;

(2) in respect of any *tontine* (*long-term insurance business class* V), 1% of the assets of the *tontine*;

(3) in the case of any other *long-term insurance business*, 1% of the *adjusted mathematical reserves*.

## 18 INSURANCE MARKET RISK CAPITAL COMPONENT

18.1 The *insurance market risk capital component* is 3% of the *adjusted mathematical reserves* for all insurance liabilities except those of a kind which:

(1) arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* does not bear any investment risk; or

(2) arise from *contracts of insurance* falling in *long-term insurance business class* V; or

(3) for a *pure reinsurer* or a *mixed insurer*, arise from *contracts of insurance* falling within:

(a) its *life protection reinsurance business*; or

(b) its *permanent health reinsurance business*.

## 19 ADJUSTED MATHEMATICAL RESERVES

19.1 The *adjusted mathematical reserves* referred to in 17.2 and 18.1 is the aggregate of the amounts which result from the performance of the calculation in 19.3 for each category of insurance liability specified in 19.2.

19.2 The categories of insurance liability referred to in 19.1 are:

(1) for the purpose of 17.2:

(a) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* I, II or IX;

(b) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* bears an investment risk;

(c) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* bears no investment risk and where the allocation to cover *management expenses* in the *contract of insurance* has a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;

(d) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class* IV; and

(e) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class* VI; and

(2) for the purpose of 18.1, those categories described in (1)(a), (b), (d) and (e).

19.3 The calculation referred to in 19.1 is the multiplication of the amount of the *mathematical reserves* (gross of *reinsurance* cessions) in respect of a category of insurance liability by the higher of:

(1) 85% or, in the case of a *pure reinsurer*, 50%; and

(2) the ratio as at the end of the *financial year* in question of:

(a) the *mathematical reserves* in respect of that category of insurance liability net of *reinsurance* cessions; to

(b) the *mathematical reserves* in respect of that category of insurance liability gross of *reinsurance* cessions.

## 20 RESILIENCE CAPITAL REQUIREMENT

20.1 A *firm* carrying on *long-term insurance business* must calculate a *resilience capital requirement* in accordance with this Chapter.

20.2 A *firm* must identify *relevant assets* which, after applying the scenarios in 20.3, have a value that is equal to the *firm's long-term insurance liabilities* under those scenarios.

20.3 For the purpose of 20.2, the scenarios are:

(1) for those *relevant assets* invested in the *UK*, the *market risk* scenario set out in 20.6;

(2) subject to (3) and to 20.10, for those *relevant assets* invested outside of the *UK*, the *market risk* scenario set out in 20.8; and

(3) where the *relevant assets* in (2) are:

(a) held to cover *index-linked liabilities* or *property-linked liabilities*; or

(b) not invested in a *significant territory* outside the *UK*;

the *market risk* scenario set out in 20.6.

20.4 The *resilience capital requirement* is the result of deducting B from A, where:

(1) A is the value of the *relevant assets* which will produce the result described in 20.2; and

(2) B is the *firm's long-term insurance liabilities*.

20.5 In calculating the value of the *firm's long-term insurance liabilities* under a scenario specified in 20.3, a *firm* is not required to adjust the provision made under Insurance Company – Overall Resources and Valuation 3.1 in respect of a *defined benefits pension scheme*.

20.6 In 20.3(1) and (3), the *market risk* scenario for assets invested in the *UK* and for assets (including assets invested outside the *UK*) held to cover *index-linked liabilities* or *property-linked liabilities* which a *firm* must assume is:

(1) a fall in the *market value* of equities of at least 10% or, if greater, the lower of:

(a) a percentage fall in the *market value* of equities which would produce an earnings yield on the FTSE Actuaries All Share Index equal to four-thirds of the *long-term gilt yield*; and

(b) a fall in the *market value* of equities of 25% less the *equity market adjustment ratio*;

(2) a fall in real estate values of 20% less the *real estate market adjustment ratio* for an appropriate real estate index; and

(3) the more onerous of either a fall or rise in yields on all fixed interest *securities* by the percentage point amount equal to 20% of the *long-term gilt yield*.

20.7 For the purposes of 20.6(1) and (2), a *firm* must:

(1) assume that earnings for equities and rack rents for real estate fall by 10%, but dividends for equities remain unaltered (see Insurance Company – Mathematical Reserves 9.5 and 9.6); and

(2) model a fall in equity and real estate markets as if the fall occurred instantaneously.

20.8 In 20.3(2), subject to 20.10, the *market risk* scenario for assets invested outside the *UK* (other than assets held to cover *index-linked liabilities* or *property-linked liabilities*) which a *firm* must assume is, for each *significant territory* in which assets are invested outside the *UK*:

(1) an appropriate fall in the *market value* of equities invested in that territory, which is at least equal to the percentage fall determined in 20.6;

(2) a fall in real estate values in that territory of 20% less the *real estate market adjustment ratio* for an appropriate real estate index for that territory; and

(3) the more onerous of either a fall or a rise in yields on all fixed interest *securities* by the percentage point amount equal to 20% of the nearest equivalent (in respect of the method of calculation) to the *long-term gilt yield*.

20.9 For the purposes of 20.8(1), an appropriate fall in the *market value* of equities invested in a *significant territory* must be determined having regard to:

(1) an appropriate equity market index for that territory; and

(2) the historical volatility of the equity market index selected in (1).

20.10 Where the assets of a *firm* invested in a *significant territory* of a kind referred to in 20.8represent less than 0.5% of the *firm's long-term insurance assets* (excluding assets held to cover *index-linked liabilities* or *property-linked liabilities*), measured by *market value*, the *firm* may assume for those assets the *market risk* scenario for assets of that kind invested in the *UK* set out in 20.6 instead of the *market risk* scenario set out in 20.8.

## 21 ISPVS

21.1 A *firm* must not treat any amounts recoverable from an *ISPV* as *reinsurance* for the purposes of the calculation of:

(1) the *reinsurance ratio*; or

(2) the *insurance death risk capital component*; or

(3) the *adjusted mathematical reserves*.

**Annex E**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - CAPITAL RESOURCES

**Chapter content**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer* other than a *non-directive friendly society*.

1.2 In this Part, the following definitions shall apply:

*called-up share capital*

has the meaning in section 547 of the Companies Act 2006.

*capital contribution*

means an item of capital that is a gift of capital and where no *coupon* is payable on it.

*capital instrument*

means any *security* issued by or loan made to that *firm* or any other investment in, or external contribution to the capital of, that *firm*.

*company*

has the meaning in section 1(1) of the Companies Act 2006.

*coupon*

means a dividend, interest payment or any similar payment.

*discounts*

means discounting or deductions to take account of investment income as set out in paragraph 48 of the *insurance accounts rules*.

*fund for future appropriations*

means the fund of the same name required by the *insurance accounts rules*, comprising all funds the allocation of which either to *policyholders* or to shareholders has not been determined by the end of the *financial year*, or the balance sheet items under international accounting standards which in aggregate represent as nearly as possible that fund.

*initial fund*

means the items of capital that were available to a *mutual* on the date it received a *Part 4A permission* to *effect contracts of insurance* or *carry out contracts of insurance*.

*member contribution*

means any paid-up contribution by a member of a *mutual* where the members' accounts meet the following criteria:

(1) the memorandum and articles of association or other constitutional documents must stipulate that payments may be made from these accounts to members only in so far as this does not cause the *mutual's capital*

*resources* to fall below the required level, or, if after dissolution of the *mutual*, all the *firm*'s other debts have been settled;

(2) the memorandum and articles of association or other constitutional documents must stipulate, with respect to the payments referred to in (1) made for reasons other than the individual termination of membership, that the *PRA* must be notified at least one *month* in advance of the intended date of such payments; and

(3) the *PRA* must be notified of any amendment to the relevant provisions of the memorandum and articles of association or other constitutional documents.

*step-up*

means (in relation to any item of capital) any change in the *coupon* rate on that item that results in an increase in the amount payable at any time, including a change already provided in the original terms governing those payments:

(1) including (in the case of a fixed rate) an increase in that *coupon* rate;

(2) including (in the case of a floating rate calculated by adding a fixed amount to a fluctuating amount) an increase in that fixed amount;

(3) including (in the case of a floating rate) a change to the benchmark by reference to which the fluctuating element of the *coupon* is calculated; and

(4) not including (in the case of a floating rate) an increase in the absolute amount of the *coupon* caused by fluctuations in the benchmark by reference to which the absolute amount of the *coupon* floats.

*tier one capital resources*

means the sum calculated at stage F (Total tier one capital after deductions) of the calculation in the *capital resources table*.

*valuation differences*

means all differences between the valuation of assets and liabilities as valued in accordance with Insurance Company – Overall Resources and Valuation and the valuation that the *firm* uses for its external financial reporting purposes, except valuation differences which are dealt with elsewhere in the *capital resources table*.

1.3 Undefined references in this Part to types, tiers or stages of capital or capital instruments must be interpreted in accordance with the *capital resources table*.

1.4 A tier one instrument or tier two instrument is treated as not having been redeemed or repaid for the purposes of this Part if:

(1) under its terms the instrument is exchanged for or converted into a new instrument or is subject to a similar process, or it is redeemed out of the proceeds of the issue of new securities;

(2) any new instrument is included in the same stage of capital or a higher stage of capital as the original instrument; and

(3) it would be reasonable (taking into account the economic substance) to treat the original instruments as continuing in issue on the same or a more favourable basis

where the question of whether that basis is more or less favourable must be judged from the point of view of the adequacy of the *firm's capital resources*.

1.5 A *share* is not redeemable for the purposes of this Part merely because the Companies Act 1985, the Companies (Northern Ireland) Order 1986 or the Companies Act 2006 allows the *firm* that issued it to purchase it.

1.6 A *capital instrument* is not redeemable for the purposes of this Part merely because the *firm* that issued it has a right to purchase it similar to the right in 1.5.

## 2 CALCULATION AND LIMITS OF RESOURCES

2.1 Subject to 2.5, a *firm* must calculate its *capital resources* in accordance with the *capital resources table*.

2.2 A *firm* must only include in a lower stage of capital, *capital resources* which are eligible for inclusion in a higher stage of capital if:

(1) 2.5 would prevent the use of that capital in that higher stage of capital;

(1) the *firm* complies with 2.5 following the inclusion of that higher stage of capital included in the lower stage of capital; and

(2) the *firm* complies with other rules in this Part governing the eligibility of capital in that lower stage of capital.

2.3 A *firm* must have at least 50% of its *tier one capital resources* accounted for by core tier one capital.

2.4 A *firm* must have no more than 15% of its *tier one capital resources* accounted for by innovative tier one capital.

2.5 A *firm* must exclude from the calculation of its *capital resources* the following:

(1) the amount (if any) by which *tier two capital resources* exceed the amount calculated at stage F (Total tier one capital after deductions) of the calculation in the *capital resources table*; and

(2) the amount (if any) by which lower tier two capital resources exceed 50% of the amount calculated at stage F of the calculation in the *capital resources table*.

2.6 A *firm* (other than a *pure reinsurer*) that carries on both *long-term insurance business* and *general insurance business* must apply the relevant limits in 2.5 separately for each type of business.

## 3 NOTIFICATION OF ISSUANCE OF CAPITAL INSTRUMENTS

3.1 [NOT YET IN FORCE]

## 4 TIER ONE CAPITAL

4.1 A *firm* must not include a *capital instrument* in its *tier one capital resources* unless it complies with the following conditions:

(1) it is included in one of the categories in 4.2;

(2) it complies with the conditions set out in 4.3; and

(3) it is not excluded under 4.4 or 4.5.

4.2 The categories referred to in 4.1(1) are:

(1) *permanent share capital*;

(2) a perpetual non-cumulative *preference share* that meets the requirements set out in 6.1; and

(3) an innovative tier one instrument that meets the requirements set out in 6.3 to 6.7.

4.3 The conditions that an item of capital of a *firm* must comply with under 4.1(2) are as follows:

(1) it is issued by the *firm*;

(2) it is fully paid and the proceeds of issue are immediately and fully available to the *firm*;

(3) it:

(a) cannot be redeemed at all or can only be redeemed on a winding up of the *firm*; or

(b) complies with the conditions in 4.5 and, if applicable, 4.11;

(4) the item of capital meets the following conditions in relation to any *coupon*:

(a) the *firm* is under no obligation to pay a *coupon*; or

(b) if the *firm* is obliged to pay the *coupon*, the *coupon* is payable in the form of an item of capital that is included in a higher stage of capital or the same stage of capital as that first item of capital;

(5) any *coupon* is either:

(a) non-cumulative; or

(b) (if it is cumulative) it must, if deferred, be paid by the *firm* in the form of *tier one capital* complying with (4)(b);

(6) it is able to absorb losses to allow the *firm* to continue trading and in particular it complies with 4.12 and 4.13 and, in the case of an innovative tier one instrument, 6.7;

(7) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses;

(8) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as these occur;

(9) it ranks for repayment upon winding up, administration or any other similar process no higher than a *share* of a company incorporated under the Companies Act 2006 (whether or not it is such a *share*); and

(10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9).

4.4 An item of capital does not qualify for inclusion as *tier one capital* if the issue of that item of capital by the *firm* is connected with one or more other transactions or arrangements which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in 4.3(1) to (9).

4.5 A *firm* must not include a *capital instrument* as *tier one capital*, unless its contractual terms are such that:

(1) if it is redeemable other than in circumstances set out in 4.3(3)(a), it is redeemable only at the option of the *firm*;

(2) the *firm* cannot exercise any redemption right:

(a) before the fifth anniversary of its date of issue, unless the conditions in 4.6 are met;

(b) unless it has given notice to the *PRA* in accordance with 4.8; and

(c) unless at the time of exercise of that right it complies with Insurance Company - Capital Resources Requirements 3.1 and will continue to do so after redemption.

4.6 The conditions in 4.5(2)(a) are that:

(1) the circumstance that entitles the *firm* to exercise that right is a change in law or regulation in any relevant jurisdiction or in the interpretation of such law or regulation by any court or authority entitled to do so;

(2) it would be reasonable for the *firm* to conclude that it is unlikely that that circumstance will occur, judged at the time of issue or, if later, at the time that the term is first included in the terms of the *capital instrument;* and

(3) the *firm's* right is conditional on it obtaining a *waiver* of 4.7.

4.7 A *firm* must not redeem a tier one instrument in accordance with a term that meets the conditions set out in 4.6(1) and (2).

4.8 A *firm* must not redeem any tier one instrument that it has included in its *tier one capital resources* unless it has notified the *PRA* in accordance with Notifications 7 of its intention at least one *month* before it becomes committed to do so.

4.9 When giving notice under 4.8, the *firm* must provide details of its position after such redemption in order to show how it will:

(1) comply with Insurance Company – Capital Resources Requirements 3.1; and

(2) have sufficient financial resources to meet Insurance Company – Overall Resources and Valuation 2.3.

4.10 If a *firm* gives notice to the *PRA* of the redemption or repayment of any tier one instrument, the *firm* must no longer include that instrument in its *tier one capital resources* from the time the notice is given.

4.11 If an innovative tier one instrument is redeemable and satisfies the following conditions:

(1) it is or may become subject to a *step-up*; and

(2) a reasonable *person* would think that:

(a) the *firm* is likely to redeem it before the tenth anniversary of its date of issue; or

(b) the *firm* is likely to have an economic incentive to redeem it before the tenth anniversary of its date of issue,

the redemption date in 4.5(2)(a) is amended by replacing “fifth anniversary” with “tenth anniversary”.

4.12 A *firm* must not include a *share* in its *tier one capital resources* unless:

(1) in the case of a *firm* that is a *company*, it is *called-up share capital*; or

(2) in the case of any other *firm*, it is:

(a) in economic terms; and

(b) in its characteristics as capital (including loss absorbency, permanency, ranking for repayment and fixed costs);

substantially the same as *called-up share capital* falling into (1).

4.13 A *firm* must not include a *capital instrument* other than a *share* in its *tier one capital resources* unless it complies with 4.12(2).

4.14 Where the redemption proceeds or any *coupon* on a potential tier one instrument can be satisfied by the issue of another *capital instrument*, a *firm* must not include an item of capital in its *tier one capital resources* unless the *firm* has unissued *capital instruments* of the kind in question (and the authority to issue them):

(1) that are sufficient to satisfy all such payments then due; and

(2) are of such amount as is prudent in respect of such payments that could become due in the future.

## 5 CORE TIER ONE CAPITAL

5.1 *Permanent share capital* means an item of capital which (in addition to satisfying the conditions in 4.3) meets the following conditions:

(1) it is:

(a) an ordinary *share*;

(b) a *member contribution*; or

(c) part of the *initial fund* of a *mutual*;

(2) any *coupon* on it is not cumulative, the *firm* is under no obligation to pay a *coupon* in any circumstances and the *firm* has the right to choose the amount of any *coupon* that it pays; and

(3) the terms upon which it is issued do not permit redemption and it is otherwise incapable of being redeemed to at least the same degree as an ordinary *share* issued

by a company incorporated under the Companies Act 2006 (whether or not it is such a *share*).

5.2 A *firm* must deduct from its *capital resources* negative amounts, including any interim net losses, from its profit and loss account and other reserves.

5.3 A *firm* must deduct dividends from reserves as soon as they are foreseeable.

5.4 A *firm* must account for a *capital contribution* as an increase in reserves and may count that increase in reserves as core tier one capital.

5.5 A *firm* must include in its core tier one capital a *share* premium account relating to the issue of a *share* forming part of its core tier one capital.

5.6 A *firm* must include *share* premium account relating to the issue of a *share* forming part of another tier of capital:

(1) in that other tier;

(2) for a *firm* that is incorporated under the Companies Act 2006, as core tier one capital to the extent that the terms of issue of the *share* concerned provide that any premium is not repayable on redemption; or

(3) for a *firm* that is not incorporated under the Companies Act 2006 as core tier one capital if its *share* premium account is subject to substantially the same or greater restraints on use than a *share* premium account falling into (2).

5.7 A *firm* must either add (if positive) or deduct (if negative) *valuation differences* from its *capital resources* in accordance with the *capital resources table*.

5.8 A *firm* that carries on *general insurance business* and which *discounts* or reduces its *technical provisions* for claims outstanding must deduct from its *capital resources* the difference between the undiscounted *technical provisions* or *technical provisions* before deductions, and the discounted *technical provisions* or *technical provisions* after deductions.

5.9 The adjustment referred to in 5.8 must be made for all *classes* of *general insurance business*, except for risks listed under *classes* 1 and 2.

5.10 For *classes* other than 1 and 2, no adjustment needs to be made in respect of the discounting of annuities included in *technical provisions*.

5.11 For *classes* 1 and 2 (other than annuities), if the expected average interval between the settlement date of the claims being discounted and the accounting date is not at least four years, the *firm* must deduct:

(1) the difference between the undiscounted *technical provisions* and the discounted *technical provisions*; or

(2) where it can identify a subset of claims such that the expected average interval between the settlement date of the claims and the accounting date is at least four years, the difference between the undiscounted *technical provisions* and the discounted *technical provisions* for the other claims.

5.12 5.8 to 5.11 do not apply to a *pure reinsurer* which ceased to conduct new *reinsurance contracts* before 31 December 2006.

5.13 A *firm* must include in its core tier one capital any *fund for future appropriations*.

## 6 OTHER TIER ONE CAPITAL

6.1 A *firm* must only include a perpetual non-cumulative *preference share* at stage B of the calculation in the *capital resources table* if (in addition to satisfying the conditions in 4.3) it satisfies the following conditions:

(1) any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances; and

(2) it is not an innovative tier one instrument.

6.2 A *firm* must not include an item of capital that is an innovative tier one instrument in stages A (Core tier one capital) or B (Perpetual non-cumulative preference shares) of the calculation in the *capital resources table*.

6.3 A tier one instrument is an innovative tier one instrument if:

(1) it is redeemable; and

(2) a reasonable *person* would think that:

(a) the *firm* is likely to redeem it; or

(b) the *firm* is likely to have an economic incentive to redeem it.

6.4 A tier one instrument is an innovative tier one instrument if it has a cumulative or mandatory *coupon*.

6.5 A potential tier one instrument is an innovative tier one instrument if:

(1) it is or may become subject to a *step-up*; and

(2) it is redeemable at any time (whether before, at or after the time of the *step-up*).

6.6 A *firm* must not include in its *tier one capital resources* a potential tier one instrument that is or may become subject to a *step-up* if that *step-up* can arise earlier than the tenth anniversary of the date of issue of that item of capital.

6.7 A *firm* must not include a *capital instrument* that is not a *share* in its innovative tier one capital resources unless (in addition to satisfying the conditions in 4.3) the *firm's* obligations under the instrument either:

(1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or

(2) do constitute such a liability but the terms of the instrument are such that:

(a) any such liability is not relevant for the purposes of deciding whether:

(i) the *firm* is, or is likely to become, unable to pay its debts; or

(ii) its liabilities exceed its assets;

(b) a *person* (including, but not limited to, a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and

(c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (wrongful trading).

## 7 STEP-UPS

7.1 Where a rule in this Part says that a particular treatment applies to an item of capital that is subject to a *step-up* of a specified amount, the question of whether that rule is satisfied must be judged by reference to the cumulative amount of all *step-ups* since the issue of that item of capital rather than just by reference to a particular *step-up*.

7.2 A *firm* must not include in its *tier one capital resources* a tier one instrument that is or may be subject to a *step-up* that is not one which results in an increase over the initial rate that is no greater than the higher of the following two amounts as at the date of issue of the relevant instrument:

(1) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or

(2) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.

7.3 Subject to 7.4, if a tier two instrument is or may be subject to a *step-up* that does not meet the condition in 7.2 as at the date of issue, the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

7.4 If a tier two instrument:

(1) is or may be subject to a *step-up* during the period beginning on the fifth anniversary of the date of issue of that item and ending immediately before the tenth anniversary of the date of issue; and

(2) the *step-up* or possible *step-up* is one which may result in an increase over the initial rate that is greater than 50 basis points, less the swap spread between the initial index basis and the stepped-up index basis;

the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

## 8 DEDUCTIONS FROM TIER ONE

8.1 A *firm* must deduct from its *tier one capital resources* the value of intangible assets.

## 9 TIER TWO CAPITAL

9.1 A *firm* must not include a *capital instrument* in its *tier two capital resources* unless it complies with the following conditions:

(1) the claims of the creditors must rank behind those of all unsubordinated creditors;

(2) the only events of default must be non-payment of any amount falling due under the terms of the *capital instrument* or the winding-up of the *firm* and any such event of default must not prejudice the subordination in (1);

(3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other

breach of the terms of the *capital instrument* must (subject to 9.2) be limited to petitioning for the winding-up of the *firm* or proving for the debt in the liquidation or administration;

(4) any:

(a) remedy permitted by (3);

(b) remedy that cannot be excluded under the laws of the relevant jurisdictions as referred to in (3);

(c) remedy permitted by 9.2; and

(d) terms about repayment as referred to in (5);

must not prejudice the matters in (1) and (2) and in particular any damages permitted by (b) or (c) and repayment obligation must be subordinated in accordance with (1);

(5) without prejudice to (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by 9.4 or 11.1 and any remedy described in (4)(a) to (c) must not prejudice this requirement;

(6) subject to 9.3, the debt agreement or terms of the *capital instrument* are governed by the law of England and Wales, or of Scotland or of Northern Ireland;

(7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts included in the *firm's capital resources* owed to them by the *firm*;

(8) the terms of the *capital instrument* must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);

(9) the debt must be unsecured and fully paid up;

(10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9); and

(11) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses.

9.2 A *firm* must only include a *capital instrument* in its *tier two capital resources* when the remedies available to the subordinated creditor go beyond those referred to in 9.1(3), if the following conditions are satisfied:

(1) those remedies are not available for failure to pay any amount of principal, interest or expenses or in respect of any other payment obligation; and

(2) those remedies do not in substance amount to remedies to recover payment of the amounts in (1).

9.3 9.1(6) does not apply if the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the same degree of subordination has been achieved under the law that governs the debt and the agreement as that which would have been achieved under the laws of England and Wales, or of Scotland, or of Northern Ireland.

9.4 A tier two instrument must not provide for any right of the *firm* to redeem the instrument to be exercisable earlier than the fifth anniversary of the date of issue of the instrument unless the conditions in 9.5 are met.

9.5 The conditions in 9.4 are that:

(1) the circumstance that entitles the *firm* to exercise that right is a change in law or regulation in any relevant jurisdiction or in the interpretation of such law or regulation by any court or authority entitled to do so;

(2) it would be reasonable for the *firm* to conclude that it is unlikely that that circumstance will occur, judged at the time of issue or, if later, at the time that the term is first included in the terms of the tier one instrument*;* and

(3) the *firm's* right is conditional on it obtaining a *waiver* of 9.6.

9.6 A *firm* must not redeem a tier one instrument in accordance with a term that meets the conditions set out in 9.5.

9.7 A *firm* must notify the *PRA* in accordance with Notifications 7 three *months* before it becomes committed to the proposed repayment of a tier two instrument (unless that *firm* intends to repay an instrument on its final maturity date).

9.8 When giving notice under 9.7, the *firm* must provide details of its position after such repayment in order to show how it will:

(1) comply with Insurance Company – Capital Resources Requirements 3.1; and

(2) have sufficient financial resources to meet Insurance Company – Overall Resources and Valuation 2.3.

9.9 If a *firm* gives notice to the *PRA* of the redemption or repayment of any tier two instrument, the *firm* must no longer include that instrument in its *tier two capital resources* from the time the notice is given.

9.10 A *firm* must not include in its *tier two capital resources* a *capital instrument* that is or may become subject to a *step-up* if that *step-up* can arise earlier than the fifth anniversary of the date of issue of that item of capital.

9.11 A *firm* must not include in its *tier two capital resources* an item of capital does not comply with any requirement in 9 to 11 if the issue of that item of capital by the *firm* is connected with one or more other transactions or arrangements which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in whichever of those rules apply.

## 10 UPPER TIER TWO CAPITAL

10.1 A *firm* must not include a *capital instrument* in its upper tier two capital resources unless it meets the following conditions:

(1) it must have no fixed maturity date;

(2) the terms of the instrument must provide for the *firm* to have the option to defer any *coupon*, except that the *firm* need not have that right in the case of a *coupon* payable in the form of an item of capital that is included in the same stage of capital or a higher stage of capital as that first item of capital;

(3) the terms of the instrument must provide for the loss-absorption capacity of the *capital instrument* and unpaid *coupons*, whilst enabling the *firm* to continue its business;

(4) it meets the conditions in 10.2; and

(5) the terms of the instrument are such that either the instrument is not redeemable or repayable or it is repayable or redeemable only at the option of the *firm*.

10.2 A *firm* must not include a *capital instrument* in its upper tier two capital resources unless (in addition to satisfying all the other requirements in relation to tier two capital) the *firm's* obligations under the instrument either:

(1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or

(2) do constitute such a liability but the terms of the instrument are such that:

(a) any such liability is not relevant for the purposes of deciding whether:

(i) the *firm* is, or is likely to become, unable to pay its debts; or

(ii) its liabilities exceed its assets;

(b) a *person* (including but not limited to a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and

(c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (wrongful trading).

## 11 LOWER TIER TWO CAPITAL

11.1 A *firm* must only include a *capital instrument* in its lower tier two capital resources if (in addition to meeting the requirements of the rules about eligibility for inclusion in tier two capital) either the holder has no right to repayment or it satisfies either of the following conditions:

(1) it has an original maturity of at least five years; or

(2) it is redeemable on notice from the holder, but the period of notice of repayment required to be given by the holder is five years or more.

11.2 For the purposes of calculating the amount of a lower tier two instrument which may be included in a *firm's capital resources*:

(1) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and

(2) in the case of an instrument with or without a fixed maturity date but where five years' or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;

the principal amount must be amortised on a straight line basis.

## 12 DEDUCTIONS FROM CAPITAL

12.1 A *firm* which is not a *pure reinsurer* must deduct from total *capital resources* the value of any asset which is not an *admissible asset*, unless the asset is held to cover *linked long-term liabilities* under Insurance Company – Risk Management 4.

12.2 A *firm* must deduct from its *capital resources* the value of its investments in any *affiliated company* that is an *ancillary services undertaking*.

12.3 In relation to each *affiliated company* that has a *Part 4A permission* a *firm* must add to (if positive), at stage J in the *capital resources table* (Positive adjustments for related undertakings), or deduct from (if negative), at stage L in the *capital resources table* (Deductions from total capital), its *capital resources* the value of its *shares* in that *undertaking* calculated in accordance with Insurance Companies: Overall Resources and Valuation 8.1.

## 13 ADMISSIBLE ASSETS

13.1 An *admissible asset* is:

(1) investments that are, or amounts owed arising from the disposal of:

(a) *debt securities*, bonds and other money and capital market instruments;

(b) loans;

(c) *shares* and other variable yield participations;

(d) *units* in:

(i) *collective investment schemes* falling within the *UCITS Directive*;

(ii) *non-UCITS retail schemes*;

(iii) *recognised schemes*; or

(iv) any other *collective investment scheme* where the *firm's* investment in the scheme is sufficiently small to be consistent with a prudent overall investment strategy, having regard to the investment policy of the scheme and the information available to the *firm* to enable it to monitor the investment risk being taken by the scheme;

(e) land, buildings and immovable property rights; or

(f) an *approved derivative* or *quasi-derivative* transaction that satisfies the conditions in Insurance Company – Risk Management 6.2 or a *stock lending* transaction in respect of which the conditions in Insurance Company – Risk Management 8.2 have been met.

(2) debts and claims that are:

(a) debts owed by *reinsurers*, including *reinsurers'* shares of *technical provisions* (but excluding amounts recoverable from an *ISPV*);

(b) deposits with and debts owed by ceding *undertakings*;

(c) debts owed by *policyholders* and intermediaries arising out of direct and *reinsurance* operations (except where overdue for more than 3 *months* and other than commission prepaid to agents or intermediaries);

(d) for *general insurance business* only, claims arising out of salvage and subrogation;

(e) for *long-term insurance business* only, advances secured on, and not exceeding the *surrender value* of, *contracts of long-term insurance* issued by the *firm*;

(f) tax recoveries; or

(g) claims against the *compensation scheme* or any analogous scheme in any *EEA state*.

(3) assets that are:

(a) tangible fixed assets, other than land and buildings;

(b) cash at *bank* and in hand, *deposits* with *credit institutions* and any other bodies authorised to receive *deposits*;

(c) for *general insurance business* only, *deferred acquisition costs*;

(d) accrued interest and rent, other accrued income and prepayments; or

(e) for *long-term insurance business* only, reversionary interests.

13.2 Subject to 13.3 below a *unit* in a *collective investment scheme* is only admissible for the purposes of 13.1 above if it falls within 13.1(1)(d), notwithstanding that it may also fall into one or more other categories in 13.1.

13.3 A *derivative*, *quasi-derivative* or *stock lending* transaction is only admissible for the purposes of 13.1 if it falls within 13.1(1)(f), notwithstanding that it may also fall into one or more other categories in 13.1.

**Annex F**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY – CAPITAL RESOURCES TABLE

**Chapter content**



**Links**

## 1 APPLICATION

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer* other than a *non-directive friendly society*.

## 2 CAPITAL RESOURCES TABLE

2.1 A *firm* must use the following table to calculate its *capital resources* pursuant to Insurance Company – Capital Resources 2.1:

| Type of capital | Related rules | Stage |
|---|---|---|
| **Core tier one capital** | | **A** |
| *Permanent share capital* | Insurance Company – Capital Resources 5.1 | |
| Profit and loss account and other reserves (taking into account interim net losses) | Insurance Company – Capital Resources 5.2 to 5.4 | |
| *Share* premium account | Insurance Company – Capital Resources 5.5 to 5.6 | |
| Positive valuation differences | Insurance Company – Capital Resources 5.7 | |
| Fund for future appropriations | Insurance Company – Capital Resources 5.13 | |
| **Perpetual non-cumulative preference shares** | | **B** |
| Perpetual non-cumulative *preference shares* | Insurance Company – Capital Resources 6.1 | |
| **Innovative tier one capital** | | **C** |
| Innovative tier one instruments | Insurance Company – Capital Resources 6.2 to 6.7 | |
| **Total tier one capital before deductions = A + B + C** | | **D** |
| **Deductions from tier one capital** | | **E** |
| Investments in own *shares* | None | |
| Intangible assets | Insurance Company – Capital Resources 8.1 | |
| Amounts deducted from *technical provisions* for discounting and other negative valuation differences | Insurance Company – Capital Resources 5.7 to 5.11 | |
| **Total tier one capital after deductions = D- E** | | **F** |
| **Upper tier two capital** | | **G** |
| Upper tier two capital | Insurance Company – Capital Resources 10 | |
| **Lower tier two capital** | | **H** |
| Lower tier two capital | Insurance Company – Capital Resources 11 | |
| **Total tier two capital = G + H** | | **I** |
| **Positive adjustments for affiliated companies** | | **J** |
| *Affiliated companies* that have a *Part 4A permission* (other than *insurance undertakings*) | Insurance Company – Capital Resources 12.3 | |
| **Total capital after positive adjustments for insurance undertakings but before deductions = F + I + J** | | **K** |

| **Deductions from total capital** | | **L** |
|---|---|---|
| Inadmissible assets | Insurance Company – Capital Resources 12.1 and 13.1 | |
| Assets in excess of *market risk* and *counterparty* limits | Insurance Company – Exposure Limits 7.2 to 7.4 | |
| *Affiliated companies* that are *ancillary services undertakings* | Insurance Company – Capital Resources 12.2 | |
| Negative adjustments for *affiliated companies* that have a *Part 4A permission* (other than *insurance undertakings*) | Insurance Company – Capital Resources 12.3 | |
| **Total capital resources after deductions = K - L** | | **M** |

**Annex G**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - INTERNAL CONTAGION RISK

**Chapter content**



**Links**

## 1 APPLICATION

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer,* other than a *non-directive friendly society.*

1.2 This Part applies to the whole of the *firm's* business carried on world-wide.

## 2 RESTRICTION OF BUSINESS

2.1 A *firm* other than a *pure reinsurer* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.

2.2 A *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

## 3 FINANCIAL LIMITATION OF NON-INSURANCE ACTIVITIES

3.1 A *firm* must limit, manage and control its non-insurance activities so that there is no significant risk arising from those activities such that it may be unable to meet its liabilities as they fall due.

## 4 SEPARATELY IDENTIFY AND MAINTAIN LONG-TERM INSURANCE ASSETS

4.1 A *firm* carrying on *long-term insurance business* must identify the assets relating to its *long-term insurance business* which it is required to hold by virtue of:

(1) in the case of a *pure reinsurer*:

(a) Insurance Company - Technical Provisions 4.1 or 4.2; and

(b) Insurance Company - Risk Management 5.1; and

(2) in any other case:

(a) Insurance Company - Technical Provisions 4.1 or 4.2; and

(b) Insurance Company - Risk Management 4.2 and 4.3.

4.2 (1) A *firm's long-term insurance assets* are the items in (2), adjusted to take account of:

(a) outgoings in respect of the *firm's long-term insurance business*; and

(b) any transfers made in accordance with 4.5.

(2) The items referred to in (1) are:

(a) the assets identified under 4.1 (including assets into which those assets have been converted) but excluding any assets identified as being held to cover liabilities in respect of subordinated debt;

(b) any other assets identified by the *firm* as being available to cover its *long-term insurance liabilities* (including assets into which those assets have been converted) including, if the *firm* so elects, assets which are excluded under (a);

(c) *premiums* and other receivables in respect of *contracts of long-term insurance*;

(d) other receipts of the *long-term insurance business*; and

(e) all income and capital receipts in respect of the items in (a) to (d).

4.3 (1) Unless (2) applies, all the *long-term insurance assets* of the *firm* constitute its *long-term insurance fund*.

(2) Where a *firm* identifies particular *long-term insurance assets* in connection with different parts of its *long-term insurance business*, the assets identified in relation to each such part constitute separate *long-term insurance funds* of the *firm*.

4.4 A *firm* must maintain a separate accounting record in respect of each of its *long-term insurance funds*.

4.5 A *firm* may not transfer assets out of a *long-term insurance fund* unless:

(1) the assets represent an *established surplus*; and

(2) no more than three months have passed since the determination of that surplus.

## 5 EXCLUSIVE USE OF LONG-TERM INSURANCE ASSETS

5.1 (1) A *firm* must apply a *long-term insurance asset* only for the purposes of its *long-term insurance business*.

(2) For the purposes of (1), applying an asset includes coming under any obligation (even if only contingently) to apply that asset.

5.2 A *firm* must not agree to, or allow, any mortgage or charge on its *long-term insurance assets* other than in respect of a *long-term insurance liability*.

**Annex H**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - EXPOSURE LIMITS

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *non-directive insurer*, other than a *non-directive friendly society*; and

(2) subject to 1.2, a *Swiss general insurer*.

1.2 This Part only applies to a *Swiss general insurer* in respect of the activities of the *firm* carried on from a *branch* in the *UK*.

1.3 This Part applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.

1.4 Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this Part applies separately to each type of business.

1.5 In this Part, the following definitions shall apply:

*asset exposure*

has the meaning in 3.

*business amount*

means the sum of:

(1) the *firm's* total gross *technical provisions* (that is, calculated gross of *reinsurance)*;

(2) the amount of its other liabilities (except those included in the calculation of capital resources in accordance with the *capital resources table*); and

(3) such amount as the *firm* may select not exceeding the amount of the *firm's* total capital after deductions as calculated at stage M of the *capital resources table* or if higher:

(i) in the case of a *firm* carrying on *general insurance business*, the amount of its *general insurance capital requirement*; and

(ii) in the case of a *firm* carrying on *long-term insurance business*, the amount of its *long-term insurance capital requirement* .

and for the purposes of (1), a *firm's* total gross *technical provisions* exclude *technical provisions* in respect of *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, the total gross *technical provisions* include the *technical provisions* in respect of that guaranteed element.

*closely related*

has the meaning in 10.1.

*control*

means the relationship between a *parent undertaking* and a *subsidiary* where that relationship falls within s1162(2), (4) and (5) of the Companies Act 2006, or a similar relationship between any *person* and an *undertaking.*

*counterparty exposure*

has the meaning in 4.

*hybrid security*

means a *debt security*, other than an *approved security*, the terms of which provide, or have the effect that, the holder does not, or would not, have an unconditional entitlement to payment of interest and repayment of capital in full within 75 years of the date on which the *security* is being valued.

*reinsurance*

includes retrocession and *analogous non-reinsurance financing agreements*.

*reinsurer*

includes an issuer of an *analogous non-reinsurance financing agreement.*

*reinsurance exposure*

has the meaning in 5.

*total default*

occurs where:

(a) the single *counterparty* or all of the *counterparties* within the group of closely related *counterparties* fail to meet its or their obligations and simultaneously any securities issued or guaranteed by it or any of them become worthless; or

(b) the asset becomes worthless or all of the assets within the identical class become worthless at the same time.

*unsecured debt*

means any debt in respect of which the conditions in 9.3 or 9.4 are not satisfied or, if satisfied only in relation to part of the debt, that part of the debt which is not covered by *collateral* or a guarantee, letter of credit or credit *derivative* in accordance with those rules.

## 2 OVERALL LIMITATION OF CREDIT RISK

2.1 Taking into account all relevant risks, a *firm* must restrict its *counterparty exposures* and *asset exposures* to prudent levels and ensure that those exposures are adequately diversified.

2.2 If a *firm* elects under 9.3 to make a deduction in respect of *collateral*, the *firm* must deduct from the loss so much of the value of that *collateral* as:

(1) would be realised by the *firm* were it to exercise its rights in relation to the *collateral*; and

(2) does not exceed any of the relevant limits in 7.4.

2.3 For the purposes of 2.1 and of determining *counterparty exposure, asset exposure* and *reinsurance exposure*, a *firm* must:

(1) only rely upon a loss mitigation technique where it has good reason to believe that, taking into account the possible circumstances of default, it is likely to be effective; and

(2) not rely upon preferential access to assets unless it has taken into account appropriate professional advice as to its effectiveness.

## 3 ASSET EXPOSURE

3.1 (1) For the purposes of this Part, *asset exposure* is the amount a *firm* would lose if an asset or class of identical assets (whether or not held directly by the *firm*) were to become worthless.

(2) For the purposes of (1), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *counterparty* failing to meet its obligations and the *securities* or assets becoming worthless.

(3) In determining the amount of loss in accordance with (2), the *firm* must take into account decreases in its capital resources that would result not only from its own direct exposures but also from:

(a) exposures held by any of its *subsidiaries*; and

(b) synthetic exposures arising from *derivatives* or *quasi-derivatives* held or entered into by the *firm* or any of its *subsidiaries*.

## 4 COUNTERPARTY EXPOSURE

4.1 (1) For the purposes of this Part, *counterparty exposure* is the amount a *firm* would lose if a *counterparty* were to fail to meet its obligations (either to the *firm* or to any other *person*) and if simultaneously *securities* issued or guaranteed by the *counterparty* were to become worthless.

(2) For the purposes of (1), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *counterparty* failing to meet its obligations and the *securities* or assets becoming worthless.

(3) In determining the amount of loss in accordance with (2), the *firm* must take into account decreases in its capital resources that would result not only from its own direct exposures but also from:

(a) exposures held by any of its *subsidiaries*; and

(b) synthetic exposures arising from *derivatives* or *quasi-derivatives* held or entered into by the *firm* or any of its *subsidiaries*.

## 5 REINSURANCE EXPOSURE

5.1 (1) For the purposes of this Part, a *reinsurance exposure* is the amount of loss which a *firm* would suffer if a *reinsurer* or group of *closely related reinsurers* were to fail to meet its or their obligations under contracts of *reinsurance* reinsuring any of the *firm's contracts of insurance*.

(2) For the purposes of (1), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *reinsurer* or group of *closely related reinsurers* failing to meet its or their obligations under the contracts of *reinsurance*.

## 6 LARGE EXPOSURE LIMITS

6.1 This Chapter does not apply to:

(1) a *reinsurance exposure*; or

(2) a *counterparty exposure* or *asset exposure* to an *CRD credit institution*.

6.2 A *firm* must take reasonable steps to limit its *counterparty exposure* or *asset exposure* to:

(1) a single *counterparty*;

(2) each of the *counterparties* within a group of *closely related counterparties*; and

(3) an asset or class of identical assets;

to a level where, if a *total default* were to occur, the *firm* would not become unable to meet its liabilities as they fall due.

## 7 MARKET RISK AND COUNTERPARTY LIMITS

7.1 This Chapter does not apply to a *pure reinsurer*.

7.2 A *firm* must calculate the amount of the deduction from total capital required by stage L in the *capital resources table* in respect of assets in excess of *market risk* and *counterparty* limits as the aggregate amount by which its *counterparty exposures* and *asset exposures* exceed the relevant limits set out in 7.4.

7.3 Except where the contrary is expressly stated, whenever:

(1) a rule refers to assets of a *firm*, or of any part of a *firm*, or of any fund or part of a fund within a *firm*, which are assets of a kind referred to in any of the limits in 7.4; and

(2) the *firm's counterparty exposure* (or aggregate exposure arising from the *counterparty exposures* to each member of a group of *closely related persons*) or *asset exposure* in respect of those assets exceeds any of the limits in 7.4

the *firm* must deduct from the measure of the value of those assets (as determined in accordance with Insurance Company – Overall Resources and Valuation 3 to 8) the amount by which that exposure exceeds the relevant limit in 7.4, or that portion of the deduction that relates to the part of the *firm* or fund or part of a fund in question.

7.4 The limits referred to in 7.2 and 7.3 are the following, expressed as a percentage of the *firm's business amount*:

(1) for a *counterparty exposure* to an individual, unincorporated body of individuals or the aggregate exposure arising from the *counterparty exposures* to each member of a group of *closely related* individuals or unincorporated bodies of individuals:

(a) 0.25% for that part of the exposure that arises from *unsecured debt*; and

(b) 1% for the whole exposure (after deduction of the excess arising from the limit in (a));

(2) for a *counterparty exposure* to an *approved counterparty* or the aggregate exposure arising from the *counterparty exposures* to each member of a group of *closely related approved counterparties*:

(a) 40% for that part of the exposure arising from *covered bonds*;

(b) (i) subject to (ii), 5% for that part of the exposure not arising from *covered bonds* or, if the *counterparty* is an *CRD credit institution*, from *short term deposits*; and

(ii) the limit in (i) is increased to 10% if the total of such exposures which are greater than 5% arising from applying a 10% limit, when taken together with any exposures arising from *covered bonds* which are within the 40% limit in (a), does not exceed 40%;

(c) 20% or £2 million, if larger, for the whole exposure (but excluding any exposure arising from *covered bonds* and after deduction of the excess arising from the limit in (b));

(3) for a *counterparty exposure* to a *person*, or the aggregate exposure arising from the *counterparty exposures* to each member of a group of *closely related persons*, who do not fall into the categories of *counterparty* to whom (1) and (2) apply:

(a) (i) subject to (ii), 1% for that part of the exposure arising from *unsecured debt*;

(ii) the limit in (i) is increased to 2.5% in the case of an exposure to a *regulated institution*;

(b) (i) subject to (ii), 1% for that part of the exposure arising from *shares* and other variable yield participations, bonds, *debt securities* and other *money-market instruments* and capital market instruments from the same *counterparty* that are not dealt in on a *regulated market*, or a beneficial interest in a *collective investment scheme* to which 9.5 applies;

(ii) the limit in (i) for that part of the exposure arising from *debt securities* (other than *hybrid securities*) issued by the same *regulated institution* is increased to 5%; and

(c) 5% for the whole exposure (after deduction of the excesses arising from the limits in (a) and (b));

(4) 5% for the aggregate of all *counterparty exposures* that fall within (3)(a) whether or not they arise from *persons* who are *closely related,* but excluding amounts that are in excess of the limit in (3)(a);

(5) 10% for the aggregate of all *counterparty exposures* and *asset exposures* that fall within (3)(b) above or (10) below, whether or not they arise from *persons* who are *closely related*, but excluding amounts that are in excess of the limit in (3)(b) above or, in the case of an *asset exposure*, (10) below;

(6) 5% for the aggregate of all *counterparty exposures* arising from unsecured loans, other than those falling within (2);

(7) 3% for the *asset exposure* arising from all cash in hand;

(8) 10% for the *asset exposure* (including an exposure arising from a reversionary interest) arising from any one piece of land or building, or a number of pieces of land or buildings close enough to each other to be considered effectively as one investment;

(9) 5% for the *asset exposure* arising from a beneficial interest in any single *non-UCITS retail scheme* or *recognised scheme* which does not fall within the *UCITS Directive*; and

(10) 1% for the *asset exposure* arising from a beneficial interest in any single *collective investment scheme* which does not fall within the *UCITS Directive* and is not a *non-UCITS retail scheme* or a *recognised scheme*.

## 8 LARGE EXPOSURE CALCULATION FOR REINSURANCE EXPOSURES

8.1 A *firm* must notify the *PRA* immediately*,* in accordance with Notifications 7, as soon as it first becomes aware:

(1) that a *reinsurance exposure* to a *reinsurer* or group of *closely related reinsurers* is reasonably likely to exceed the limit of 100% of its *capital resources*; or

(2) if (1) does not apply, that it has exceeded the limit referred to in (1).

8.2 Upon notification under 8.1, a *firm* must:

(1) demonstrate that prudent provision has been made for the *reinsurance exposure* in excess of the 100% limit, or explain why in the opinion of the *firm* no provision is required; and

(2) explain how the *reinsurance exposure* is being safely managed.

8.3 If a *firm* elects under 9.3 to make a deduction in respect of *collateral*, the *firm* must deduct from the amount of loss determined in accordance with 5.1(2) so much of the value of that *collateral* as:

(1) would be realised by the *firm* were it to exercise its rights in relation to the *collateral*; and

(2) does not exceed any of the relevant limits in 7.4(3).

8.4 A *firm* must, in determining its *reinsurance exposures* for the purposes of this Part, aggregate any *reinsurance exposure* where the identity of the *reinsurer* is not known by the *firm* with the highest *reinsurance exposure* where it does know the identity of the *reinsurer*.

8.5 A *firm* must notify the *PRA* immediately in accordance with Notifications 7 if the *gross earned premiums* which it pays to a *reinsurer* or group of *closely related reinsurers* has exceeded, or is anticipated to exceed, the higher of:

(1) 20% of the *firm's* projected *gross earned premiums* for that *financial year*; or

(2) £4 million.

8.6 Upon notification under 8.5, a *firm* must explain to the *PRA* how, despite exceeding the limits in 8.5, the credit risk is being safely managed.

## 9 EXPOSURES EXCLUDED FROM LIMITS

9.1 In 6 and 7, references to a *counterparty exposure* or an *asset exposure* do not include such an exposure arising from:

(1) *premium* debts;

(2) advances secured on, and not exceeding the *surrender value* of, the *firm*'s *contracts of long-term insurance*;

(3) rights of salvage or subrogation;

(4) *deferred acquisition costs*;

(5) assets held to cover *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, 6 and 7 will nevertheless apply to assets held to cover that guaranteed element;

(6) *monies* due from, or guaranteed by, the government of an *approved State*;

(7) an *approved security*; and

(8) a holding in a *collective investment scheme* falling within the *UCITS Directive*.

9.2 In 7, references to a *counterparty exposure* or an *asset exposure* do not include such an exposure resulting from debts arising from *reinsurance* ceded and the *reinsurer's* share of *technical provisions*.

9.3 If:

(1) a *firm* has a *counterparty exposure*, an *asset exposure* or a *reinsurance exposure* in respect of which it has rights over *collateral* (except where that *collateral* is a letter of credit); and

(2) the assets constituting that *collateral* would, if owned by the *firm*, be *admissible assets*;

the *firm* may, in determining the amount of that exposure, deduct the value of that *collateral* in accordance with 2.2 or, in the case of a *reinsurance exposure*, 8.3.

9.4 (1) If a *firm* has a *counterparty exposure*, *asset exposure* or *reinsurance exposure* the whole or any part of which is:

(a) guaranteed by a *credit institution* or an *investment firm* subject in either case to the *CRD* or supervision by a *third country* supervisory authority with a *CRD*-equivalent regime; or

(b) adequately mitigated by a credit *derivative*;

the *firm* may, for the purposes of 6, 7 and 8.1, treat that exposure, or that part of the exposure which is so guaranteed or mitigated, as an exposure to the guarantor or derivative *counterparty*, rather than to the original *counterparty*, asset or *reinsurer*.

(2) For the purposes of (1), references to an exposure being guaranteed include an exposure secured by a letter of credit, but to fall within (1) the guarantee or letter of credit must be direct, explicit, unconditional and irrevocable.

9.5 For the purposes of 6 and 7, *units* in a *collective investment scheme* that does not fall within the *UCITS Directive* must be treated as a *counterparty exposure* to the *issuer* of the *units* in that scheme if the issuer and those *units* are to be regarded as constituting a single risk because they are so interconnected that, if the *issuer* were to experience financial problems, this would be likely to affect the value of the *units*.

## 10 CLOSELY RELATED

10.1 In this Part, a group of *persons* is *closely related* if it consists solely of two or more *persons* who, unless it is shown otherwise, constitute a single risk because as between any two of them one or other of the following relationships apply:

(1) one of them, directly or indirectly, has *control* over the other or they are both controlled by the same third party; or

(2) there is no relationship of *control* but they are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other would be likely to encounter repayment difficulties.

**Annex I**

In this Annex, the text is all new and is not underlined.

**Part**

# INSURANCE COMPANY - RISK MANAGEMENT

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to;

(1) a *non-directive insurer*, other than a *non-directive friendly society*; and

(2) subject to 1.2, a *Swiss general insurer*.

1.2 This Part only applies to a *Swiss general insurer* in respect of the activities of the *firm* carried on from a *branch* in the *UK*.

1.3 This Part applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.

1.4 Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this Part applies separately to each type of business.

1.5 In this Part, the following definitions shall apply:

*investment risk*

means the risk that the assets held by a *firm*:

(1) (where they are *admissible assets* held by the *firm* to cover its *technical provisions*) might not be:

(a) of a value at least equal to the amount of those *technical provisions* as required by Insurance Company – Technical Provisions 4.1; or

(b) of appropriate safety, yield and marketability as required by Insurance Company – Technical Provisions 6.2(1); or

(c) of an appropriate currency match as required by 3.2;

(2) (where they are held to cover *index-linked liabilities*) might not be appropriate cover for those liabilities as required by 4.2; and

(3) (where they are held to cover *property-linked liabilities*) might not be appropriately selected in accordance with the requirements of INSPRU 1.5.36 R of the *FCA Handbook* and appropriate cover for those liabilities as required by 4.2.

*linked assets*

means assets held to cover *linked long-term liabilities* 4.2.

## 2 CURRENCY RISK: COVER FOR SPOT AND FORWARD CURRENCY TRANSACTIONS

2.1 A *firm* must cover a contract providing for the purchase or sale of foreign currency by:

(1) holding the currency that must be paid by the *firm* under the contract; or

(2) being subject to an *offsetting transaction*.

## 3 CURRENCY MATCHING OF ASSETS AND LIABILITIES

3.1 This Chapter does not apply:

(1) to a *pure reinsurer*; or

(2) in respect of *linked assets*.

3.2 (1) A *firm* must hold *admissible assets* in each currency of an amount equal to at least 80% of the amount of its liabilities in that currency arising under or in connection with *contracts of insurance*, except where the amount of those assets does not exceed 7% of the assets in other currencies.

(2) For the purposes of (1), references to an asset in a currency are to an asset which is expressed in or capable of being realised (without exchange risk) in that currency, and an asset is capable of being so realised if it is reasonably capable of being realised in that currency without risk that changes in exchange rates would reduce the cover for liabilities in that currency.

3.3 For the purposes of 3.2, the currency of the liability under a *contract of insurance* is the currency in which the cover under the *contract of insurance* is expressed or, if the contract does not specify a currency:

(1) the currency of the country or territory in which the risk is situated;

(2) if the *firm* on reasonable grounds so decides, the currency in which the *premium* payable under the contract is expressed;

(3) if, taking into account the nature of the risks insured, the *firm* considers it more appropriate:

(a) the currency (based on past experience) in which it expects the claims to be paid; or

(b) if there is no past experience, the currency of the country or territory in which the *firm* or relevant branch is established:

(i) for contracts covering risks falling within *general insurance business classes* 4, 5, 6, 7, 11, 12 and 13 (producer's liability only); and

(ii) for contracts covering risks falling within any other *general insurance business class* where, in accordance with the nature of the risks, the *firm's* liabilities are liabilities to be provided in a currency other than that which would result from the application of (1) or (2);

(4) (where a claim has been notified to the *firm* and the *firm's* liability in respect of that claim is payable in a currency other than that which would result from the application of (1), (2) or (3)) the currency in which the claim is to be paid; or

(5) (where a claim is assessed in a currency known to the *firm* in advance and is a currency other than that which would result from the application of (1), (2), (3) or (4)) the currency in which the claim is to be assessed.

## 4 COVERING LINKED LONG-TERM LIABILITIES

4.1 This Chapter does not apply to a *pure reinsurer*.

4.2 A *firm* must cover its *technical provisions* in respect of its *linked long-term liabilities* as closely as possible with:

(1) where the *linked benefits* are linked to the value of *units*, those *units*;

(2) where the *linked benefits* are linked to the value of assets contained in an internal fund of the *firm*:

(a) in a case where the internal fund is divided into notional units, the assets represented by those notional units; or

(b) in a case where notional units are not established, those assets; and

(3) where the *linked benefits* are linked to a *share* index or other reference value not mentioned in (1) or (2), assets of appropriate security and marketability which correspond as closely as possible to the assets on which the reference value is based.

## 5 PURE REINSURERS

5.1 A *pure reinsurer* must invest its assets in accordance with the following requirements:

(1) the assets must take account of the type of business carried out by the *firm*, in particular the nature, amount and duration of expected claims payments, in such a way as to secure the sufficiency, liquidity, security, quality, profitability and matching of its investments;

(2) the *firm* must ensure that the assets are diversified and adequately spread and allow the *firm* to respond adequately to changing economic circumstances, in particular developments in the financial markets and real estate markets or major catastrophic events; the *firm* must assess the impact of irregular market circumstances on its assets and must diversify the assets in such a way as to reduce such impact;

(3) investment in assets which are not admitted to trading on a *regulated market* must be kept to prudent levels;

(4) investment in *derivatives* and *quasi-derivatives* must contribute to a reduction of *investment risks* or facilitate efficient portfolio management and such investments must be valued on a prudent basis, taking into account the underlying assets, and included in the valuation of the *firm's* assets;

(5) the *firm* must avoid excessive risk exposure to a single *counterparty* and to other *derivative* or *quasi-derivative* operations;

(6) the assets must be properly diversified in such a way as to avoid:

(a) excessive reliance on any one particular asset, *issuer* or *group* of *undertakings*; and

(b) accumulations of risk in the portfolio as a whole;

(7) investments in assets issued by the same *issuer* or by *issuers* belonging to the same *group* must not expose the *firm* to excessive risk concentration; and

(8) (6) and (7) do not apply to investment in government bonds.

## 6 DERIVATIVES AND QUASI-DERIVATIVES

6.1 This Chapter does not apply to a *pure reinsurer.*

6.2 For the purposes of Insurance Company – Capital Resources 13, a *derivative* or *quasi-derivative* is approved if:

(1) it is held for the purpose of efficient portfolio management or reduction of *investment risk*;

(2) it is covered; and

(3) it is effected or issued:

(a) on or under the rules of a *regulated market*; or

(b) off-market with an *approved counterparty* and, except for a forward transaction, on approved terms and is capable of valuation.

6.3 (1) For the purposes of 6.2, a *derivative* or *quasi-derivative* is held for the purpose of reducing *investment risk* if the *derivative* or *quasi-derivative* (either alone or together with other fully covered transactions) reduces any aspect of *investment risk* without significantly increasing any other aspect of that risk.

(2) For the purposes (1), an increase in risk from a *derivative* or *quasi-derivative* is significant unless:

(a) relative to any reduction in *investment risk* it is both small and reasonable; or

(b) the risk is remote.

6.4 For the purposes of 6.2(3)(b), a *derivative* or *quasi-derivative* is on approved terms only if the *firm* reasonably believes that it could, in all reasonably foreseeable circumstances and under normal market conditions, readily enter into a further transaction with the *counterparty* or a third party to close out the *derivative* or *quasi-derivative* at a price not less than the value attributed to it by the *firm*, taking into account any valuation adjustments or reserves established by the *firm* under Insurance Company – Overall Resources and Valuation 7.

6.5 For the purposes of 6.2(3)(b), a *derivative* or *quasi-derivative* is capable of valuation only if the *firm*:

(1) is able to value it with reasonable accuracy on a reliable basis in compliance with Insurance Company - Overall Resources and Valuation 3.1; and

(2) reasonably believes that it will be able to do so throughout the life of the transaction.

6.6 For the purposes of 6.2(1), a *derivative* or *quasi-derivative* is held for the purpose of efficient portfolio management if the *firm* reasonably believes the *derivative* or *quasi-derivative* (either alone or together with any other covered transactions) enables the *firm* to achieve its investment objectives by one of the following:

(1) generating additional capital or income in one of the ways described in 6.7; or

(2) reducing tax or investment cost in relation to *admissible assets* or *linked assets*; or

(3) acquiring or disposing of rights in relation to *admissible assets* or *linked assets*, or their equivalent, more efficiently or effectively.

6.7 The generation of additional capital or income falls within 6.6(1) where it arises from:

(1) taking advantage of pricing imperfections in relation to the acquisition and disposal (or disposal and acquisition) of rights in relation to assets the same as, or equivalent to, *admissible assets* or *linked assets*; or

(2) receiving a premium for selling a covered call *option* or its equivalent, the underlying of which is an *admissible asset* or *linked assets*, even if that additional capital or income is obtained at the expense of surrendering the chance of greater capital or income.

## 7 COVER

7.1 This Chapter does not apply to a *pure reinsurer*.

7.2 (1) A *firm* must cover an obligation to transfer assets or pay monetary amounts that arise from:

(a) a *derivative* or *quasi-derivative*; or

(b) a contract (other than a *contract of insurance*) for the purchase, sale or exchange of assets.

(2) Cover used for one transaction must not be used for cover in respect of another transaction or any other agreement to acquire, or dispose of, assets or to pay or repay *money*.

7.3 For the purposes of 7.2, an obligation to transfer assets or pay monetary amounts must be covered:

(1) by assets, a liability or a provision; or

(2) by an *offsetting transaction*.

7.4 For the purposes of 7.2, an obligation to transfer assets (other than *money*) or to pay monetary amounts based on the value of, or income from, assets is covered if the *firm* holds:

(1) those assets; or

(2) in the case of an index or basket of assets, a reasonable approximation to those assets.

7.5 For the purposes of 7.2, an obligation to pay a monetary amount (whether or not falling in 7.4) is covered if:

(1) the *firm* holds *admissible assets* or *linked assets*, that are sufficient in value so that the *firm* reasonably believes that following reasonably foreseeable adverse variations (relying solely on cashflows from, or from realising, those assets) it could pay the monetary amount in the right currency when it falls due; or

(2) the obligation to pay the monetary amount is offset by a liability. An obligation is offset by a liability where an increase in the amount of that obligation would be offset by a decrease in the amount of that liability; or

(3) a provision at least equal to the value of the assets in (1) is, in accordance with 7.6, implicitly or explicitly set up.

7.6 For the purposes of 7.5(3), a provision is:

(1) implicitly set up to the extent that the obligation to pay the monetary amount is recognised under Insurance Company – Overall Resources and Valuation 3 to 7 either by offset against an asset or as a separate liability; and

(2) explicitly set up if it is in addition to an implicit provision.

7.7 A *firm* must implicitly or explicitly set up a provision equal to the value of the assets or *offsetting transactions* held to cover a non-approved *derivative* or *quasi-derivative* transaction.

7.8 For the purposes of 7.3(2), an *offsetting transaction* offsets an obligation to transfer assets away from the *firm* only if it provides for the transfer to the *firm* of those assets, or their value, at the time, or before, the obligation falls due.

7.9 For the purposes of 7.3(2), an *offsetting transaction* offsets an obligation to pay a monetary amount only if it provides for that monetary amount to be paid to the *firm* at or before the earliest date on which the obligation might fall due.

7.10 For the purposes of this Chapter, assets that have been lent by the *firm* are not available for cover, unless:

(1) they are non-monetary assets that have been lent under a transaction that fulfils the conditions in 8.2; and

(2) the *firm* reasonably believes the assets to be obtainable (by return or re-acquisition) in time to meet the obligation for which cover is required.

7.11 For the purposes of this Chapter, assets that have been borrowed by the *firm* are not available for cover except as allowed by 7.12.

7.12 For the purposes of this Chapter, borrowed *money* may be used as cover only where:

(1) the *money* has been advanced or an *approved credit institution* has committed itself to advance the *money*; and

(2) the borrowing is or would be covered.

## 8 STOCK LENDING

8.1 This Chapter does not apply to a *pure reinsurer*.

8.2 (1) For the purposes of Insurance Company – Capital Resources 13, a *stock lending* transaction (including a *repo* transaction) is approved if:

(a) the *firm* is the lender;

(b) the assets lent by the *firm* are *admissible assets*;

(c) the *counterparty* is an *authorised person*, an *approved counterparty*, a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America or a bank, or a branch of a bank, supervised, and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities of the United States of America:

(i) the Office of the Comptroller of the Currency;

(ii) the Federal Deposit Insurance Corporation; and

(iii) the Board of Governors of the Federal Reserve System; and

(d) adequate and sufficiently immediate *collateral* is obtained to secure the obligation of the *counterparty*.

(2) 8.2(1)(d) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

8.3 For the purposes of 8.2(1)(d), *collateral* is adequate only if it:

(1) is transferred to the *firm* or its agent or, in the case of a letter of credit, meets the conditions described in 8.4;

(2) is:

(a) at the time of the transfer and on a continuing basis; or

(b) (in the case of a letter of credit) at the time of issue and on a continuing basis;

at least equal in value to the value of the *securities* transferred, or consideration provided, by the *firm*; and

(3) is of adequate quality.

8.4 The conditions referred to in 8.3(1) are that the letter of credit is:

(1) direct, explicit, unconditional and irrevocable; and

(2) issued by an *undertaking* which is:

(a) not an *affiliated company* of the *counterparty*; and

(b) either an *approved credit institution* or a bank, or a branch of a bank, whether chartered by the federal government of the United States of America or a US state, that is supervised and examined by at least one of the following US federal banking supervisory authorities:

(i) the Office of the Comptroller of the Currency;

(ii) the Federal Deposit Insurance Corporation; and

(iii) the Board of Governors of the Federal Reserve System.

8.5 For the purposes of 8.3(2), where the validity of the *collateral* or the *firm's* interest in the *collateral* is about to expire or has expired, *collateral* will only be adequate on a continuing basis if sufficient *collateral* will again be transferred or issued at the latest by the close of business on the day of expiry.

8.6 For the purposes of 8.2(1)(c), *collateral* is sufficiently immediate only if:

(1) it is transferred or, in the case of a letter of credit, issued before, or at the same time as, the transfer of the *securities* by the *firm*; or

(2) it will be transferred or, in the case of a letter of credit, issued, at latest, by the close of business on the day of the transfer.

**Annex J**

In this Annex, the text is all new and is not underlined.

**Part**

# FRIENDLY SOCIETY - OVERALL RESOURCES AND GUARANTEE FUND

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive friendly society*.

1.2 In this Part, the following definitions shall apply:

*ancillary risk*

means, in relation to a principal risk belonging to a *class* of *general insurance business*, a risk included in another such *class* which is:

(1) connected with the principal risk;

(2) concerned with the object which is covered against the principal risk; and

(3) the subject of the same *contract of insurance* as the principal risk.

*annual contribution income*

means, in relation to a *firm's long-term insurance business*, the income of the *firm* in a *financial year* without any deduction for *reinsurance* cessions.

*implicit items*

means economic reserves arising in respect of assets which relate to future surpluses, *zillmerising* or hidden reserves.

*initial fund*

means the items of capital that were available to a *mutual* on the date it received a *Part 4A permission* to *effect contracts of insurance* or *carry out contracts of insurance*.

1.3 For the purposes of this Part:

(1) a *contract of insurance* is to be treated as falling within a *class* of *long-term insurance business* notwithstanding the fact that it contains supplementary provisions falling within *general insurance business class* 1 (accident) or *class* 2 (sickness) if:

(a) its principal object is that of a contract falling within a *class* of *long-term insurance business*;

(b) it is effected or carried out by a *firm* which has *Part 4A permission* to *effect contracts of insurance* or *carry out contracts of insurance* falling within *long-term insurance business class* I (life and annuity); and

(2) a *contract of insurance* whose principal risk falls within any of *general insurance business classes* 1, 2 or 16 is to be treated as falling within that *class* and no other, notwithstanding the fact that it also covers *ancillary risks*.

## 2 BASIC MARGIN OF SOLVENCY REQUIREMENT

2.1 Subject to 2.3, a *firm* (other than a *flat rate benefits business friendly society*) must maintain a *margin of solvency* equal to or greater than the *required margin of solvency*.

2.2 Where a *firm* carries on both *long-term insurance business* and *general insurance business*, 2.1 has effect as if the requirement to maintain a *margin of solvency* were a requirement to maintain separate margins in respect of the two kinds of business.

2.3 2.1 does not apply to a *firm* which does not have *Part 4A permission* to *effect contracts of insurance* and is only *carrying out contracts of insurance* which were effected before 13 September 1993 (or effected pursuant to the terms of such a contract), provided that the *firm* maintains an excess of the value of its assets over the amount of its liabilities.

## 3 CALCULATING THE REQUIRED MARGIN OF SOLVENCY

3.1 Subject to 3.2 to 3.6, the *required margin of solvency* must be determined:

(1) with respect to *long-term insurance business* carried on by a *firm*, in accordance with Friendly Society - Required Margin 2 to 6; and

(2) with respect *general insurance business* carried on by a *firm*, by taking the greater of:

(a) the higher of the two sums resulting from the calculation of a premiums basis solvency margin set out in Friendly Society - Required Margin 7; and

(b) the sum resulting from the calculation of a claims basis solvency margin set out in Friendly Society - Required Margin 8.

3.2 For a *contract of insurance* to which 1.3 applies, the *required margin of solvency* must be determined by taking the aggregate of the results arrived at by applying:

(1) in the case of that portion of the contract as is within any *class* of *long-term insurance business*, the method of calculation set out in 3.1(1) for that *class*; and

(2) in the case of that portion of the contract as is within *general insurance business class* 1 or 2, the method of calculation set out in 3.1(2).

3.3 Where a *firm* carries on *long-term insurance business* and owing to the nature of that business more than one *required margin of solvency* applies in respect of that business by the operation of these rules, those *required margins of solvency* must be aggregated.

3.4 Where a *firm* carries on both *long-term insurance business* and *general insurance business* and is accordingly required to maintain separate *margins of solvency* in respect of the two kinds of business:

(1) the provisions in 3.1 to 3.3 apply for determining the *required margin of solvency* for each kind of business separately; and

(2) assets other than those representing the funds maintained by the *firm* in respect of its *long-term insurance business* must only be taken into account in covering the liabilities and the *required margin of solvency* for the *firm's long-term insurance business* if they are not included among the assets covering the liabilities and the *required margin of solvency* relating to the *firm's general insurance business*.

3.5 Subject to 3.6, in each case in which 3.1(2) applies, if the *required margin of solvency* under 3.1(2) is lower than the *required margin of solvency* of the preceding *financial year*, then the *required margin of solvency* must be adjusted so it is at least equal to the *required margin of solvency* of the preceding *financial year* multiplied, if the ratio is less than one, by the ratio (expressed as a percentage) of:

(1) the amount of the *insurance liabilities* for claims outstanding at the end of the preceding *financial year*; to

(2) the amount of the *insurance liabilities* for claims outstanding at the beginning of the preceding *financial year*.

3.6 For the purpose of 3.5:

(1) *insurance liabilities* must not be discounted, or reduced, to take account of investment income, unless:

(a) they relate to risks in *general insurance business classes* 1 or 2; or

(b) they are reduced to reflect the discounting of annuities; and

(2) *insurance liabilities* must be calculated net of *reinsurance*.

3.7 A *firm* must notify the *PRA* immediately in accordance with Notifications 7 where the nature or quality of *reinsurance* relied on to reduce the *required margin of solvency* materially changes during the *financial year*.

## 4 GUARANTEE FUND

4.1 This Chapter only applies to an *incorporated friendly society.*

4.2 A *firm* must ensure that its *margin of solvency* does not fall below the *guarantee fund.*

## 5 CALCULATING THE GUARANTEE FUND

5.1 The *guarantee fund* is an amount equal to the greater of:

(1) one-third of the *required margin of solvency*; and

(2) the *minimum guarantee fund*.

5.2 In the case of *long-term insurance business*, a *firm* must maintain a *margin of solvency* (excluding *implicit items*), that are sufficient to cover the greater of:

(1) the *minimum guarantee fund*; and

(2) 50% of the *guarantee fund*.

5.3 In the case of *general insurance business*, the unpaid *initial fund* of a *firm* and, in the case of a *firm* with variable contributions, any claim which the *firm* has against its members by way of a call for supplementary contributions for a *financial year* may not be taken into account in complying with 4.2.

5.4 In the case of *long-term insurance business*, the unpaid *initial fund* of a *firm* and *implicit items* which relate to future profits and *zillmerising* may not be taken into account in complying with 4.2.

## 6 MINIMUM GUARANTEE FUND: LONG-TERM INSURANCE BUSINESS

6.1 Subject to 6.2, the *minimum guarantee fund* for *long-term insurance business* is the amount in column 2 of the following table, which corresponds to the *firm's* highest *annual contribution income* in respect of that business in any preceding *financial year*, as shown in column 1 of the table:

| **Contribution income (in UK sterling)** | ***Minimum guarantee fund* (in UK sterling)** |
|---|---|
| 800,000 | 90,000 |
| 800,001 - 1,200,000 | 185,000 |
| 1,200,001 – 1,600,000 | 280,000 |
| 1,600,001 – 2,000,000 | 370,000 |
| 2,000,001 – 2,400,000 | 470,000 |
| 2,400,001 or more | 560,000 |

6.2 If a *firm* has not been in existence long enough to have a preceding *financial year*, the *minimum guarantee fund* for *long-term insurance business* is £90,000.

## 7 MINIMUM GUARANTEE FUND: GENERAL INSURANCE BUSINESS

7.1 The *minimum guarantee fund* for *general insurance business* is £210,000.

## 8 VALUATION OF SOLVENCY MARGINS

8.1 A *firm* must take account of 8.2 to 8.6 in determining the extent to which a *firm's margin of solvency* covers the *required margin of solvency*, the *guarantee fund* and the *minimum guarantee fund*.

8.2 A *firm* with variable contributions, carrying on *general insurance business*, must treat any claim which the *firm* has against its members by way of a call for supplementary contributions for a *financial year* as having no value.

8.3 A *firm* must treat *implicit items* as having no value.

8.4 A *firm* must treat an unpaid *initial fund* as having no value.

8.5 Subject to 8.6, if a *firm* discounts or reduces its *insurance liabilities* for claims outstanding to take account of investment income, the *margin of solvency* must be reduced by the difference between:

(1) the undiscounted *insurance liabilities* for claims outstanding or the *insurance liabilities* for claims outstanding before deductions; and

(2) the discounted *insurance liabilities* for claims outstanding or the *insurance liabilities* for claims outstanding after deductions.

For these purposes, *insurance liabilities* must be calculated net of *reinsurance*.

8.6 8.5 does not apply:

(1) to risks in *general insurance business classes* 1 or 2; or

(2) in respect of the discounting of annuities.

**Annex K**

In this Annex, the text is all new and is not underlined.

**Part**

# FRIENDLY SOCIETY – REQUIRED MARGIN

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive friendly society*.

1.2 In this Part, the following definitions shall apply:

*amount of claims paid*

means, in relation to a *financial year*, the amount that is recorded in the *firm's* books at the end of the *financial year* as paid by it (whether or not payment has been effected in that year) in full or partial settlement of:

(1) claims including claims relating to business accounted for over a longer period than a *financial year*; and

(2) expenses (including legal or medical costs) which are incurred by the *firm*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual claims, whether or not the individual claims in question are those mentioned in (1),

less any amounts *recoverable* by the *firm* in respect of the claims mentioned in (1) or other claims, including amounts *recoverable* from third parties and amounts *recoverable* from other *insurance undertakings* but excluding amounts *recoverable* in respect of *reinsurance* ceded by the *firm*.

*capital at risk*

means:

(1) in any case in which an amount is payable in consequence of death other than a case falling within (2), the amount payable on death; or

(2) in any case in which the benefit under the contract in question consists of the making, in consequence of death, of the payment of an annuity, payment of a sum by instalments or any other kind of periodic payments, the present value of that benefit,

less in either case the *mathematical reserves* in respect of the relevant contracts.

*gross premiums*

means, in respect of a *financial year*, *premiums* after deduction of discounts, refunds and rebates of *premiums* but before deduction of *premiums* for *reinsurance* ceded and before deduction of commission payable.

*gross premiums earned*

means, in respect of a *financial year*, such proportion of *gross premiums receivable* as is attributable to risk borne by the *firm* during that *financial year*.

*provision for claims outstanding*

means, in respect of a *financial year*, the amount set aside by the *firm* as at the beginning or end of the *financial year* as being an amount likely to be sufficient to meet:

(1) claims in respect of incidents occurring:

(a) in the case of an amount set aside as at the beginning of the *financial year*, before the beginning of that year; and

(b) in the case of an amount set aside as at the end of a *financial year*, before the end of that year,

being claims which have not been treated as claims paid and including claims relating to business accounted for over a longer period than a *financial year*, claims the amounts of which have not been determined and claims arising out of incidents that have not been notified to the *firm*; and

(2) expenses (such as, for example, legal or medical costs) which are likely to be incurred by the *firm*, whether through the employment of its own staff or otherwise and are directly attributable to the settlement of individual claims, whether or not the individual claims in question are those mentioned in (1),

less any *recoverable* amounts estimated by the *firm* to be *recoverable* by it in respect of the claims mentioned in (1), including amounts *recoverable* from third parties and amounts *recoverable* from other *insurance undertakings* but excluding amounts *recoverable* in respect of *reinsurance* ceded by the *firm*.

*receivable*

means such amounts as become due to a *firm*, whether or not received (including, where appropriate, income which has accrued) in respect of *contracts of insurance* incepted in the relevant period.

*recoverable*

means, in relation to a *financial year*:

(1) for the purpose of a *provision for claims outstanding*, amounts estimated by the *firm* to be recorded in the *firm's* books as due in that year; or

(2) otherwise, recorded in the *firm's* books as due in that year, whether or not the *firm* has received any payment.

*reference period*

means the three last preceding *financial years*.

## 2 LONG-TERM INSURANCE BUSINESS MARGIN OF SOLVENCY: CLASSES I AND II

2.1 A *firm* must calculate the *required margin of solvency* in respect of *classes* I and II as the aggregate of the results arrived at by applying the calculation described in 2.2 and the calculation described in 2.3.

2.2 A *firm* must calculate the following:

(1) a sum equal to 4% of the *mathematical reserves* for direct *insurance business* and *reinsurance* acceptances without any deduction for *reinsurance* cessions;

(2) the amount of the *mathematical reserves* at the end of the last preceding *financial year* after the deduction of *reinsurance* cessions, expressed as a percentage of the amount of those *mathematical reserves* before any such deduction; and

(3) the sum mentioned in (1) must be multiplied:

(a) where the percentage arrived at under (2) is greater than 85%, by that percentage; or

(b) in any other case, by 85%.

2.3 A *firm* must calculate the following:

(1) subject to (4) and (5), a sum equal to 0.3% of the *capital at risk* for contracts on which the *capital at risk* is not a negative figure;

(2) the amount of the *capital at risk* at the end of the last preceding *financial year* for contracts on which the *capital at risk* is not a negative figure, after the deduction of *reinsurance* cessions, expressed as a percentage of the amount of that *capital at risk* before any such deduction; and

(3) the sum arrived at under (1) must be multiplied:

(a) where the percentage arrived at under (2) is greater than 50%, by that greater percentage; or

(b) in any other case, by 50%.

(4) Where a contract provides for benefits payable only on death within a specified period and:

(a) is valid for a period of not more than three years from the date when the contract was first made, the percentage to be taken for the purposes of (1) must be 0.1%; or

(b) is valid for a period of more than three years but not more than five years from the date when the contract was first made, the percentage to be taken for the purposes of (1) must be 0.15%.

(5) For the purposes of (4), the period of validity of the contract evidencing a group policy is the period from the date when the *premium* rates under the contract were last reviewed for which the *premium* rates are guaranteed.

2.4 A *firm* must calculate the amount of *mathematical reserves* referred to in 2.2(1) and the *capital at risk* referred to in 2.3(1) as at the day on which the *required margin of solvency* is determined.

2.5 For the purposes of calculating the *capital at risk, a firm* must calculate the *mathematical reserves*:

(1) in respect of 2.3(1), on the day on which the *capital at risk* is calculated; and

(2) in respect of 2.3(2), as at the last preceding *financial year*.

## 3 LONG-TERM INSURANCE BUSINESS MARGIN OF SOLVENCY: CLASSES III AND VII

3.1 A *firm* must calculate the *required margin of solvency* in respect of *classes* III and VII in accordance with 3.2 to 3.4.

3.2 If and in so far as a *firm* bears an investment risk, the calculation in 2.2 must be applied.

3.3 If and in so far as a *firm* bears no investment risk and if the allocation to cover *management expenses* in the relevant contract:

(1) has a fixed upper limit which is effective as a limit for a period exceeding five years, the calculation in 2.2 must be applied, but as if 2.2(1) contained a reference to 1% instead of 4%; or

(2) does not have a fixed upper limit which is effective as a limit for a period exceeding five years, the *required margin of solvency* is an amount equivalent to 25% of the preceding *financial year's* net administrative expenses pertaining to such business.

3.4 Where a *firm* covers a death risk, a sum arrived at by applying the calculation in 2.3 (but excluding for these purposes 2.3(4) and (5)) must be added to the *required margin of solvency*, including a *required margin of solvency* of zero, arrived at under any of 3.2 and 3.3.

## 4 LONG-TERM INSURANCE BUSINESS MARGIN OF SOLVENCY: CLASS IV

4.1 A *firm* must calculate the *required margin of solvency* in respect of *class* IV by applying the calculation in 2.2 plus the sum arrived at by applying Friendly Society – Overall Resources and Guarantee Fund 3.1(2) as though it were *general insurance business class* 2.

4.2 If both 4.1 and Friendly Society – Overall Resources and Guarantee Fund 3.2(2) apply, a single combined *required margin of solvency* must be calculated under Friendly Society – Overall Resources and Guarantee Fund 3.2(2) in respect of the *class* IV business and subsidiary provisions in *classes* 1 and 2.

## 5 LONG-TERM INSURANCE BUSINESS MARGIN OF SOLVENCY: CLASS V

5.1 A *firm* must calculate the *required margin of solvency* in respect of *class* V as 1% of the assets of the relevant *tontine*.

## 6 LONG-TERM INSURANCE BUSINESS MARGIN OF SOLVENCY: CLASS VI

6.1 A *firm* must calculate the *required margin of solvency* in respect of *class* VI by applying the calculation in 2.2.

## 7 GENERAL INSURANCE BUSINESS SOLVENCY MARGIN: PREMIUMS BASIS

7.1 A *firm* must calculate a premiums basis solvency margin by:

(1) aggregating the *gross premiums receivable* (or contributions, as the case may be) in respect of the *firm's* entire *general insurance business* for the last preceding *financial year*; and

(2) aggregating the *gross premiums earned* (or contributions, as the case may be) in respect of the *firm's* entire *general insurance business* for the last preceding *financial year,*

and applying the calculation set out in 7.2 to 7.10.

7.2 From each of the aggregates arrived at under 7.1(1) and 7.1(2) a *firm* must deduct:

(1) any taxes included in the *premiums*; and

(2) any levies that are related to *premiums* and are recorded in the *firm's* books as payable in the last preceding *financial year* in respect of *general insurance business*.

7.3 A *firm* must multiply the amount arrived at under 7.2 by twelve and divide by the number of *months* in the *financial year*.

7.4 A *firm* must calculate 18% of the amount arrived at under 7.3.

7.5 In the case of *general insurance business* consisting of health insurance based on actuarial principles, 7.4 applies with the substitution of 6% for 18% if the following conditions are satisfied:

(1) the *gross premiums* paid are calculated on the basis of sickness tables appropriate to *insurance business*;

(2) the reserves include provision for increasing age or, in the case of *class* IV, either the reserves include provision for increasing age, or the business is conducted on a group basis;

(3) an additional *premium* is collected in order to set up a safety margin of an appropriate amount;

(4) the contract does not allow the *firm* to cancel the contract after the end of the third year of the contract; and

(5) the contract provides for the possibility of increasing *premiums* or reducing payments during its currency.

7.6 Where 7.5 applies to a *firm* whose *general insurance business* consists partly of health insurance based on actuarial principles and partly of other business, the procedure provided in 7.1 to 7.5 must operate separately for each part of the *general insurance business*, so as to produce a sum under 7.5 for the health insurance and a sum under 7.4 for the other business.

7.7 If the *provision for claims outstanding* at:

(1) the end of the last preceding *financial year* exceeds the *provision for claims outstanding* at the beginning of the *financial year* two years prior to the last preceding *financial year*, then a *firm* must add the amount of the excess to the *amount of claims paid* in the three year period; and

(2) the beginning of the *financial year* two years prior to the *financial year* in question exceeds the *provision for claims outstanding* at the end of the *financial year* in question, then a *firm* must deduct the amount of the excess from the *amount of claims paid* in the three year period.

7.8 From the amount determined under 7.7(1) or (2), a *firm* must deduct the total sum *recoverable* in respect of that amount under *reinsurance* contracts ceded during the relevant period.

7.9 A *firm* must express the amount determined under 7.8 as a percentage of the amount determined under 7.7(1) or (2).

7.10 A *firm* must multiply the sum arrived at under 7.4 or 7.5, or the aggregate of the sums arrived at under 7.4 and 7.5, as the case may be:

(1) where the percentage arrived at under 7.9 is greater than 50% but not greater than 100%, by the percentage so arrived at;

(2) where the percentage arrived at under 7.9 is greater than 100%, by 100%; and

(3) in any other case, by 50%.

## 8 GENERAL INSURANCE BUSINESS SOLVENCY MARGIN: CLAIMS BASIS

8.1 This Chapter does not apply to a *firm* that has not been in existence long enough to acquire a *reference period*.

8.2 A *firm* must calculate a claims basis solvency margin by applying the calculation in 8.3 to 8.9.

8.3 If the provision for claims outstanding at:

(1) the end of the *reference period* exceeds the provision for claims outstanding at the beginning of the *reference period*, a *firm* must add the amount of the excess to the *amount of claims* paid in the *reference period*; or

(2) the beginning of the *reference period* exceeds the provision for claims outstanding at the end of the *reference period*, a *firm* must deduct the amount of the excess from the *amount of claims paid* in the *reference period*,

where for the purposes of this Chapter, the definitions of *amount of claims paid* and *provision for claims outstanding* must be read so as to refer to a *reference period* rather than a *financial year*.

8.4 A *firm* must divide the aggregate obtained under 8.3(1) or (2) by the number of *months* in the *reference period* and multiply by twelve.

8.5 A *firm* must calculate 26% of the amount arrived at under 8.4.

8.6 In the case of *general insurance business* consisting of health insurance based on actuarial principles, 8.5 applies with the substitution of 8.66% for 26% if the conditions in 7.5(1) to (5) are satisfied.

8.7 Where 8.6 applies to a *firm* whose *general insurance business* consists partly of health insurance based on actuarial principles and partly of other business, 8.2 to 8.6 must operate separately for each part of the *general insurance business*, so as to produce a sum under 8.6 for the health insurance and a sum under 8.5 for the other business.

8.8 A *firm* must multiply the sum arrived at under 8.6 or 8.7, or the aggregate of the sums arrived at under 8.6 and 8.7, by the same percentage as is applicable for the purposes of 7.10.

**Annex L**

In this Annex, the text is all new and is not underlined.

**Part**

# FRIENDLY SOCIETY - FINANCIAL PRUDENCE

**Chapter content**



**Links**

## 1 APPLICATION

1.1 Unless otherwise stated, this Part applies to a *non-directive friendly society*.

## 2 ADEQUACY OF ASSETS

2.1 This Chapter only applies to an *incorporated friendly society*.

2.2 A *firm* must ensure that:

(1) its liabilities under *contracts of insurance*, other than *linked long-term liabilities*, are covered by assets of appropriate safety, yield and marketability having regard to the *classes* of business it carries on; and

(2) its investments, other than those in respect of *linked long-term liabilities*, are appropriately diversified and adequately spread and excessive reliance is not placed on investments of any particular category or description.

2.3 A *firm* must cover its *insurance liabilities* in respect of its *linked long-term liabilities* as closely as possible with:

(1) where the *linked benefits* are linked to the value of *units*, those *units*;

(2) where the *linked benefits* are linked to the value of assets contained in an internal fund of the *firm*:

(a) in a case where the internal fund is divided into notional units, the assets represented by those notional units; or

(b) in a case where notional units are not established, those assets; and

(3) where the *linked benefits* are linked to a *share* index or other reference value not mentioned in (1) or (2), assets of appropriate security and marketability which correspond as closely as possible to the assets on which the reference value is based.

## 3 SEPARATION BETWEEN LONG-TERM INSURANCE BUSINESS ASSETS AND OTHER ASSETS

3.1 This Chapter only applies to an *incorporated friendly society*.

3.2 A *firm* must, in relation to any *long-term insurance business*, ensure that:

(1) the assets representing the funds maintained by the *firm* in respect of its *long-term insurance business* are only applied for the purposes of that business; and

(2) adequate arrangements are in place for ensuring that transactions affecting the assets of the *firm* do not operate unfairly between the assets representing the funds maintained by the *firm* in respect of its *long-term insurance business* and the other assets of the *firm*.

## 4 LIQUIDITY

4.1 A *firm* must maintain liquid assets sufficient to meet its liabilities as they become due.

**Annex M**

In this Annex, the text is all new and is not underlined.

**Part**

# FRIENDLY SOCIETY - ASSET VALUATION

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive friendly society***.**

1.2 Subject to Friendly Society – Financial Prudence 2.2, this Part applies with respect to the determination of the value of assets of a *firm*.

1.3 In this Part, the following definitions shall apply:

*business amount*

means:

(1) for a *friendly society* carrying on only *general insurance business*, the *general insurance business amount*;

(2) for a *friendly society* carrying on only *long-term insurance business*, the *long-term insurance business amount*; and

(3) for a *friendly society* carrying on both *general insurance business* and *long-term insurance business*, in the case of its *general insurance business assets*, the *general insurance business amount* and in the case of *its long-term insurance business assets*, the *long-term insurance business amount*.

*connected individual*

of a *friendly society*, means a natural *person* who:

(1) controls, or is a partner of a natural *person* who controls, the *friendly society;* or

(2) is a member of the *governing body* of the *friendly society* or the spouse or civil partner or a minor son or daughter of such a member;

and for the purposes of the above, a natural *person* controls a *friendly society* if he is:

(3) a natural *person* in accordance with whose directions or instructions the *governing body* is accustomed to act; or

(4) a natural *person* who either alone or with any *associate* or *associates* is entitled to exercise or control the exercise of, 15% or more of the voting power at any general meeting of the *friendly society.*

*deferred acquisition costs*

means those items referred to at G II under the heading "Assets" in Part I of Schedule 2 to the *Accounts Regulations*.

*dependant*

of a *friendly society*, means:

(1) a *subsidiary* of that *friendly society*; or

(2) a *jointly controlled body.*

*deposit back arrangement*

(in relation to a contract of *reinsurance*) means an arrangement whereby an amount is deposited by the *reinsurer* with the cedant.

*established surplus*

means an excess of assets representing the whole or a particular part of the fund or funds maintained by the *firm* in respect of its *long-term insurance business* over the liabilities, or a particular part of the liabilities, of the *firm* attributable to that business as shown by an investigation to which IPRU(FSOC) 5.1 or 5.2 of the *PRA Handbook* as at 31 December 2015 applies pursuant to Non-Solvency II Firms – Transitional Measures 3.

*excess concentration with a number of counterparties*

means the amount by which the *firm* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit,* calculated in accordance with 26.

*exposure*

means:

(1) (in relation to assets), an amount determined in accordance with 18 to 24;

(2) (in relation to a *counterparty*), an amount determined in accordance with 25 to 27.

*general insurance business amount*

means the higher of:

(1) the total of:

(a) the *friendly society's insurance liabilities* (net of *reinsurance* ceded) in respect of *general insurance business* less *debts*:

(i) which are due from *dependants* to which 23.3 relates,

(ii) which are not *reinsurance* which has already been netted off the *friendly society's insurance liabilities*, and

(iii) which are included in *general insurance business assets*; which amount is to be zero where the *debts* are greater than the *friendly society's insurance liabilities*, and

(b) an amount equal to whichever is the greater of £320,000 or 20% of the *general premium income*; or

(2) such other amount as the *friendly society* may select not exceeding:

(a) the value of its *general insurance business assets* as determined in accordance with this Part;

(b) excluding *debts* due from *dependants* to which paragraph 23.2 relates and *reinsurance* recoveries; and

(c) less *debts* due to *dependants* of the *friendly society* included in *general insurance business liabilities* (excluding *reinsurance* *recoveries,* other than amounts due or that relate to claims already paid by the *dependant*) except that for a *dependant* to which 23.2 does not relate, the amount deducted will not exceed the *dependant's surplus assets* (or *proportional share*).

*general insurance business assets*

means the assets of a *firm* which are, for the time being, identified as representing the *general insurance business* fund or funds maintained by that body in respect of its *general insurance business*.

*general premium income*

means, in any year, the net amount, after deduction of any *premiums* payable for *reinsurance*, of the *premiums receivable* in that year in respect of all *insurance business* other than *long-term insurance business*.

*implicit item*

means economic reserves arising in respect of items which relate to future surpluses, *zillmerising* or hidden reserves.

*linked assets*

means, in relation to a *friendly society*, *long-term insurance business assets* of the *friendly society* which are, for the time being, identified in the records of the *friendly society* as being assets by reference to the value of which *property-linked benefits* are to be determined.

*long-term insurance business assets*

means the assets of a *firm* which are, for the time being, identified as representing the *long-term insurance business* fund or funds maintained by that firm in respect of its *long-term insurance business*.

*long-term insurance business amount*

means the higher of:

(1) the total of:

(a) the *friendly society's insurance liabilities* in respect of *long-term insurance business* (net of *reinsurance* ceded) and the amount of any deposit back under a *deposit-back arrangement* in relation to a contract of *reinsurance* in respect of *long-term insurance business*;

(i) excluding *property-linked liabilities*; and

(ii) less:

(A) the amount of any *debt,* that is a *long-term insurance business asset* (excluding reinsurance ceded which has already been deducted from the *friendly society's insurance liabilities*), due from a *dependant* to which paragraph 23.2 relates, and

(B) the amount of any *implicit item* valued in accordance with a *waiver*; (which amount is to be zero where the result is negative); and

(C) the amount of the *required margin of solvency* or *minimum guarantee fund*, whichever is greater for its long-*term insurance business* (or, in the case of a *friendly society* whose head office is not in the *UK*, that amount which would apply if its head office were in the *UK*); or

(2) such other amount as the *friendly society* may select not exceeding the value of its assets determined in accordance with the this Chapter;

(a) excluding:

(i) *reinsurance* recoveries;

(ii) assets required to match *property-linked liabilities*;

(iii) *debts* due from *dependants* of the *friendly society* to which 23.2 relates; and

(iv) if the *friendly society* is a *general insurer, general insurance business assets*, and

(b) less:

(i) if the *friendly society* is a *general insurer*, *debts* due to *dependants of the friendly society* included in *long-term insurance liabilities* (excluding *reinsurance* recoveries (other than amounts due or that relate to claims already paid by the *dependant*)); or

(ii) if the *friendly society* is not a *general insurer*, *debts* due to *dependants* of the *friendly society* (excluding *reinsurance* recoveries (other than amounts due or that relate to claims already paid by the *dependant*)), but for the purposes of (b) above, for *dependants* to which 23.2 does not relate, the amount deducted will not exceed the *dependant's surplus assets* (or *proportional share*);

except that for the purposes of determining the *permitted asset exposure limit* under 28, *index-linked liabilities* must also be excluded from (1)(a) and assets required to match such liabilities must be also excluded from (2).

*permitted asset exposure limit*

means the limits referred to in 28.

*permitted counterparty exposure limit*

means the limits referred to in 29.

*readily realisable*

means a *listed* investment in respect of which 12.4 does not apply or, by virtue of 12.5, is to be taken not to apply.

*receivable*

means such amounts as become due to a *friendly society*, whether or not received (including where appropriate, income which has accrued) in respect of *contracts of insurance* incepted in the relevant period.

## 2 SECURED DEBTS

2.1 In this Part, a *debt* owed to (or an obligation to be fulfilled for the benefit of) a *firm* must be regarded as being secured only to the extent that it is:

(1) secured by;

(a) a letter of credit established with a *CRD credit institution*; or

(b) a guarantee provided by a *CRD credit institution*

and the sum of the aggregate amount available under all letters of credit established for the benefit of the *firm* with the same *counterparty*, the aggregate amount of all guarantees issued for the benefit of the *firm* by that *counterparty* and the amount of any *exposure* of the *firm* to that *counterparty* does not exceed the *permitted counterparty exposure limit* for that *counterparty*; or

(2) secured by assets for the valuation of which provision is made in this Part and;

(a) the value of such assets (after deducting reasonable expenses of sale and the amount of any other *debt* or obligation secured thereon having priority to or ranking equally with the *debt* or obligation) is sufficient to enable the *debt* or obligation to be discharged in full;

(b) the value of the assets when aggregated with the *firm*'s *exposure* to assets of the same description does not exceed the *permitted asset exposure limits*; and

(c) where the assets give rise to *exposure* to a *counterparty*, the *exposure* of the *firm* to that *counterparty*, when added to the sum of the aggregate amount available under all letters of credit established for the benefit of the *firm* with that *counterparty*, and the aggregate amount of all guarantees issued for the benefit of the *firm* by that *counterparty*, does not exceed the *permitted counterparty exposure limit* for that *counterparty*.

2.2 For the purposes of 2.1:

(1) the aggregate amount available under letters of credit established with a *counterparty* must be taken not to exceed the sum of the aggregate amount of all *debts* and the aggregate value of all obligations in respect of which those letters of credit were established;

(2) the aggregate amount of guarantees issued by a *counterparty* must be taken not to exceed the sum of the aggregate amount of all *debts* and the aggregate value of all obligations so guaranteed; and

(3) assets which are securing any other *debt* owed to (or obligation to be fulfilled for the benefit of) the *firm* must be treated as if they were assets of the *firm*.

## 3 PROPERTY-LINKED BENEFITS

3.1 Where a *firm* has entered into any contracts for the payment of *property-linked benefits*, 4 to 17 do not apply with respect to the determination of the value of the *linked assets* to the extent that they are held in compliance with the requirements of Friendly Society - Financial Prudence 2.3 to match liabilities in respect of such benefits under such contracts and the value of such assets must be determined in accordance with generally accepted accounting practice or other generally accepted methods appropriate for *insurance business*.

## 4 GENERAL PRINCIPLES

4.1 (1) Subject to (2), any asset to which this Part applies, for the valuation of which no provision is made in this Part, must be left out of account for the purposes specified in 1.2.

(2) (1) does not apply to cash.

4.2 Where in all the circumstances of the case it appears that any asset is of a lesser value than the amount calculated in accordance with this Part, such lesser value must be taken to be the value of the asset.

4.3 For the purposes of 4.2, in determining whether it appears that an asset is of a lesser value than the amount calculated in accordance with this Part, regard must be had to:

(1) the underlying security; and

(2) in the case of bonds, *debt securities* and other money and capital market instruments, the credit rating of the *issuer*.

4.4 (1) In relation to an actuarial investigation of its *long-term insurance business*, a *firm* may, subject to the conditions set out in (2), elect to assign to any of its assets the value given to the asset in question in the books or other records of the *firm*.

(2) The conditions referred to in (1) are:

(a) that the election must not enable the *firm* to bring into account any asset for the valuation of which no provision is made in this Part; and

(b) that the value assigned to the aggregate of the assets must not be higher than the aggregate of the value of those assets as determined in accordance with this Part.

4.5 (1) Where a *firm* has entered into a contract for the conversion of currency which satisfies the conditions set out in (2), then for any of the purposes of this Part, the *firm* must treat the conversion as having been made on the *relevant date*.

(2) The conditions referred to in (1) are that:

(a) the contract provides for either;

(i) the conversion into another currency of an amount representing the sale of an asset which has, on the *relevant date*, been sold but not delivered; or

(ii) the purchase of currency for the purpose of settling the purchase of an asset which has, on the *relevant date*, been purchased but not delivered;

(b) the conversion referred to in (1) is to take place during a period which is:

(i) where the contract is in connection with the delivery of a *listed security* or a *security admitted to trading*, a period commencing on the date of the contract and extending for the usual period of settlement as laid down by the rules of the relevant stock exchange or *regulated market*; or

(ii) where the contract is in connection with the delivery of any other asset, a period commencing on the date of the contract and extending for 20 *working day*s thereafter; and

(c) the contract is *listed* or has been entered into with an *approved counterparty*.

4.6 A *firm* must derecognise any *defined benefit asset*.

## 5 SHARES IN AN AFFILIATED COMPANY

5.1 Where any *shares* are held by a *firm* in a *regulated affiliated company*, the value of the *shares* may be taken as, and in any event must not exceed:

(1) the value; or

(2) where the shareholding, whether held directly or indirectly, is less than 100%, the relevant *proportional share* of the value,

determined in accordance with this Part (other than 17.2(1) to (3)), of the *surplus assets* of that *regulated affiliated company*.

5.2 Where any *shares* are held by a *firm* in an *affiliated company* other than a *regulated affiliated company,* the value of the *shares* must not exceed the greater of:

(1) the value (or, where the shareholding, whether held directly or indirectly, is less than 100%, the relevant *proportional share* of the value), determined in accordance with this Part (other than 17.2(1) to(3)), of the *affiliated company's surplus assets*; and

(2) the value of those *shares* as determined under 12 reduced:

(a) by an appropriate amount, to the extent that the *shares* cannot effectively be made available or realised to meet losses (if any) arising in the *firm*;

(b) by an appropriate amount, to the extent needed to exclude value attributable to goodwill generated from business with the *firm* or any *regulated affiliated company* of the *firm*; and

(c) by the amount by which the value of any *shares* held by the *affiliated company* in a *regulated affiliated company* of the *firm* exceeds the value (or *proportional share*), determined in accordance with this Part (other than 17.2(1) to(3)), of the *surplus assets* of the *affiliated company*.

5.3 The surplus assets of an *affiliated company* are its total assets excluding:

(1) the assets that are selected to cover liabilities and, in the case of a *regulated affiliated company*, to cover any capital requirement imposed by any relevant provisions of the *PRA* Rulebook or *FCA Handbook*;

(2) assets that are interests directly or indirectly held in the *affiliated company's* own capital (as defined by any relevant provisions of the *PRA* Rulebook or *FCA Handbook* for that *affiliated company*);

(3) where the *affiliated company* carries on *long-term insurance business*, profit reserves and future profits;

(4) assets which represent either a *long-term insurance* fund or a fund the allocation of which as between *policyholders* and other purposes has yet to be determined;

(5) amounts due, or to become due, in respect of *share* capital, or other contributions from members of the *affiliated company*, subscribed or called for but not fully paid up; and

(6) assets that cannot effectively be made available or realised to meet losses (if any) arising in the *firm*, including assets that represent capital not owned, directly or indirectly, by the *firm*.

5.4 The assets selected pursuant to 5.3(1) and which are excluded from the total assets:

(1) where the *affiliated company* is an *insurance undertaking*, must be identified and valued in accordance with any relevant provision of the *PRA* Rulebook or *FCA Handbook* as to the value, admissibility, nature, location or matching that apply to the assets available to cover its liabilities (determined under any relevant provision of the *PRA* Rulebook or *FCA Handbook*);

(2) where the *group undertaking* is a *regulated affiliated company* (excluding an *insurance undertaking*), must be identified and valued in accordance with the relevant provisions of the *PRA* Rulebook or *FCA Handbook* applicable to the *regulated affiliated company* as to cover its liabilities and the applicable regulatory requirement identified in 5.3(1);

(3) where the *group undertaking* is not a *regulated affiliated company*, must be of a value at least equal to the amount of its liabilities, determining that value and that amount in accordance with this Part (other than 17.2(1) to(3)) and Friendly Society - Liability Valuation Part; and

(4) in all cases, must not include:

(i) assets falling within 5.3(2), or

(ii) assets falling within 5.3(5) where the amount is due, or to become due, from an *affiliated company*; but

(5) notwithstanding 5.1, 5.2 and 5.3, a liability of an *affiliated company* which is a *debt* due to the *firm* is not required to be determined at an amount which is higher than the value placed on that *debt* as an asset of the *firm*.

5.5 For the purposes of 5.4, the relevant provisions of the *PRA* Rulebook or *FCA Handbook* must be treated as if 17.2(1) to (3) do not apply for the purpose of valuing *shares* in *affiliated companies* that are not *dependants*.

5.6 For the purposes of this Part, any value attributed to any *shares* held directly or indirectly in an *affiliated company* which is an *ancillary services undertaking* must be deducted from the assets of the *firm*.

**6 VALUE OF NON-CAPITAL INTERESTS IN A GROUP UNDERTAKING**

6.1 A *firm* must notify the *PRA* of:

(1) any *affiliated company*:

(a) in which no participation is held by another *affiliated company*; and

(b) which is not a *subsidiary*; but

(c) which is linked by a consolidation *Article 12(1) relationship* with another *affiliated company*; and

(2) the value of that *affiliated company* calculated in accordance with 5.

**7 DEBTS DUE OR TO BECOME DUE FROM AN AFFILIATED COMPANY**

7.1 The value of any *debt* due, or to become due, from an *affiliated company* must not exceed the amount reasonably expected to be recovered in respect of the *debt* taking into account only the value of:

(1) the assets identified in 5.3(1); and

(2) any security held in respect of the *debt*.

**8 REPO AGREEMENTS**

8.1 Where a *firm* has sold *securities* to or purchased *securities* from a *CRD credit institution* or a *MiFID investment firm* and such sale or purchase was made subject to an agreement that the *CRD credit institution* or *MiFID investment firm* would, either on demand by the *firm* or within six *months* of such sale or purchase, subsequently sell to or purchase from the *firm* equivalent securities, then if at the relevant date such subsequent sale or purchase has not taken place and the conditions specified in 8.2 and either 8.3 or 8.4 (as appropriate) are satisfied, the *firm*:

(1) must value:

(a) *securities* sold by it under such agreement as if such *securities* had been retained by it, and

(b) assets provided by it as consideration for the purchase of *securities* under such agreement as if such consideration had not been provided by it; and

(2) must not ascribe a value to:

(a) any consideration received for the sale of *securities* under such agreement (or any assets purchased by it with such consideration) up to the limit of the value of the *securities* sold; or

(b) any *securities* purchased by it under such agreement (or any assets purchased with the proceeds of the sale of any such *securities*) up to the limit of the consideration (valued in accordance with generally accepted accounting practice or other generally accepted methods appropriate to *friendly societies*) provided by it.

8.2 The condition specified in this Chapter is that, where at any time after the sale or purchase of *securities* by the *firm* under an agreement described in 8.1 either:

(1) the amount of the consideration received by the *firm* for the sale of the *securities* fell below the value of the *securities* sold by it; or

(2) the value of the *securities* purchased by the *firm* fell below the value of the consideration provided by it,

by more than 2.5% of the value of the *securities* sold or purchased (as the case may be), the *firm* demanded additional consideration equal to the shortfall and such demand was complied with before the end of the *working day* following the day on which the shortfall occurred.

8.3 The conditions specified in this Chapter are that, if the *firm* purchases *securities* from a *CRD credit institution* or a *MiFID investment firm* and the consideration provided by the *firm* is other than by way of sale of *securities*:

(1) the *securities* purchased are:

(a) *approved securities*,

(b) *listed securities*, or

(c) *securities* issued by a *CRD credit institution*; and

(2) the *securities* purchased do not include:

(a) *securities* (other than *approved securities*) issued by the same *counterparty* whose aggregate value amounts to more than 15% of the value of the *securities* purchased; or

(b) if the condition in (2)(a) is not satisfied, *securities* whose value when aggregated with the *firm's* existing *exposure* to assets of the same description or to the same *counterparty* would exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* as determined in accordance with 17 to 29.

8.4 The conditions specified in this Chapter are that, if the *firm* sells *securities* to a *CRD credit institution* or a *MiFID investment firm*:

(1) the consideration provided by the *CRD credit institution* or *MiFID investment firm* is:

(a) cash;

(b) *approved securities*;

(c) *listed securities*;

(d) *securities* issued by a *CRD credit institution*;

(e) a charge over assets set out in (a) to (d);

(f) a letter of credit established with a *CRD credit institution*; or

(g) a guarantee provided by a *CRD credit institution*; and

(2) the consideration :

(a) except to the extent that the condition in (2)(b) is satisfied, when aggregated with the *firm's* existing *exposure* to assets of the appropriate description or to the relevant *counterparty*, does not exceed the appropriate *permitted asset exposure limit* or *permitted counterparty exposure limit* as determined in accordance with 17 to 29; or

(b) does not include :

(i) *securities* (other than *approved securities*) issued by;

(ii) letters of credit established with;

(iii) guarantees provided by,

(iv) cash deposited with:

(v) a charge over cash deposited with; or

(vi) a charge over *securities* issued by,

the same *counterparty* in excess of 15% of the total consideration; and

(3) the consideration to be provided by the *firm* for the subsequent purchase of *equivalent securities* is:

(a) where the consideration for the original purchase by the *CRD credit institution* or *MiFID investment firm* was (wholly or in part) cash, cash denominated in the same currency; and

(b) where the consideration was (wholly or in part) *securities*, *securities* equivalent to the *securities* provided by way of consideration.

8.5 For the purposes of this Chapter, where the *firm* has received consideration in respect of a sale of the kind described in 8.1, in addition to any other *exposure* to assets or to a *counterparty*:

(1) if such consideration takes the form of a letter of credit established with, or a guarantee provided by, a *CRD credit institution*, it must be considered to give rise to *exposure* to that institution by the amount of the consideration;

(2) if such consideration takes the form of a charge over *securities*, it must be considered to give rise to *exposure* to *securities* of the same description and to the *issuer* of those *securities* by the amount of the consideration; and

(3) if such consideration takes the form of cash deposited with another party for the benefit of the *firm*, or a charge over cash deposited with another party, it must be considered to give rise to *exposure* to that party by the amount of the consideration.

8.6 For the purposes of this Chapter, the amount of any consideration must be:

(1) where the consideration is a letter of credit established with a *CRD credit institution*, the lower of the amount made available under the letter of credit and the value of the assets sold;

(2) where the consideration is a guarantee provided by a *CRD credit institution*, the lower of the amount of the guarantee and the value of the assets sold; and

(3) where the consideration takes the form of assets of any of the types mentioned in 8.4(1)(a) to (d), or a charge over such assets, the value of the assets as determined in accordance with this Part.

8.7 Where a *firm* has entered into a number of agreements described in 8.1, for the purposes of 8.3 and 8.4:

(1) any or all agreements under which the subsequent sale or purchase has not taken place at the *relevant date* may be treated as one agreement; and

(2) in such case, the 15% limits referred to in 8.3(2)(a) and 8.4(2)(b) must be calculated by reference to the aggregate of the value of the *securities* purchased under 8.3 and the amount of any consideration under 8.4.

## 9 DEBTS AND OTHER RIGHTS

9.1 This Chapter does not apply to any rights (other than *debts* due) in respect of:

(1) investments in an *affiliated company*;

(2) *securities* or beneficial interests in a limited partnership;

(3) units or other beneficial interests in a *collective investment scheme*;

(4) a *derivative*, except as provided under 9.8 or 9.9; or

(5) a contract or asset which has the effect of a *derivative* except as provided under 9.8 or 9.9 or under 16.4 or 9.6.

9.2 The value of any *debt* due, or to become due, to a *firm*, other than a *debt* to which 7, 9.3, 9.4, 9.5, 9.7 or 14 applies, must be:

(1) in the case of a *debt* which is due, or will become due, within twelve *months* of the *relevant date* (including any *debt* which would become due within that period if the *firm* were to exercise any right to which it is entitled to require payment of the same), the amount which can reasonably be expected to be recovered in respect of that *debt*; and

(2) in the case of any other *debt*, the amount which would reasonably be paid by way of consideration for an immediate assignment of the *debt*; and

in either case due account being taken of the terms and conditions for payment of the *debt* and, where the *debt* is secured, the nature and quality of the security.

9.3 Any *debt* due, or to become due, to a *firm* under a letter of credit must be left out of account for the purposes of this Part.

9.4 In the case of *long-term insurance business* carried on by a *firm*, the value of any *debt* due, or to become due, to the *firm* which is secured on a policy of insurance issued by the *firm* and which (together with any other *debt* secured on that policy) does not exceed the amount payable on a surrender of that policy at the *relevant date* must be the amount of that *debt*.

9.5 Subject to 9.6, the value of any rights of the *firm* under a contract of *reinsurance* to which it is a party must be the amount which can reasonably be expected to be recovered in respect of those rights.

9.6 9.5 does not apply to:

(1) rights under a contract of *reinsurance* in respect of *long-term insurance business* except to the extent that *debts* are due under such contracts; or

(2) *debts* to which 7 applies which are due or are to become due.

9.7 Any *debt* due, or to become due, to a *firm*:

(1) from an *intermediary* in respect of money advanced on account of commission to which that *intermediary* is not absolutely entitled at the *relevant date*; or

(2) which is a *debt* owed in respect of *premiums* (due account being taken of rebates, refunds and commissions payable) which is recorded in the *firm*'s accounting records as due and payable and has been outstanding for more than three *months*,

must be left out of account for the purposes of this Part.

9.8 The value of any right to recover assets transferred by way of *initial margin* in respect of a *derivative* or a contract or asset having the effect of a *derivative* must be determined:

(1) where the *initial margin* was a payment in cash, as if there were a *debt* owed to the *firm* for that amount; and

(2) where the *initial margin* took the form of a transfer of *securities*, as if there were a *debt* owed to the *firm* of an amount equal to the value of such *securities* as determined in accordance with this Part.

9.9 The value of any rights arising under a *derivative* or under a contract or asset having the effect of a *derivative*, must be the value of any right to recover assets transferred by way of *initial margin* together with the value of any other unconditional right to receive a specified amount.

## 10 LAND

10.1 The value of any land of a *firm* (other than land held by the *firm* as security for a *debt* or to which 10.2 or 15.1 applies) must be not greater than the amount which (after deduction of the reasonable expenses of sale) would be realised if the land were sold at a price equal to the most recent *proper valuation* of that land which has been provided to the *firm* and any such land of which there is no *proper valuation* must be left out of account for the purposes of this Part.

10.2 The value of any interest in land which is determinable upon the death of any *person* or upon the happening of some other future event or at some future time must be the amount which would reasonably be paid by way of consideration for an immediate transfer thereof.

## 11 EQUIPMENT

11.1 The value of any computer equipment of a *firm*:

(1) in the *financial year* of the *firm* in which it is purchased, must not be greater than three-quarters of the cost thereof to the *firm*;

(2) in the first *financial year* thereafter, must not be greater than one-half of that cost;

(3) in the second *financial year* thereafter, must be not greater than one-quarter of that cost; and

(4) in any subsequent *financial year*, must be left out of account for the purposes of this Part.

11.2 The value of any office machinery (other than computer equipment), furniture, motor vehicles and other equipment of a *firm*, must be, in the *financial year* of the *firm* in which it is purchased, not greater than one-half of the cost thereof and must be, in any subsequent *financial year*, left out of account for the purposes of this Part.

## 12 SECURITIES AND BENEFICIAL INTERESTS IN LIMITED PARTNERSHIPS

12.1 Subject to 12.2, this Chapter applies to the valuation of investments comprising *securities* and beneficial interests in limited partnerships.

12.2 This Chapter does not apply to the valuation of *securities* which are:

(1) *derivatives*;

(2) units or other beneficial interests in *collective investment schemes*; or

(3) contracts or assets having the effect of *derivatives*.

12.3 Subject to 12.6, the value of an investment to which this Chapter applies must be:

(1) where the investment is transferable and 12.4 does not apply, the *market value*;

(2) where the investment is transferable and 12.4 applies, the lower of:

(a) the *market value*; and

(b) the amount which would reasonably be expected to be received by way of consideration for an assignment or transfer of the investment at a date not later than twelve *months* after the *relevant date*, it being assumed that negotiations for the assignment or transfer commenced on the *relevant date* and the assignment or transfer was made other than to the *issuer* or to an *associate* of the *issuer* or of the *firm*; or

(3) where the investment is not transferable:

(a) the amount payable on redemption on the *relevant date* or the most recent date before the *relevant date* on which the *issuer* of the investment could have been required to redeem the investment; or

(b) where the investment cannot be redeemed, the amount which would reasonably be paid by way of compensation for the surrender of the interest in the investment.

12.4 Subject to 12.5, this Chapter applies where it is not reasonable to assume that, had negotiations for the assignment or transfer of the investment commenced not more than seven *working days* before the *relevant date*, the investment could have been assigned or transferred on the *relevant date* for an amount not less than 97.5% of the *market value* other than to the *issuer* or to an *associate* of the *issuer* or of the *firm*.

12.5 12.4 does not apply where it would otherwise apply because:

(1) the *listing* or *admission to trading* of the investment has been temporarily suspended following receipt of price sensitive information by the stock exchange on which the investment is *listed*, or *admitted to trading* or the *regulated market* on which facilities for dealing have been granted; or

(2) the extent of the holding would prevent an orderly disposal of the investment for an amount equal to or greater than 97.5% of the *market value*.

12.6 Where a *firm* has made more than one investment (including loans) that is not *listed* (other than a number of investments exclusively comprising loans) and the value of such investments when taken together is greater than the aggregate of the values of each investment valued separately, then such higher value may be ascribed to the investments if it is reasonable to assume that none of the investments would be assigned or transferred separately.

## 13 BENEFICIAL INTERESTS IN COLLECTIVE INVESTMENTS SCHEMES

13.1 Subject to 13.2, this Chapter applies to holdings of units, or other beneficial interests in:

(1) a scheme falling within the *UCITS Directive*;

(2) an *authorised unit trust scheme* or a *recognised scheme* (not falling within (1)); or

(3) any other *collective investment scheme* where:

(a) the scheme does not employ *derivatives* unless they are *approved derivatives* or *approved quasi-derivatives*; and

(b) the property of the scheme does not include assets other than those for the valuation of which provision is made in this Part.

13.2 This Chapter does not apply to units or other beneficial interests in a *collective investment scheme* which has the effect of a *derivative*.

13.3 The value of units or other beneficial interests in a *collective investment scheme* to which this Chapter applies must be:

(1) where the *issuer* can be required to purchase the units or other beneficial interests from the holder upon the holder giving notice of one *month* or less, the price at which the *issuer* would have purchased the units or other beneficial interests on the *relevant date* or the most recent date before the *relevant date* on which it could have been required to make such a purchase; or

(2) where the *issuer* cannot be required to purchase the units or other beneficial interests as set out in (1), a value determined in accordance with 12.

## 14 DEFERRED ACQUISITION COSTS

14.1 In the case of *general insurance business*, the value of *deferred acquisition costs* must be the value as determined in accordance with generally accepted accounting practice or other generally accepted methods appropriate to *friendly societies*.

## 15 FUTURE INTERESTS

15.1 The value of any *long-term insurance business asset* of a *firm* consisting of an interest in property which is a remainder, reversionary interest, right of fee subject to a life rent or other future interest, whether vested or contingent, must be the amount which would reasonably be paid by way of consideration for an immediate transfer or assignment of it.

## 16 CONTRACTS AND ASSETS HAVING THE EFFECT OF DERIVATIVES

16.1 Rights in respect of a contract or asset whose effect is that of a *derivative* must have a value determined in accordance with 9.9.

16.2 Subject to 16.4, for the purposes of this Part, a contract has the effect of a *derivative* if it is a contract (other than a *derivative*) which provides whether upon the exercise of a right by the *firm* or otherwise:

(1) for payment (at any time) of amounts which are determined by fluctuations in:

(a) the value of property of any description;

(b) an index of the value of property of any description;

(c) income from property of any description; or

(d) an index of income from property of any description;

(2) for delivery of an asset (other than an asset for the valuation of which provision is made in 11) to or by the *firm*; or

(3) for the conversion of an asset held by the *firm* or another party to:

(a) an asset of a different type; or

(b) a different asset of the same type.

16.3 Subject to 16.4 for the purposes of this Part an asset has the effect of a *derivative* if the asset is an asset (other than an *approved security* or an asset falling within 13.1(1)) and the holding of the asset confers contractual rights or imposes contractual obligations to make or accept payment, delivery or conversion as set out in 16.2.

16.4 A contract or asset does not have the effect of a *derivative* by reason only that:

(1) it provides for the unconditional delivery of assets, or for the payment for unconditional delivery of assets, such delivery or payment to be made within a period not exceeding the period commencing at the date of the contract and extending:

(a) in the case of a *listed security* or a *security admitted to trading*, for the usual period for delivery or payment as determined by the rules of the stock exchange or *regulated market* on which the *securities* are *listed* or *admitted to trading*, or facilities for dealing have been granted; or

(b) in any other case, for 20 *working day*s;

(2) it is a contract of the type described in 4.5(1) in respect of which the conditions set out in 4.5(2) have been satisfied; or

(3) it is a transaction to which 8.1 applies.

## 17 ASSETS TO BE TAKEN INTO ACCOUNT ONLY TO A SPECIFIED EXTENT

17.1 This Chapter only applies to an *incorporated friendly society.*

17.2 Subject to 17.2 to 17.6, the aggregate value of the assets of a *firm* must be reduced by an amount representing the aggregate of:

(1) the amount by which the *firm* is exposed to assets of any description in excess of the *permitted asset exposure limit* for assets of that description;

(2) the amount by which the *firm* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* for such *counterparty*;

(3) the amount by which the *firm* has an *excess concentration with a number of counterparties*;

(4) the value of any assets transferred to or for the benefit of the *firm* in pursuance of a condition in a *derivative* or a related contract; and

(5) the value of any assets transferred to or for the benefit of the *firm* in pursuance of a contract whose effect is that of a *derivative* or a related contract,

as determined in accordance with 18 to 29.

17.3 Where a *firm* is exposed to assets of any description in excess of the *permitted asset exposure limit* for such assets, the reduction required to be made by 17.2(1) must be made:

(1) by deducting (as far as possible) the amount of the excess from the assets of that description held by the *firm*; and

(2) where the *firm* does not hold sufficient (or any) assets of that description to eliminate the excess, by making an appropriate deduction from the aggregate value of the assets which the *firm* would otherwise be permitted to take into account for any of the purposes of this Part.

17.4 Where a *firm* is required to make a reduction in accordance with 17.2(2), (3), (4) or (5), the reduction must be made by making a deduction from the aggregate value of the assets which the *firm* would otherwise be permitted to take into account for any of the purposes of this Part.

17.5 Where a *firm* carrying on *long-term insurance business* has attributed assets partly to a *long-term insurance business* fund and partly to its other assets, any reduction required to be made by this rule must be made in the same proportion as the attribution.

17.6 Assets of a *firm* comprising:

(1) *approved securities* or any interest accrued thereon;

(2) *debts* to which 9.4 applies;

(3) rights to which 9.5 applies;

(4) *debts* in respect of *premiums*;

(5) moneys due from, or guaranteed by, the government of any *approved State*;

(6) *shares* in or *debts due or to become due* from a *dependant* falling within 5;

(7) holdings in a scheme falling within the *UCITS Directive*; or

(8) *deferred acquisition costs*,

must not be taken into account in any of the calculations described in 17.2.

17.7 Assets of *dependants* of the *firm* that are *debts due or to become due* from the *firm* or from a *dependant* of the *firm* must not be taken into account in any of the calculations described in 17.2.

17.8 Where a *firm* has entered into any contracts providing for the payment of *index-linked benefits*, the provisions of 17.2(1) must not apply to assets of that *firm* to the extent that they are held to match liabilities in respect of such benefits.

## 18 CALCULATION OF EXPOSURE TO ASSETS

18.1 A value must be ascribed to assets of each description which must be an amount determined in accordance with this Part or, where the assets are of a description for the valuation of which no provision is made in those rules, an amount which would reasonably be paid by way of consideration for an immediate assignment or transfer of such assets. The amount by which the *firm* is exposed to assets of each description must be determined by adjusting the value of the assets in accordance with 19 to 23.

## 19 ADJUSTMENTS IN RESPECT OF FUTURES CONTRACTS

19.1 The value ascribed under 18 in respect of assets of each description must be increased or decreased by the value of assets of that description which the *firm* is deemed to have acquired or disposed of pursuant to a *futures* contract.

19.2 For the purposes of 19.1, the *firm* must be deemed to have acquired or disposed of assets pursuant to a *futures* contract if, at the *relevant date*, it has entered into (and not closed out) a *futures* contract which:

(1) provides for the acquisition of assets by the *firm*;

(2) is *listed* and provides for the disposal of assets by the *firm*; or

(3) is not *listed* but provides for the disposal of assets by the *firm* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

## 20 ADJUSTMENTS IN RESPECT OF OPTIONS

20.1 The value ascribed under 18 to 19 in respect of assets of each description must be increased or decreased by the value of assets of that description which the *firm* is deemed to have acquired or disposed of pursuant to an *option*.

20.2 For the purposes of 20.1, the *firm* must be deemed to have acquired or disposed of assets pursuant to an *option* if, at the *relevant date*, it is a party to an *option* and it is prudent to assume that the *option* will be exercised and the *option* is one which:

(1) provides for the acquisition of assets by the *firm*;

(2) is *listed* and provides for the disposal of assets by the *firm*; or

(3) is not *listed* but provides for the disposal of assets by the *firm* to an *approved counterparty* and it is prudent to assume that such disposal will take place within one year of the *relevant date*.

**21 ADJUSTMENTS IN RESPECT OF INITIAL MARGINS**

21.1 The value ascribed under 18 to 20 in respect of assets of each description must be increased by an amount representing the value of any assets of that description which have been transferred by the *firm* by way of *initial margin*.

**22 ADJUSTMENTS IN RESPECT OF CERTAIN CONTRACTS**

22.1 The value ascribed under 18 to 21 must be increased or decreased by an amount representing the value of assets which the *firm* is deemed to have acquired or disposed of under:

(1) an undiversified *contract for differences*; or

(2) a contract or asset other than a diversified *contract for differences* which has the effect of a *derivative*.

22.2 For the purposes of 22.1, the *firm* must be deemed to have achieved the effect of such contract by entering into appropriate *futures* contracts or *options*. The assets deemed to be acquired or disposed of must be dealt with in accordance with the provisions in 19.1 and 20.1 respectively.

**23 ADJUSTMENT IN RESPECT OF SUBSIDIARIES**

23.1 Subject to 23.2 and 23.3, the amount of the *firm's exposure* to assets determined in accordance with 18 to 22 must be increased by an amount representing the *exposure*, if any, of the *firm's dependants* to assets of that description.

23.2 For the purposes of 23.1, the *exposure* of each *dependant* must be calculated by applying 18 to 22 to that *dependant* as if it were a *firm* to which those provisions apply (whether it is or not).

23.3 In relation to a *dependant*:

(1) which is an *insurance undertaking*; or

(2) in respect of which 17.2(1) to (3) have (notwithstanding 5.4(1)) been applied when valuing the assets selected under 5.3(1),

23.1 applies only in relation to the *dependant's surplus assets* (or *proportional share*).

**24 EXCESS ASSET EXPOSURE**

24.1 (1) The amount by which the *firm* is exposed to assets of a particular description in excess of the *permitted asset exposure limit* must be calculated by subtracting the *permitted asset exposure limit* for assets of that description from the corresponding amount of the *exposure*, calculated in accordance with 18 to 23.

(2) For the purpose of (1), *exposure* to assets must be excluded to the extent that such *exposure* has caused the recognition of excess *exposure* to assets of a different description and if the figure arrived at is negative, it must be taken to be zero.

## 25 CALCULATION OF EXPOSURE TO A COUNTERPARTY

25.1 (1) Subject to 25.2 to 25.4, the value of all investments (determined in accordance with 12) issued by any one *counterparty* and the value of all rights (determined in accordance with 9 and 16) against that *counterparty*, in each case up to the amount of the appropriate *permitted asset exposure limit*, must be aggregated.

(2) For the purposes of (1), where the *counterparty* is an *issuer* of a *collective investment scheme* falling within 13.1(3), the value of units or other beneficial interest in the *collective investment scheme* must be included.

25.2 Where a *firm* has rights in respect of a secured obligation to be fulfilled by a *counterparty*:

(1) which:

(a) is secured by cash deposited with, or a letter of credit established with, or *securities* issued by, or a guarantee provided by, a *CRD credit institution* or an *approved financial institution*; and

(b) is due to be fulfilled within 12 *months* of the *relevant date*; or

(2) which is secured by *listed securities* which are *readily realisable* or by *approved securities* which in either case:

(a) have been deposited with a *CRD credit institution*, an *approved financial institution* or a *MiFID investment firm*; and

(b) are beneficially owned by the *counterparty* but will not be available for the benefit of creditors generally in the event of the winding-up of the *counterparty*,

the aggregation required by 25.1 need not include the value of such rights.

25.3 If the *firm* has liabilities to the *counterparty* which may be offset against the assets in 25.1 in accordance with generally accepted accounting practice or other generally accepted methods appropriate for *friendly societies*, then such liabilities may be offset for the purposes of the aggregation required by 25.1.

25.4 Subject to 25.5, the amount arrived at under 25.1 to 25.4 must be increased by the amount by which any *dependant* of the *firm* is exposed to the same *counterparty*.

25.5 In relation to a *dependant*:

(1) which is an *insurance undertaking*; or

(2) in respect of which 17.2(1) to (3) have (notwithstanding 5.4(1)) been applied when valuing the assets selected under 5.3(1),

25.4 applies only in relation to the *dependant's surplus assets* (or *proportional share*).

## 26 EXCESS COUNTERPARTY EXPOSURE

26.1 The amount by which a *firm* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* must be calculated by subtracting from the amount of the *exposure* to such *counterparty* the amount of the *permitted counterparty exposure limit* for such *counterparty*. If the figure arrived at is negative, it must be taken to be zero. If the *firm* is exposed to a *counterparty* in excess of the *permitted counterparty exposure limit* in more than one of the circumstances set out in 29(1), it must make the deduction required under 17.2(2) only in respect of the circumstances leading to the greatest excess *exposure*.

## 27 EXCESS CONCENTRATION WITH A NUMBER OF COUNTERPARTIES

27.1 In accordance with 27.2, where there is *exposure* to a *counterparty* of the type mentioned in 29.1(3)(b), 40% of the *business amount* must be deducted from the aggregate of such *exposures*. The amount so arrived at is the excess concentration with a number of counterparties. Where this amount is negative, it must be taken to be zero.

27.2 For the purposes of this Chapter:

(1) *exposure* to a *counterparty* must be taken into account only up to the level of the *permitted counterparty exposure limit* for that *counterparty*;

(2) *exposure* to a *counterparty* must not be taken into account if it does not exceed 5% of the *business amount*; and

(3) *exposure* to a *counterparty* must not be taken into account if the corresponding *permitted counterparty exposure limit* does not exceed 5% of the *business amount*.

## 28 PERMITTED ASSET EXPOSURE LIMITS

28.1 The *permitted asset exposure limits* are those set out in 28.2 to 28.23.

28.2 5% for a piece of land or a number of pieces of land (or one or more interests in such pieces of land) to which in the most recent *proper valuation* of such pieces of land an aggregate value is ascribed which is greater than the aggregate of the value of each of such pieces of land or interests valued separately.

28.3 1% for a reversionary interest or a remainder not falling within 28.2.

28.4 1% for all *debts due or to become due* from any one individual (other than a *connected individual* of the *firm*), being *debts* which are fully secured on any dwelling or any land appurtenant (or in Scotland, appertaining) thereto owned or to be purchased by the individual and used or to be used by him for his own residence.

28.5 0.25% for all *debts due or to become due* from any one individual, other than *debts* specified in 28.4.

28.6 1% for all unsecured *debts* (other than *debts* arising under the terms of *debt securities* or *debts* from a *regulated institution*) *due or to become due* from any one *counterparty* other than an individual, body corporate or group.

28.7 1% for all unsecured *debts* (other than *debts* arising under the terms of *debt securities* or *debts* from a *regulated institution*) *due or to become due* from any one *body corporate*, taken together with all such *debts due or to become due* from an *affiliated company* of that *body corporate*.

28.8 2.5% for all unsecured *debts* (other than *debts* arising under the terms of *debt securities* or *debts* from an *approved counterparty*) *due or to become due* from any one *regulated institution*, taken together with (where that institution is a *body corporate*) all such *debts due or to become due* from an *affiliated company* of that institution.

28.9 5% for all *debts*, other than *debts* arising under the terms of *debt securities*, *due or to become due* from any one *counterparty,* which is not an *approved counterparty,* taken together with all such *debts due or to become due* from any *affiliated company* (other than an *approved counterparty*) of that *counterparty*.

28.10 10% for all *debts*, other than short-term deposits with a *CRD credit institution* or *debts* arising under the terms of *debt securities*, *due or to become due* from any one *approved counterparty*, taken together with all such *debts due or to become due* from any *affiliated company* of that *approved counterparty*.

28.11 20% for all *debts due or to become due* from a *CRD credit institution* (or an *affiliated company* of that institution) taken together unless:

(1) the *firm* has notified the *PRA* that it places deposits with that institution; and

(2) the total amount of *debts due or to become due* does not exceed £2 million.

28.12 5% for the aggregate of *debts* of the descriptions in 28.5, 28.6 and 28.7.

28.13 1% for all investments of a kind which may be valued in accordance with 12 (other than secured *debt securities*, *debt securities* issued by a *regulated institution* or investments which are *listed* and *readily realisable*) issued by any one *issuer* taken together with:

(1) all units or other beneficial interests in a *collective investment scheme* failing within 13.1(3) issued by that *issuer*; and

(2) all investments of the kinds mentioned in this Chapter issued by an *affiliated company* of that *issuer*.

28.14 10% for the aggregate of assets of any of the descriptions in 28.3 and 28.13.

28.15 2.5% for all *shares* and hybrid *securities* issued by any one *issuer* taken together with all such *securities* issued by an *affiliated company* of that *issuer*.

28.16 In the case of a *firm effecting contracts of insurance* or *carrying out contracts of insurance* that are *with-profits policies* and holding *shares* as *long-term insurance business assets*, for *shares* that are ordinary *listed shares* in the issuer, the *permitted asset exposure limit* in 28.15 may exceed 2.5% of the *long-term insurance business amount* to a maximum of 5% of the *long-term insurance business amount* or the formula result, whichever is lower, where:

(1) the 'formula result' means 0.8 multiplied by M/T multiplied by P, expressed as a percentage of the *long-term insurance business amount,* where:

(a) M = the aggregate market capitalisation of the ordinary *listed shares* in the *issuer*,

(b) T = the aggregate market capitalisation of all *securities* in the Financial Times Stock Exchange All Share Index, and

(c) P = the value of the assets supporting the *firm's long-term insurance business* fund, determined in accordance with this Part; and

(2) 'value of the assets' means the value of the assets:

less

(a) the amount of the *firm's mathematical reserves* for *linked-long-term contract of insurance* and *non-profit policies* net of *reinsurance*, and plus

(b) (if the *firm* does not *effect contracts of insurance* or *carry out contracts of insurance* that are *contracts of general insurance*) the *firm*'s net assets outside the *firm's long-term insurance business* fund.

28.17 5% for all *securities* issued by any one *issuer* which is not an *approved counterparty* taken together with (where that *issuer* is a *body corporate*) all *securities* issued by an *affiliated company*, other than an *approved counterparty*, of that *issuer*.

28.18 10% for all *securities* issued by any one *counterparty*.

28.19 5% for all holdings in any one authorised unit trust scheme or recognised scheme.

28.20 3% for all cash.

28.21 5% for all computer equipment.

28.22 2.5% for all office machinery (other than computer equipment) taken together with all furniture, motor vehicles and other equipment.

28.23 In the case of an asset which is not covered by 28.2 to 28.22 (other than a *derivative*), the *permitted asset exposure limit* is nil.

## 29 PERMITTED COUNTERPARTY EXPOSURE LIMITS

29.1 The *permitted counterparty exposure limits* are as follows:

(1) where the *counterparty* is an individual or an unincorporated body of persons, 5% of the *business amount*;

(2) where the *counterparty* is a *counterparty* of the type mentioned in (5) in the definition of *counterparty*, 5% of the *business amount*;

(3) where the *counterparty* is a body corporate or group, each of:

(a) 20% of the *business amount* or £2 million, whichever is the larger;

(b) 10% of the *business amount* where the *exposure* arises otherwise than by reason that *debt*s are due, or are to become due, as a result of *short term deposit*s made with an *CRD credit institution*; and

(c) 5% of the *business amount* where the *exposure* is to bodies which are not *approved counterparties*.

**Annex N**

In this Annex, the text is all new and is not underlined.

**Part**

# FRIENDLY SOCIETY - LIABILITY VALUATION

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive friendly society.*

1.2 In this Part, the following definitions shall apply:

*defined percentage*

means the percentage arrived at by taking (for all contracts of the same type as the contract in question for which an adjustment is made) the average of the percentages of the *relevant capital sum* under each such contract that represent the acquisition costs incurred which, after allowing for the effects of taxation, might reasonably be recovered from the *premiums* payable under the contract.

*established surplus*

means an excess of assets representing the whole or a particular part of the fund or funds maintained by the *firm* in respect of its *long-term insurance business* over the liabilities, or a particular part of the liabilities, of the *firm* attributable to that business as shown by an investigation to which IPRU(FSOC) 5.1 or 5.2 of the *PRA Handbook* as at 31 December 2015 applies pursuant to Non-Solvency II Firms – Transitional Measures 3.

*exposure*

means:

(1) (in relation to assets), an amount determined in accordance with Friendly Society - Asset Valuation 18 to 24;

(2) (in relation to a *counterparty*), an amount determined in accordance with Friendly Society - Asset Valuation 25 to 27.

*general insurance business liabilities*

means liabilities of the *friendly society* which are attributable to its *general insurance business*.

*linked assets*

means the *long-term insurance business assets* of the *friendly society* which are, for the time being, identified in the records of the *friendly society* as being assets by reference to the value of which *property-linked benefits* are to be determined.

*valuation date*

in relation to an actuarial investigation, means the date to which the investigation relates.

*variable interest investments*

means investments other than *fixed interest securities*.

## 2 LONG-TERM AND GENERAL INSURANCE BUSINESS

2.1 Subject to 2.2, the amount of liabilities of a *firm* in respect of *long-term insurance business* and *general insurance business* and other lawful activities must be determined in accordance with generally accepted accounting practice or other generally accepted methods appropriate for *insurance business*.

2.2 In determining under 2.1 the amount of liabilities of a *firm*, all contingent and prospective liabilities must be taken into account.

## 3 PROVISION FOR ADVERSE CHANGES

3.1 This Chapter does not apply to a contract to the extent that it relates to, or is for the purposes of the making of an investment in, or is in connection with the making of an investment in, a building which is to be occupied by the *firm* and used by the *firm* for the conduct of its business.

3.2 Subject to 3.1, this Chapter applies to an obligation:

(1) under a contract relating to investments of the kind mentioned in item B under the heading "Assets" in Part I of Schedule 2 to *Accounts Regulations* (whether such contract constitutes an asset or liability of the *firm*);

(2) undertaken for the purposes of, or in connection with the making of, investments of the kind mentioned in (1); or

(3) under a contract providing for the purchase, sale or exchange of currency.

3.3 A *firm* which has or may have (following the exercise of any right by the *firm* or any other party) an obligation referred to in 3.2, to deliver assets or make a payment must:

(1) at all times identify the assets held by it which it considers to be the most suitable to cover such obligation; and

(2) make prudent provision for the effect on the amount of its excess assets of all reasonably foreseeable adverse variations between the value of the assets identified and the value of the assets which it is or may be obliged to deliver or the amount of the payment which it is or may be obliged to make.

3.4 For the purposes of 3.3, the 'amount of its excess assets' is the difference between the aggregate value of its assets (other than *linked assets* to the extent that they are held to match *property-linked liabilities*) determined in accordance with Friendly Society - Asset Valuation and the amount of its liabilities (other than *property-linked liabilities* or liabilities for which provision is made in accordance with this Chapter).

## 4 PROVISION FOR AFFILIATED COMPANIES

4.1 Except to the extent that provision for the deficit has been made (whether in the calculation of *surplus assets* or otherwise) in another *affiliated company* the value of whose *shares* is taken to be the value of its *surplus assets* under Friendly Society – Asset Valuation 5.1 or 5.2 (but only to the extent of the *firm's proportional share* of that *undertaking*), a *firm* must make provision in respect of a *regulated affiliated company*:

(1) where the *affiliated company* is also a *subsidiary* of the *firm*, for the whole of any *solvency deficit*; and

(2) in any other case, for the *firm's proportional share* of any such deficit.

4.2 For the purposes of 4.1, the identification and valuation of assets of a *regulated affiliated company,* available to cover liabilities and any capital requirement imposed by any relevant provisions of the *PRA* Rulebook or *FCA Handbook*, must be determined in accordance with Friendly Society – Asset Valuation 5.4.

## 5 GENERAL INSURANCE BUSINESS LIABILITIES

5.1 The amount of *insurance liabilities* which are *general insurance business liabilities* must be determined in accordance with the regulations set out in Part VI of Schedule 6 to the *Accounts Regulations*.

## 6 LONG-TERM INSURANCE BUSINESS LIABILITIES

6.1 In accordance with 6.2 to 6.4, the determination of the amount of *long-term insurance liabilities* (other than liabilities which have fallen due for payment before the *valuation date*) must be made in accordance with generally accepted actuarial principles and have due regard to the reasonable expectations of *policyholders* and make proper provision for all liabilities on prudent assumptions that include appropriate margins for adverse deviation.

6.2 The determination referred to in 6.1 must take account of all prospective liabilities as determined by the policy conditions for each existing contract, taking credit for *premiums* payable after the *valuation date*.

6.3 Without prejudice to the generality of 6.1, the amount of the *long-term insurance liabilities* must be determined in compliance with 7 to 16 and must take into account at least the following factors:

(1) all guaranteed benefits, including guaranteed surrender values;

(2) declared bonuses to which *policyholders* are already contractually entitled;

(3) all options available to the *policyholder* under the terms of the contract;

(4) discretionary charges and deductions;

(5) expenses, including commissions; and

(6) any rights under contracts of reinsurance in respect of *long-term insurance business*.

6.4 The determination referred to in 6.1 must take into account the nature and term of the assets representing those liabilities and the value placed upon them and must include prudent provision against the effects of possible future changes in the value of the assets on:

(1) the ability of the *firm* to meet its obligations arising under contracts for *long-term insurance business* as they arise; and

(2) the adequacy of the assets to meet the liabilities as determined in accordance with 7 to 16.

## 7 METHOD OF CALCULATION

7.1 Subject to 7.2, 7.3 and 7.4, the amount of the *long-term insurance liability* must be determined for each contract by a prospective calculation.

7.2 A retrospective calculation may only be applied to determine the liabilities where a prospective method cannot be applied to a particular type of contract or benefit, or where it can be demonstrated that the resulting amount of liabilities would be no lower than would be required by a prudent prospective calculation.

7.3 Appropriate approximations or generalisations may only be made where they are likely to provide the same, or a higher, result than a determination made in accordance with 7.1.

7.4 Where necessary, additional amounts must be set aside on an aggregated basis for general risks which are not specific to individual contracts.

7.5 The method of calculation of the amount of the liabilities and the assumptions used must not be subject to discontinuities from year to year arising from arbitrary changes and must recognise the distribution of profits in an appropriate way over the duration of each policy.

7.6 The liabilities for contracts under which the *policyholder* is eligible to participate in any *established surplus* must have regard to the level of the *premiums* under the contracts, to the assets held in respect of those liabilities, and to the custom and practice of the *firm* in the manner and timing of the distribution of profits or the granting of discretionary additions, as the case may be.

## 8 AVOIDANCE OF FUTURE VALUATION STRAIN

8.1 The amount of the liability determined in respect of a group of contracts must not be less than such amount as, if the assumptions adopted for the valuation were to remain unaltered and were fulfilled in practice, would enable liabilities similarly determined at all times in the future to be covered from resources arising solely from the contracts and the assets covering the amount of the liability determined at the current valuation.

## 9 VALUATION OF FUTURE PREMIUMS

9.1 Where further specified *premiums* are payable by the *policyholder* under a contract (not being a *linked long-term contract of insurance*) under which the *policyholder* is eligible to participate in any *established surplus* and benefits (other than benefits arising from a distribution of surplus) are determined from the outset in relation to the total *premiums* payable thereunder, then, subject to 9.4 and 10:

(1) where the *premiums* under the contract are at a uniform rate throughout the period for which they are payable, the *premiums* to be valued must not be greater than such level *premiums* as, if payable for the same period as the actual *premiums* under the contract and calculated according to the rates of interest and rates of mortality or disability which are to be employed in calculating the liability under the contract, would have been sufficient at the outset to provide for the benefits under the contract according to the contingencies upon which they are payable, exclusive of any additions for profits, expenses or other charges;

(2) where the *premiums* under the contract are not at a uniform rate throughout the period for which they are payable, the *premiums* to be valued must not be greater than such *premiums* as would be determined on the principles set out in (1) modified as appropriate to take account of the variations in the *premiums* payable by the *policyholder* in each year,

save that a *premium* to be valued must in no year be greater than the amount of the *premium* payable by the *policyholder*.

9.2 Where the terms of the contract have changed since the contract was first made (the terms of the contract being taken to change, for the purposes of this rule, if the change is indicated in an endorsement on the policy but not if a new policy is issued), then, for the purposes of 9.1 one of the following assumptions must be made, namely that;

(1) the change from the date it occurred was provided for in the contract when it was made;

(2) the terms of the contract are those which apply from the date of the change except that a single *premium* is payable, at the date of the change, of an amount equal to the liability under the policy immediately before the change, calculated on a basis consistent with this Part and with the *premiums* actually payable from the date of the change; or

(3) the contract is in two parts, the first of which is for the benefits purchased by the actual *premiums* payable from the date of the change under the *firm's* scales of *premiums* at that date, and the second of which is for all other benefits under the policy for which no *premiums* are payable after that date.

9.3 Where under a contract (not being a *linked long-term contract of insurance*) the *policyholder* is eligible to participate in any *established surplus*; and

(1) each *premium* paid increases the benefits (other than benefits arising from a distribution of surplus) provided under the contract; or

(2) the amount of a *premium* payable in future is not determinable until it comes to be paid,

future *premiums* and the corresponding liability may be left out of account so long as adequate provision is made against any risk that the increase in the liabilities of the *firm* resulting from the payment of future *premiums* might exceed the amount of the *premiums*.

9.4 An alternative valuation method to that described in 9.1 to 9.3 may be used where it can be demonstrated that the alternative method results in reserves no less, in aggregate, than would result from use of the method described in 9.1 to 9.3.

## 10 ACQUISITION EXPENSES

10.1 In order to take account of acquisition expenses, the maximum annual *premium* to be valued under 9 may, subject to 10.2, be increased by an amount not greater than the equivalent, taken over the whole period of *premium* payments and calculated according to the rates of interest and rates of mortality or disability employed in valuing the contract, of 3.5% (or the *defined percentage*, if it is lower than 3.5%) of the *relevant capital sum* under the contract.

10.2 The increase permitted by 10.1 must be subject to the limitation that the amount of a future *premium* valued must not in any event be greater than the amount of the *premium* actually payable by the *policyholder*.

## 11 RATES OF INTEREST

11.1 The rates of interest to be used in calculating the present value of future payments by or to a *firm* must be no greater than the rates of interest determined from a prudent assessment of the yields on existing assets attributed to the *long-term insurance business* and, to the extent appropriate, the yields which it is expected will be obtained on sums to be invested in the future.

11.2 For the purposes of 11.1, the assumed yield on an asset attributed to the *long-term insurance business*, before any adjustment to take account of the effect of taxation, must not exceed the yield on that asset calculated in accordance with 11.3 to 11.13, reduced by 2.5% of that yield.

11.3 For the purpose of calculating the yield on an asset:

(1) the asset must be valued in accordance with the Friendly Society – Asset Valuation Part of the *PRA* Rulebook, excluding any provision under which assets may be taken at lower book values for the purposes of an investigation to which IPRU(FSOC) 5.1 or 5.2 of the *PRA Handbook* as at 31 December 2015 applies pursuant to Non-Solvency II Firms – Transitional Measures 3; and

(2) the future income from the asset required to be taken into account (whether interest, dividends or repayment of capital) must be reduced by a proportion corresponding to such part of any excess *exposure* to assets of that description, calculated in accordance with Friendly Society – Asset Valuation 22.2, as may reasonably be attributed to such assets.

11.4 For *fixed interest securities* the yield on an asset, subject to 11.13, must be that annual rate of interest which, if used to calculate the present value of future payments of interest before the deduction of tax and the present value of repayments of capital, would result in the sum of those amounts being equal to the value of the asset.

11.5 (1) For *variable interest investments* that are equity *share*s (other than those within 11.6) or land, the yield on an asset must, subject to 11.13, be the ratio to the value of the asset of the income before deduction of tax which would be received in the period of twelve *months* following the *valuation date* on the assumption that the asset will be held throughout that period and that the factors which affect income will remain unchanged.

(2) Account must be taken of any changes in the factors referred to in (1) known to have occurred by the *valuation date* and in particular:

(a) any known changes in the rental income from property or in dividends on equity *shares*;

(b) any forecast changes in dividends which have been publicly announced by the *valuation date*;

(c) the effect of any alterations in capital structure; and

(d) the value (at the most recent date for which it is known at the *valuation date*) of any determinant of the amount of any future interest payment, such value being deemed to remain unaltered for all subsequent dates.

11.6 For *variable interest investments* that are equity *shares* in *bodies corporate* drawing up accounts in accordance with legislation implementing the *Accounts Directives* or in accordance with the International Accounting Standards Committee accounting standards or US generally accepted accounting practice, the yield on an asset must, subject to 11.14, be the ratio to the value of the asset of:

(1) A + B; or

(2) 2 times A,

whichever is lower, where A = the income which would be received if it were calculated in accordance with 11.5, and B = half the excess (if any) of the relevant amount over A, but B must not be less than zero.

11.7 For the purposes of 11.6, the ‘relevant amount’ in relation to equity *shares* is the *issuer’s* profits after taxation from its ordinary activities for the most recent financial year ending on or before the *valuation date* which is reported in accounts in accordance with 11.8 which are publicly available, in so far as attributable to those equity *shares*, taking account of the effect of any alterations in capital structure.

11.8 For the purposes of 11.7, the *issuer’s* profits after taxation from its ordinary activities for the relevant financial year must be derived from accounts drawn up in accordance with legislation implementing the *Accounts Directives* or, if accounts are not drawn up in accordance with the *Accounts Directives*, from accounts drawn up in accordance with International Accounting Standards Committee accounting standards or US generally accepted accounting practice.

11.9 Where 11.6 applies, and a *undertaking’s* accounting period is longer or shorter than a year, the amount of profits or losses for that period must be annualised, and the annualised figure must be used to calculate the yield.

11.10 If the requirements in 11.7 and 11.8 are not, or cannot be, met, then the relevant amount is zero.

11.11 Subject to 11.12, for *variable interest investments* other than equity *shares* or land, the yield on an asset must, subject to 11.13, be that annual rate of interest which, if used to calculate the present value of future payments of interest (before deduction of tax), and the present value of repayments of capital, where applicable, would result in the sum of these amounts being equal to the value of the asset, on the assumption that:

(1) the value of any determinant of the amount of the next interest rate payment and capital repayment made during the following 12 *months* will be the value of that determinant at the most recent date for which it is known at the *valuation date*;

(2) the amount of future interest payments and capital repayments will take account, where appropriate, of:

(a) the right of either party to have the investment repaid, and

(b) an assumed yield on other comparable investments made in the future not exceeding an amount determined in accordance with 11.15 to 11.17; and

(3) indices and all other factors which affect future income payments or capital repayment will remain unchanged after the *valuation date*.

11.12 For investments in *collective investment schemes* given a value as an asset in accordance with Friendly Society – Asset Valuation 13, the yield may be determined as the weighted average of the yields (as determined by this Chapter) on each of the investments held by the *collective investment scheme.*

11.13 In calculating the yield on an asset under this Chapter:

(1) for an asset other than equity *shares* or land:

(a) a prudent adjustment must be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due; and

(b) in making that adjustment, regard must be had wherever possible to the yields on risk-free investments of a similar term in the same currency;

(2) for equity *share*s or land, adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each category of assets of a similar nature, type and degree of risk that is needed to compensate for the risk that the aggregate income from such category of assets, taking one year with another, might not be maintained.

11.14 Notwithstanding 11.13(2), for equity *shares* within 11.6, adjustments to yields must be made as appropriate to exclude that part, if any, of the yield from each category of assets of a similar nature, type and degree of risk that is needed to compensate for the risk that the aggregate profits earned by a *undertaking* might not be maintained.

11.15 To the extent that it is necessary to make an assumption about the yields which will be obtained on sums to be invested in future, the yield must be determined in accordance with 11.16 and 11.17.

11.16 Where the liabilities are denominated in *UK* sterling, the yield assumed, before any adjustments to take account of the effect of taxation;

(1) on any investment to be made more than three years after the *valuation date*, must not exceed the lowest of:

(a) the long-term gilt yield current on the *valuation date*,

(b) 3% per annum, increased by two-thirds of the excess, if any, of the long-term gilt yield current on the *valuation date* over 3% per annum, or

(c) 6.5% per annum, where "the long-term gilt yield" means the annualised equivalent of the 15 year yield for United Kingdom Government *fixed interest securities* jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and

(2) on any investment to be made at any time not more than three years after the *valuation date* must not exceed the assumed yield determined under 11.2 adjusted linearly over the said three years to the yield determined in accordance with (1).

11.17 Where the liabilities are denominated in currencies other than *UK* sterling, the yield must be determined on assumptions that are as prudent as those made under 11.16.

11.18 (1) In no case must a rate of interest determined for the purposes of 11.1 exceed the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets arrived at under 11.2.

(2) In calculating the weighted averaged referred to in (1):

(a) the weight given to each investment must be its value as an asset determined in accordance with the Friendly Society – Asset Valuation, except where asset*s* may be taken at lower book values for the purposes of any investigation to which IPRU(FSOC) 5.1 or 5.2 of the *PRA Handbook* as at 31 December 2015 applies pursuant to Non-Solvency II Firms – Transitional Measures 3; and

(b) except in relation to the rate of interest used in valuing payments of *property linked benefits*, both the yield and the value of any *linked assets* must be omitted from the calculation.

## 12 RATES OF MORTALITY AND DISABILITY

12.1 A *firm* must determine the amount of the liability in respect of any category of contract, where relevant, on the basis of prudent rates of mortality and disability and any other decrement that take into account:

(1) where the *policyholder* is an individual, the state in which he has his habitual residence; and

(2) where the *policyholder* is not an individual, the state in which the establishment of the *policyholder* to which the commitment covered by the contract relates is situated.

## 13 EXPENSES

13.1 In accordance with 13.2, a *firm's* provision for expenses, whether implicit or explicit, must not be less than the amount required, on prudent assumptions, to meet the total net cost (after taking account of the effect of taxation) that would be likely to be incurred in fulfilling contracts if the *firm* were to cease to transact new business twelve *months* after the *valuation date*.

13.2 The provision mentioned in 13.1 must have regard to the *firm*'s actual expenses in the last twelve *months* before the *valuation date* and the effects of inflation on future expenses on prudent assumptions as to the future rates of increase in prices and earnings.

## 14 OPTIONS

14.1 A *firm* must make provision on prudent assumptions to cover any increase in liabilities caused by *policyholder*s exercising *options* under their contracts.

14.2 Where a contract includes an *option* whereby the *policyholder* may secure a guaranteed cash payment within twelve *months* following the *valuation date*, the provision for that *option* must be such as to ensure that the value placed on the contract is not less than the amount required to provide for the payments that would have to be made if the *option* were exercised.

14.3 Where a contract includes an option whereby the *policyholder* may secure a cash payment but 14.2 does not apply, the provision for that option must be such as to ensure that, if the assumptions adopted for the valuation of the contract are fulfilled in practice:

(1) the resulting value is not less than the amount required to provide for the payment which would have to be made if the option were exercised; and

(2) the payment when it falls due is covered from resources arising solely from the contract and from the assets covering the amount of the liability determined at the current valuation.

14.4 For the purposes of 14.3 the amount of a cash payment secured by the exercise of an option is assumed to be:

(1) in the case of an *accumulating with-profits policy*, the lower of:

(a) the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *firm*; and

(b) the amount in (a), disregarding all discretionary adjustments; and

(2) in the case of any other policy to which this Chapter applies, the amount which would reasonably be expected to be paid if the option were exercised, having regard to the representations of the *firm*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus* or in anticipation of such additions.

## 15 CONTRACTS NOT TO BE TREATED AS ASSETS

15.1 A *firm* must not treat any *contract of long-term insurance* as an asset.

## 16 PROFITS FROM VOLUNTARY DISCONTINUANCE

16.1 A *firm* must not make allowance in the valuation for the voluntary discontinuance of any *contract of insurance* if the amount of the liability so determined would thereby be reduced.

**Annex O**

In this Annex, the text is all new and is not underlined.

**Part**

# NON-SOLVENCY II FIRMS – GOVERNANCE

**Chapter content**

## 1 APPLICATION AND DEFINITION

1.1 Unless otherwise stated, this Part applies to:

(1) a *non-directive insurer*; and

(2) subject to 1.2, a *Swiss general insurer*.

1.2 Only Chapters 2, 5, 6 and 7 apply to a *Swiss general insurer* and only in respect of the activities of the *firm* carried on from a *branch* in the *UK*.

1.3 In this Part, the following definition shall apply:

*registered branch*

means a branch of a *registered friendly society* which is separately registered within the meaning of the Friendly Societies Act 1974.

## 2 GENERAL GOVERNANCE FOR SMALL NON-DIRECTIVE INSURERS

2.1 This Chapter only applies to a *small non-directive insurer* and a *Swiss general insurer*.

2.2 A *firm* must take reasonable care to establish and maintain such systems and controls as are appropriate to its business.

2.3 A *firm* must take reasonable steps to establish and maintain adequate *internal controls*.

2.4 A *firm* must have in place an effective risk-management system.

2.5 A *firm's* risk-management system must ensure that the *firm's governing body* is furnished with the information it needs to contribute to identifying, measuring, managing and controlling risks which relate to the safety and soundness of *firms*.

2.6 A *firm* must establish and maintain appropriate systems and controls for managing *operational risk* that can arise from inadequacies or failures in its processes and systems (and, as appropriate, the systems and processes of third party suppliers, agents and others).

2.7 A *firm* must establish and maintain appropriate systems and controls for the management of its IT system risks.

2.8 A *firm* must establish and maintain appropriate systems and controls for the management of the risks involved in expected changes.

2.9 A *firm* must provide for an effective internal audit function.

2.10 The internal audit function must monitor the appropriateness and effectiveness of the *firm's* systems and controls.

2.11 The internal audit function must provide independent assurance to the *firm's governing body*, audit committee or an appropriate senior manager of the integrity and effectiveness of the *firm's* systems and controls.

## 3 GENERAL GOVERNANCE FOR LARGE NON-DIRECTIVE INSURERS

3.1 This Chapter only applies to a *large non-directive insurer*.

3.2 (1) A *firm* must have in place an effective system of governance which provides for sound and prudent management of its business.

(2) The system of governance must include at least:

(a) an adequate transparent organisational structure with a clear allocation and appropriate segregation of responsibilities; and

(b) an effective system for ensuring the transmission of information.

(3) The system of governance must include compliance with the requirements laid down in:

(a) 3.5

(b) 4 to 10 (as applicable);

(c) Large Non-Solvency II Firms – Fitness and Propriety 2.1 to 2.3, 4.1, 4.3 and 4.4; and

(d) Large Non-Solvency II Firms – Allocation of Responsibilities 4.

(4) The system of governance must be subject to regular internal review.

3.3 A *firm's* system of governance must be proportionate to the nature, scale and complexity of its operations.

3.4 A *firm* must:

(1) have written policies in relation to at least risk management, internal control, internal audit and, where relevant, *outsourcing*;

(2) make those policies subject to prior approval of its *governing body*;

(3) ensure those policies are implemented;

(4) review those policies at least annually; and

(5) adapt those policies in view of any significant change in the system or area concerned.

3.5 The written policy on risk management referred to in 3.4(1) must comprise at least the specific policies required by 7.2.

3.6 A *firm* must take reasonable steps to ensure continuity and regularity in the performance of its activities, including the development of contingency plans, to which end, the *firm* must employ appropriate and proportionate systems, resources and procedures.

## 4 GOVERNANCE FOR NON-DIRECTIVE FRIENDLY SOCIETIES

4.1 This Chapter only applies to a *non-directive insurer* that is also a *non-directive friendly society*.

4.2 A *firm* must take reasonable steps to ensure that it does not carry on activities beyond its powers.

4.3 A *firm* must take reasonable steps to ensure that it and its *registered branches* comply with:

(1) any requirements of or under the Friendly Societies Act 1992 or *FSMA* which relate to the conduct of its *insurance business*; and

(2) any requirement which is otherwise applicable to its insurance activities.

4.4 A *firm* must supervise the activities of any:

(1) *subsidiary*;

(2) *jointly controlled body*; and

(3) *registered branch* of the *firm;*

with due care and diligence, having due regard to the interests of its *policyholders* and without detriment to the conduct of the *firm's* activities.

4.5 A *firm* must ensure that every *jointly controlled body* and *registered branch* complies with:

(1) 2.2 or 3.2, whichever is applicable; and

(2) any applicable requirements of *FSMA* and the Friendly Societies Act 1992.

4.6 A *firm* must and must procure that each *registered branch*:

(1) keeps adequate accounting records; and

(2) establishes and maintains adequate systems of control of its business and records and of inspection and reporting.

4.7 A *firm* must ensure that the systems of control and of inspection and reporting are adequate to enable the *governing body* to properly discharge:

(1) the duties imposed on it by or under *FMSA*, the Friendly Societies Act 1992 or the Friendly Societies Act 1974; and

(2) the functions of direction of the affairs of the *friendly society* or *registered branch.*

No such system of control will be treated as adequate unless there is kept available to the *governing body* a detailed statement in writing of the system as in operation for the time being.

4.8 A *firm* must ensure that the systems of control and of inspection and reporting ensure that its:

(1) activities are conducted; and

(2) records that are kept are:

(a) sufficiently accurate; and

(b) available when required,

to enable the *governing body* to discharge its duties and functions.

4.9 A *firm* must within the period of 6 months beginning with the end of each *financial year* make and send to the *PRA* a statement of their opinion whether the requirements of 4.6 to 4.8 have been complied with in respect of that year by the *firm* and the statement must be signed by the chairman on behalf of the *governing body* and by the chief executive.

## 5 OUTSOURCING

5.1 A *firm* must take reasonable care to supervise the discharge of *outsourced* functions by an *outsourced* provider.

5.2 A *firm* must take steps to obtain sufficient information from its *outsourced* provider to enable it to assess the impact of *outsourcing* on its systems and controls.

5.3 Before entering into, or significantly changing, an *outsourcing* arrangement, a *firm* must:

(1) analyse how the arrangement will fit with its organisation and reporting structure, business strategy, overall risk profile and ability to meet its regulatory obligations;

(2) consider whether the agreements establishing the arrangement will allow it to monitor and control its operational risk exposure relating to the *outsourcing*;

(3) conduct appropriate due diligence of the service provider's financial stability and expertise; and

(4) consider how it will ensure a smooth transition of its operations from its current arrangements to a new or changed *outsourcing* arrangement, including what will happen on the termination of the contract or following a significant loss of services from the service provider.

## 6 RECORDS

6.1 A *firm* must take reasonable care to make and retain adequate records of matters and dealings (including accounting records) which are the subject of requirements and standards under the *regulatory system*.

6.2 The records required by 6.1 must be capable of being reproduced on paper and:

(1) in English; or

(2) if a *firm's* records relate to business carried on from an establishment in a country or territory outside the *UK*, the official language of that country or territory.

6.3 A *firm* must make and regularly update accounting and other records that are sufficient to enable the *firm* to demonstrate to the *PRA*:

(1) that the *firm* is financially sound and has appropriate systems and controls;

(2) the *firm's* financial position and exposure to risk (to a reasonable degree of accuracy); and

(3) the *firm's* compliance with applicable rules.

6.4 A *firm* must retain the records in 6.1 and 6.3 for the longer of either:

(1) three years; or

(2) for as long as they are relevant for the purposes for which they were made.

6.5 A *firm* must be able to make available the records in 6.1 and 6.3 within a reasonable timeframe when requested to do so by the *PRA*.

6.6 A *firm* must keep the records required in 6.1 and 6.3 in the *UK*, except where:

(1) they relate to business carried on from an establishment in a country or territory that is outside the *UK*; and

(2) they are kept in that country or territory.

6.7 When a *firm* keeps the records required in 6.1 and 6.3 outside the *UK*, it must periodically send an adequate summary of those records to the *UK*.

## 7 BUSINESS PLANNING AND RISK MANAGEMENT

7.1 A *firm* must take reasonable steps to ensure the establishment and maintenance of:

(1) a business plan; and

(2) appropriate systems for the management of prudential risk.

7.2 A *firm's* business planning must involve the creation and maintenance of specific risk policies that outline a *firm's* strategy and objectives for the identification and management of at least its market, credit, liquidity, *reinsurance*, operational, insurance and group risks and the processes that it intends to adopt to achieve these objectives.

7.3 When establishing and maintaining its business plan and prudential risk management systems, a *firm* must document:

(1) an explanation of its overall business strategy, including its business objectives;

(2) a description of, as applicable, its policies towards market, credit (including provisioning), liquidity, operational, insurance and group risks (that is, its risk policies), including its appetite or tolerance for these risks and how it identifies, measures or assesses, monitors and controls these risks;

(3) the systems and controls that it intends to use in order to ensure that its business plan and risk policies are implemented correctly;

(4) a description of how the *firm* accounts for assets and liabilities, including the circumstances under which items are netted, included or excluded from the *firm's* balance sheet and the methods and assumptions for valuation;

(5) appropriate financial projections and the results of its stress testing and scenario analysis;

(6) details of, and the justification for, the methods and assumptions used in financial projections and stress testing and scenario analysis; and

(7) its procedures to allow managers to monitor the application and effect of its *reinsurance* programme.

7.4 A *firm's* business plan and risk management systems must be effectively communicated so that all *employees* understand and adhere to the procedures related to their own responsibilities.

## 8 INTERNAL CONTROL

8.1 This Chapter only applies to a *large non-directive insurer*.

8.2 (1) A *firm* must have in place an effective internal control system.

(2) That system must include administrative and accounting procedures, an internal control framework, appropriate reporting arrangements at all levels of the *firm* and a compliance *function*.

8.3 The compliance *function* referred to in 8.2(2) must include:

(1) advising the *governing body* on compliance with applicable rules; and

(2) an assessment of the possible impact of any changes in the legal environment on the operations of the *firm* concerned and the identification and assessment of compliance risk.

8.4 A *firm* must have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of its *technical provisions*.

## 9 INTERNAL AUDIT

9.1 This Chapter only applies to a *large non-directive insurer*.

9.2 (1) A *firm* must provide for an effective internal audit *function*.

(2) The internal audit *function* must:

(a) include an evaluation of the adequacy and effectiveness of the internal control system and other elements of the system of governance; and

(b) be objective and independent from the operational *functions*.

(3) A *firm* must ensure that any findings and recommendations of the internal audit *function* are reported to the *firm's governing body* which must:

(a) determine what actions are to be taken with respect to each of the internal audit findings and recommendations; and

(b) ensure that those actions are carried out.

## 10 ACTUARIAL FUNCTION

10.1 This Chapter only applies to a *large non-directive insurer*.

10.2 A *firm* must provide for an effective actuarial *function* to:

(1) coordinate the calculation of *technical provisions*;

(2) ensure the appropriateness of the methodologies and underlying models used, as well as the assumptions made in the calculation of *technical provisions*;

(3) assess the sufficiency and quality of the data used in the calculation of *technical provisions*;

(4) inform the *governing body* of the reliability and adequacy of the calculation of *technical provisions*;

(5) express an opinion on the overall underwriting policy;

(6) express an opinion on the adequacy of *reinsurance* arrangements; and

(7) contribute to the effective implementation of the risk management system referred to in 7.1.

10.3 The actuarial *function* must be carried out by *persons* who have knowledge of actuarial and financial mathematics, commensurate with the nature, scale and complexity of the risks inherent in the *firm's* business, and who are able to demonstrate their relevant experience with applicable professional and other standards.

**Annex P**

In this Annex, all text is new and is not underlined.

**Part**

# NON-SOLVENCY II FIRMS – WITH-PROFITS

**Chapter content**

## 1 APPLICATION

1.1 Subject to 1.2, this Part applies to a *non-directive insurer* carrying on *with-profits insurance business*.

1.2 This Part does not apply to *with-profits insurance business* that consists of *effecting contracts of insurance* or *carrying out contracts of insurance* that are *Holloway sickness policies*.

## 2 ASSETS IN THE WITH-PROFITS FUND

2.1 A *firm, other than a friendly society,* must ensure that it holds *admissible assets* in each of its *with-profits funds* of a value (calculated in accordance with Insurance Company – Overall Resources and Valuation) sufficient to cover the *with-profits policy liabilities* in respect of all of the business written in, or transferred into, that *with-profits fund*.

2.2 A *friendly society* must ensure that it holds assets in each of its *with-profits funds* of a value (calculated in accordance with Friendly Society – Asset Valuation) sufficient to cover the *with-profits policy liabilities* in respect of all of the business written in, or transferred into, that *with-profits fund*.

## 3 DISTRIBUTION STRATEGIES

3.1 A *firm* must ensure at all times that its strategy for distribution of discretionary benefits in respect of each of its *with-profits funds*:

(1) is affordable and sustainable; and

(2) cannot reasonably be expected to have an adverse effect on the safety and soundness of the *firm* as a whole, or on the benefit security of all *policyholders* of the *firm*.

## 4 SUPPORT ARRANGEMENTS

4.1 If a *firm* is using, or intends to use, *support arrangements* to contribute to benefit security for the *policyholders* of a *with-profits fund,* it must ensure that:

(1) all the terms and conditions governing those *support arrangements*, including the circumstances in which they take effect and the terms on which they are or may be repayable, are adequately documented in the *firm's* records; and

(2) the extent of any restrictions on the *firm's* use of those *support arrangements* is clearly identified.

**Annex Q**

In this Annex, the text is all new and is not underlined.

**Part**

# NON-SOLVENCY II FIRMS – ACTUARIAL REQUIREMENTS

**Chapter content**



**Links**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer*.

1.2 Chapters 2 to 6 only apply to a *long-term insurer* other than:

(1) a *registered friendly society*; and

(2) an *incorporated friendly society* that is a *flat rate benefits business friendly society*.

1.3 Chapter 7 only applies to:

(1) a *registered friendly society*; and

(2) an *incorporated friendly society* that is a *flat rate benefits business friendly society*.

1.4 This Part applies to an *actuary* appointed under 2 or 7 or appointed under or as a result of a statutory provision other than in *FSMA*.

1.5 In this Part, the following definitions shall apply:

*actuarial function*

means the function of acting in the capacity of an *actuary* appointed by a firm under 2.1(1) to perform the duties set out in 5.

*appropriate actuary*

means an *actuary* appointed under 7.1

*Chief Executive function*

means the *PRA controlled function* CF3 in the table of *PRA controlled functions* in SUP 10B.4.3 R of the *PRA Handbook*, described more fully in SUP 10B.6.7 R of the *PRA Handbook*.

*With-Profits Actuary function*

means the function of acting in the capacity of an *actuary* appointed by a *firm* under 2.1(2) to perform the duties set out in 6.

## 2 APPOINTMENT OF ACTUARIES

2.1 A *firm* must appoint one or more *actuaries* to perform and be responsible for:

(1) the *actuarial function* in respect of all classes of its *long-term insurance business*; and

(2) the *With-Profits Actuary function* in respect of all classes of its *with-profits insurance business* (if any).

2.2 A *firm* must:

(1) when it becomes aware that a vacancy of an *actuary* required under 2.1 will arise or has arisen:

(a) notify the *PRA*; and

(b) give reasons for the vacancy,

without delay, using the form referred to in Notifications 10.3;

(2) appoint an *actuary* to fill any vacancy of an *actuary* required under 2.1;

(3) ensure that the replacement *actuary* can take up the vacant post at the time the vacancy arises or as soon as reasonably practicable after that; and

(4) when a new *actuary* is appointed:

(a) notify the *PRA* of that appointment; and

(b) advise the *PRA* of the name and business address of the *actuary* appointed and the date from which the appointment has effect,

using the form referred to in Notifications 10.3.

2.3 Where a *firm* fails to appoint an *actuary* under 2.1 within 28 days of a vacancy arising the *PRA* may appoint an *actuary* to perform either of the functions in 2.1(1) or (2) for that *firm* on the following terms:

(1) the *actuary* to be remunerated by the *firm* on the basis agreed between the actuary and *firm* or, in the absence of agreement, on a reasonable basis; and

(2) the *actuary* to perform the function required under 2.1 until he resigns or the *firm* appoints another *actuary*.

2.4 A *firm* must comply with and is bound by the terms on which an *actuary* has been appointed by the *PRA*.

2.5 Where the *PRA* appoints an *actuary* to perform either of the functions in 2.1(1) or (2) for a *firm*, the requirements under 2.1 to make appointments under that rule still apply to that *firm*.

## 3 ACTUARIES' QUALIFICATIONS

3.1 Before a *firm* appoints an *actuary* under 2.1, it must take reasonable steps to ensure that the *actuary* has the required skill and experience to perform his functions under the *regulatory system* commensurate with the nature, scale and complexity of the *firm's* business and the requirements and standards under the *regulatory system* to which it is subject.

3.2 A *firm* must not appoint as *actuary* a *person* who is disqualified under Part XXII of *FSMA* from acting as an *actuary* either for that *firm* or for a relevant class of *firm*.

3.3 A *firm* must take reasonable steps to ensure that an *actuary*, which it is planning to appoint or has appointed, provides information to the *PRA* about the *actuary's* qualifications, skills, experience and any other relevant matters in accordance with the reasonable requests of the *PRA*.

## 4 CONFLICTS OF INTEREST

4.1 A *firm* must take reasonable steps to ensure that an *actuary* that it appoints:

(1) does not perform the *Chief Executive function*;

(2) does not, if he is to perform the *With-Profits Actuary function*, become a member of the *firm's governing body*; and

(3) does not perform any other function on behalf of the *firm* which could give rise to a significant conflict of interest.

## 5 THE ACTUARIAL FUNCTION

5.1 An *actuary* appointed to perform the *actuarial function* must, in respect of those classes of the *firm's long-term insurance business* which are covered by his appointment:

(1) advise the *firm's* management, at the level of seniority that is reasonably appropriate, on the risks the *firm* runs in so far as they may have a material impact on the *firm's* ability to meet *liabilities to policyholders* in respect of *contracts of long-term insurance* as they fall due and on the capital needed to support the business, including regulatory capital requirements;

(2) monitor those risks and inform the *firm's* management, at the level of seniority that is reasonably appropriate, if he has any material concerns or good reason to believe that the *firm*:

(a) is not meeting *liabilities to policyholders* under *contracts of long-term insurance* as they fall due, or may not be doing so, or might not have done so, or might, in reasonably foreseeable circumstances, not do so;

(b) is, or may be, effecting new *contracts of long-term insurance* on terms under which the resulting income earned is insufficient, under reasonable actuarial methods and assumptions, and taking into account the other financial resources that are available for the purpose, to enable the *firm* to meet its *liabilities to policyholders* as they fall due (including amounts required to enable the *firm* to fulfil its regulatory duty to treat its customers fairly under any relevant provision in the *FCA Handbook*);

(c) does not, or may not, have sufficient financial resources to meet *liabilities to policyholders* as they fall due (including reasonable bonus expectations) and the capital needed to support the business, including regulatory capital requirements or, if the *firm* currently has sufficient resources, might, in reasonably foreseeable circumstances, not continue to have them;

(3) advise the *firm's governing body* on the methods and assumptions to be used for the investigations required by IPRU(INS) rule 9.4 or IPRU(FSOC) rule 5.1, each of the *PRA Handbook* as at 31 December 2015;

(4) perform those investigations and calculations in (3), in accordance with the methods and assumptions determined by the *firm's governing body*;

(5) report to the *firm's governing body* on the results of the investigations and calculations in (3);

(6) in the case of a *friendly society*, perform the functions of the appropriate actuary under section 87 (Actuary's report as to margin of solvency) of the Friendly Societies Act 1992; and

(7) if applicable, be responsible for the actuarial *function* required by Governance 10.2.

## 6 WITH-PROFITS ACTUARY FUNCTION

6.1 An *actuary* appointed to perform the *With-Profits Actuary function* must:

(1) advise the *firm's* management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the *with-profits insurance business* of the *firm* in respect of which he has been appointed;

(2) at least once a year, report to the *firm's governing body* on key aspects (including those aspects of the *firm's* application of its *PPFM* on which the advice described in (1) has been given) of the discretion exercised in respect of the period covered by his report affecting those classes of *with-profits insurance business* of the *firm*;

(3) request from the *firm* such information and explanations as he reasonably considers necessary to enable him properly to perform the duties in (1) and (2);

(4) advise the *firm* as to the data and systems that he reasonably considers necessary to be kept and maintained to provide the duties in (3); and

(5) in the case of a *friendly society*, perform the function of appropriate actuary under section 12 (Reinsurance) of the Friendly Societies Act 1992 or section 23A (Reinsurance) of the Friendly Societies Act 1974 as applicable, in respect of those classes of its *with-profits insurance business* covered by his appointment.

## 7 APPROPRIATE ACTUARY

7.1 A *firm* must:

(1) appoint an *appropriate actuary* to carry out the triennial investigation and prepare an abstract of the report as required by IPRU(FSOC) rule 5.2(2) of the *PRA Handbook* as at 31 December 2015 and provide the interim certificate or statement as required by IPRU(FSOC) rule 5.2(3) of the *PRA Handbook* as at 31 December 2015; and

(2) appoint a replacement for that *actuary* if he ceases to hold office before he has carried out the duty described in (1).

7.2 A *firm* must not appoint as *appropriate actuary* a *person* who is disqualified under Part XXII of *FSMA* (Auditors and Actuaries) from acting as an *actuary* either for that *firm* or for a relevant class of *firm*.

## 8 DUTIES OF ACTUARIES

8.1 An *actuary* appointed under this Part must be objective in performing his duties.

8.2 An *actuary* appointed under this Part must take reasonable steps to satisfy himself that he is free from bias, or from any conflict of interest from which bias may reasonably be inferred. He must take appropriate action where this is not the case.

8.3 When carrying out his duties, an *actuary* appointed under this Part must pay due regard to generally accepted actuarial practice.

8.4 An *appropriate actuary* must carry out the triennial investigation and prepare an abstract of the report as required by IPRU(FSOC) rule 5.2(2) of the *PRA Handbook* as at 31 December 2015 and provide the interim certificate or statement as required by IPRU(FSOC) rule 5.2(3) of the *PRA Handbook* as at 31 December 2015.

8.5 An *actuary* must notify the *PRA* without delay if the *actuary*:

(1) is removed from office by a *firm*;

(2) is formally notified of such removal from office;

(3) resigns before the term of office expires;

(4) is not re-appointed by a *firm*; or

(5) is disqualified from being the *actuary* of:

(a) any *undertaking* or particular class of *undertaking*; or

(b) any *firm* or particular class of *firm*.

8.6 In the circumstances set out in 8.5, the *actuary* must notify the *PRA* without delay:

(1) of any matter connected with the removal or ceasing of the office of *actuary* that the *actuary* thinks ought to be drawn to the *PRA's* attention; or

(2) that there is no such matter.

**Annex R**

In this Annex, the text is all new and is not underlined.

**Part**

# RUN-OFF OPERATIONS

**Chapter content**



**Links**

**APPLICATION AND DEFINITIONS**

1.1 Unless otherwise stated, this Part applies to a *non-directive insurer.*

1.2 In this Part, the following definitions shall apply:

*close links*

has the meaning given in section 4F(3) of Schedule 6 to *FSMA*.

*material transaction*

means a transaction (or a series of similar transactions in aggregate) in which:

(1) the price actually paid or received for the transfer of assets or liabilities or the performance of services; or

(2) the price which would have been paid or received had that transaction been negotiated at arm's length between unconnected parties;

exceeds:

(a) in the case of a *firm* which carries on *long-term insurance business*, but not *general insurance business*, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *long-term insurance business*, excluding *linked long-term liabilities* and net of *reinsurance* ceded; or

(b) in the case of a *firm* which carries on *general insurance business*, but not *long-term insurance business*, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *general insurance business*, net of *reinsurance* ceded; or

(c) in the case of a *firm* which carries on both *long-term insurance business* and *general insurance business*:

(i) where the transaction is in connection with the *firm's long-term insurance business*, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *long-term insurance business*, excluding *linked long-term liabilities* and net of *reinsurance* ceded; and

(ii) in all other cases, the sum of €20,000 and 5% of the *firm's* liabilities arising from its *general insurance business*, net of *reinsurance* ceded.

*scheme of operations*

means a scheme which:

(1) describes the nature of the risks which the *firm* is underwriting, or intends to underwrite, and the guiding principles which it intends to follow in reinsuring or covering those risks; and

(2) contains the information required under 6.

**CEASING TO EFFECT CONTRACTS OF INSURANCE**

2.1 If a *firm* decides to cease to effect new *contracts of insurance* in respect of the whole of its insurance business, it must, within 28 days of that decision, submit a run-off plan to the *PRA* including:

(1) a *scheme of operations* in accordance with 6; and

(2) an explanation of how, or to what extent, all *liabilities to policyholders* will be met in full as they fall due.

2.2 For the purposes of 2.1, a new *contract of insurance* excludes contracts effected under a term in a subsisting *contract of insurance*.

**MARGIN OF SOLVENCY BELOW REQUIRED MARGIN OF SOLVENCY**

3.1 This Chapter only applies to a *non-directive friendly society* (other than a *flat rate benefits business friendly society*).

3.2 If a *firm's margin of solvency* no longer equals to or exceeds its *required margin of solvency*, it must, within 28 days of becoming aware of this event, submit to the *PRA* a plan for the restoration of a sound financial position, including:

(1) a *scheme of operations*; and

(2) an explanation of how, if at all, and by when, it expects its *margin of solvency* to be adequately restored to the *required margin of solvency*.

**MARGIN OF SOLVENCY BELOW GUARANTEE FUND**

4.1 This Chapter only applies to an *incorporated friendly society*.

4.2 If a *firm's margin of solvency* falls below its *guarantee fund*, it must, within 28 days of the *firm* becoming aware of this event, submit to the *PRA*, a short-term financial plan, including:

(1) a *scheme of operations*; and

(2) an explanation of how, if at all, and by when, it expects its *margin of solvency* to be adequately restored to the *guarantee fund*.

**CAPITAL RESOURCES BELOW CR REQUIREMENT**

5.1 This Chapter applies to a *non-directive insurer* (other than a *non-directive friendly society).*

5.2 If a *firm's capital resources* fall below its *CR Requirement*, it must, within 28 days of becoming aware of this event:

(1) notify the *PRA*; and

(2) submit a plan for restoration, which:

(a) explains why the *firm's capital resources* have fallen below its *CR Requirement*; and

(b) demonstrates how, if at all, and by when, it expects its *capital resources* to be restored to its *CR Requirement*.

**CONTENT OF SCHEME OF OPERATIONS**

6.1 In accordance with 6.2, a *scheme of operations* must:

(1) describe the *firm's* run-off strategy;

(2) include a description of the business underwritten by the *firm*;

(3) include the following financial projections (including appropriate scenarios and stress-tests) as applicable:

(a) a forecast summary profit and loss account in accordance with 6.3;

(b) a forecast summary balance sheet in accordance with 6.4;

(c) in the case of a *non-directive friendly society* only, a forecast statement of its *margin of solvency* and *required margin of solvency* at the end of each *financial year* or part *financial year*;

(d) in the case of an *incorporated friendly society* only, a forecast statement of its *margin of solvency* and *guarantee fund* at the end of each *financial year* or part *financial year;* and

(e) in the case of a *non-directive insurer* (other than a *non-directive friendly society)*, a forecast statement of *capital resources* and *the CR Requirement* at the end of each *financial year* or part *financial year;*

(4) as at the end of each *financial year* which falls (in whole or part) within the period to which the *scheme of operations* relates:

(a) describe the assumptions which underlie those forecasts and the reasons for adopting those assumptions; and

(b) identify any *material transactions* proposed to be entered into or carried out with, or in respect of, any associate or any other *person* with whom the *firm* has *close links*;

(5) cover the run-off period until all *liabilities to policyholders* are met.

6.2 The information required by 6.1 must:

(1) in the case of a *non-directive friendly society* (other than a *flat rate benefits business friendly society),* reflect the nature and content of the *rules* relating to the *margin of solvency* and the *required margin of solvency*;

(2) in the case of an *incorporated friendly society,* reflect the nature and content of the *rules* relating to the *margin of solvency* and the *guarantee fund;*

(3) in the case of a *non-directive insurer* (other than a *non-directive friendly society*), reflect the nature and content of the *rules* relating to *capital resources* applicable to a *firm*; and

(4) where a *firm* carries on both *long-term insurance business* and *general insurance business,* be separated for *long-term insurance business* and *general insurance business.*

6.3 The forecast summary profit and loss account referred to in 6.1(3) (a) must contain the following information:

(1) *premiums* and claims (gross and net of *reinsurance*) analysed by accounting *class* of *insurance business*;

(2) investment return;

(3) expenses;

(4) other charges and income;

(5) taxation; and

(6) dividends paid and accrued.

6.4 The forecast summary balance sheet referred to in 6.1(3) (b) must contain the following information:

(1) investments analysed by type;

(2) assets held to cover *linked long-term liabilities*;

(3) other assets and liabilities separately identifying cash at bank and in hand;

(4) capital and reserves analysed into called up share capital or equivalent funds, share premium account, revaluation reserve, other reserves and profit and loss account;

(5) subordinated liabilities;

(6) the fund for future appropriations;

(7) *technical provisions* gross and net of *reinsurance* analysed by accounting *class* of *insurance business* and separately identifying the provision for *linked long-term liabilities*, unearned *premiums*, unexpired risks and equalisation; and

(8) other liabilities and credits.

**SUBMITTED SCHEMES OF OPERATION**

7.1 A firm which has previously submitted a *scheme of operations* to the PRA must, during the period covered by that *scheme of operations*:

(1) notify the *PRA* at least 28 days before entering into or carrying out any *material transaction* with, or in respect of, an associate or any other *person* with whom the *firm* has *close links,* unless that transaction is in accordance with a *scheme of operations* which has been submitted to the *PRA*:

(2) notify the *PRA* promptly of any matter which has happened or is likely to happen and which represents a significant departure from the *scheme of operations* and either:

(a) explain the nature of the departure and the reasons for it and provide revised forecast financial information in 6.1 (3) in the *scheme of operations* for its remaining term; or

(b) provide an amended *scheme of operations* and explain the amendments and the reasons for them.

**Annex S**

In this Annex, the text is all new and is not underlined.

**Part**

# NON-SOLVENCY II FIRMS - TRANSITIONAL MEASURES

**Chapter content**

## 1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to:

(1) a *run-off firm*;

(2) a *non-directive insurer*; and

(3) a *Swiss general insurer.*

1.2 In this Part, the following definitions shall apply:

*application rules*

means any application rule in any Part in the Non-Solvency II Firms Sector of the *PRA* Rulebook.

*run-off firm*

means a *firm* to which, but for the application of Transitional Measures 2.1 to 2.3 in the Solvency II Firms Sector, the *Solvency II rules* would apply.

*Solvency II rules*

means the *PRA* rules in the Valuation, Technical Provisions, Own Funds, Solvency Capital Requirement – General Provisions, Solvency Capital Requirement – Standard Formula, Solvency Capital Requirement – Internal Models, Minimum Capital Requirement, Undertakings in Difficulty, Investments, Composites, Conditions Governing Business, Insurance Special Purpose Vehicles, Group Supervision, Reporting, Surplus Funds, With-Profits, Insurance – Conduct Standards, Insurance – Senior Insurance Management Functions, Insurance – Allocation of Responsibilities and Insurance – Fitness and Propriety Parts of the Solvency II Firms Sector of the *PRA* Rulebook.

## 2 TRANSITIONAL APPLICATION OF RULES IN RELATION TO RUN-OFF FIRMS

2.1 Notwithstanding the *application rules*, each Part in the Non-Solvency II Firms Sector of the *PRA* Rulebook applies to a *run-off firm* for so long as it remains a *run-off firm* as if the *firm* was a *non-directive insurer* and not a *UK Solvency II firm*.

## 3 REPORTING

3.1 A *firm* must comply with the rules in:

(1) IPRU(FSOC) Chapter 5; and

(2) IPRU(INS) Chapters 9 and 12

of the *PRA Handbook* as at 31 December 2015, as they were applicable to the *firm* (including any *waiver*) at that date, in respect of *financial years* ending on or before 31 December 2015.