

**INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS
(FINANCIAL PENALTIES AND CHANGES TO VALUATION AND REPORTING)
INSTRUMENT 2002**

Powers exercised

- A. The Financial Services Authority 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 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force as follows:
- (1) the amendments to rules 2.3 and 4.1 come into force on 31 December 2002; and
 - (2) the remainder of this instrument comes into force on 1 November 2002.

Amendment of the Interim Prudential sourcebook for insurers

- D. IPRU(INS) is amended in accordance with Annex A to this instrument.

Amendment of the Enforcement manual

- E. The Enforcement manual is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Interim Prudential Sourcebook for Insurers (Financial Penalties and Changes to Valuation and Reporting) Instrument 2002.

By order of the Board
17 October 2002

Annex A

Amendments to IPRU(INS)

In this Annex, underlining indicates new text and striking through indicates deleted text.

Financial penalties

Rule 1.1(b) is amended as follows:

- (b) subject to rule 3.5(3) (payment of financial penalties) and rules 3.6 and 3.7 (application of rules to *linked long-term contracts*), an *EEA insurer* qualifying for authorisation under Schedules 3 or 4 to the *Act*.

The heading to rule 3.5 is amended as follows:

Arrangements to avoid unfairness between separate insurance funds, source of funds for payment of financial penalties, etc.

Rule 3.5 is amended by adding the following:

- (3) Where the *FSA* imposes a financial penalty on a *long-term insurer* (including an *insurer* qualifying for authorisation under Schedules 3 or 4 to the *Act*), which is not a *mutual*, the *insurer* must not pay that financial penalty from a *long-term insurance fund*.

Permitted asset exposure limit

Rule 4.1(1) is amended as follows:

- (1) Subject to (2) and to rule 2.3(1), the *Valuation of Assets Rules* apply to the determination of the value of assets of *insurers*.

In Part II of Appendix 4.2 (Assets to be taken into account only to a specified extent), paragraph 13 is amended and a new paragraph 13A is inserted as follows:

13. All *shares* and ~~hybrid~~ *hybrid securities* issued by any one *issuer* taken together with all such *securities* issued by a *connected company* of that *issuer* 2.5%

- 13A. In the case of an *insurer* effecting or carrying out *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 13 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 -

- (a) 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 -

- (i) M = the aggregate market capitalisation of the ordinary *listed* shares in the *issuer*.
 - (ii) T = the aggregate market capitalisation of all *securities* in the Financial Times Stock Exchange All Share Index, and
 - (iii) P = the ‘value of the assets’ supporting the *insurer’s long-term insurance fund*, determined in accordance with the *Valuation of Assets Rules*; and
- (b) value of the assets means the value of the assets –
- (i) less the amount of the *insurer’s mathematical reserves for linked long-term contracts and non-profit policies* net of reinsurance, and
 - (ii) if the *insurer* does not effect or carry out *general insurance contracts*, plus the *insurer’s* net assets outside the *insurer’s long-term insurance fund*.

Aggregation of internal linked funds

In Appendix 9.3 (Long-term insurance business: revenue account and additional information), the following paragraph is added as paragraph 5 of the ‘Instructions for completion of Form 43’ and as paragraph 4 of the ‘Instructions for completion of Form 45’:

Self-invested *internal linked funds* (where the *policy holder* selects the investments to which his or her *policy* is linked) or adviser *internal linked funds* (where a financial adviser selects the investments to which a *policy* is linked) may be aggregated if (in either case) they meet the following conditions:

- (a) there is a precise matching of the assets of the fund with the corresponding unit liabilities;
- (b) there is no negative liquidity in the fund (that is, the sum of the values of *approved securities*, short-term deposits and cash held in the fund exceeds the total of the liabilities in columns 6 and 7 of Form 43); and
- (c) the *policy holder* is periodically (at least annually) provided (by the *insurer* or the financial adviser) with the information on the investments that would otherwise be provided in the *return* if the funds were not aggregated, whether in the format of the relevant Forms or not.

In Appendix 9.4 (Abstract of valuation report prepared by appointed actuary), the following paragraph 9 is added to the ‘Instructions for completion of Form 55’:

- 9. Self-invested *internal linked funds* or adviser *internal linked funds* which meet the conditions in paragraph 5 of the Instructions for completion of Form 43 in Appendix 9.3 may (in either case) be aggregated.

Liability valuation rules

Rule 5.11 (rates of interest) is amended as follows:

- (5B) For the purposes of (5A), the **relevant amount** in relation to equity *shares* is the issuing *company's* profits after taxation from its ordinary activities for the ~~preceding financial year~~ most recent financial year ending on or before the *relevant date* which is reported in accounts drawn up in accordance with (5C) which are publicly available, in so far as attributable to those equity *shares*, so however, without prejudice to the generality of the foregoing, that account is taken of the effect of any alterations in capital structure.
- (5C) For the purposes of (5B), the issuing *company's* profits after taxation from its ordinary activities for the ~~preceding financial year~~ 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.
- (5D) Where (5A) applies, and a *company'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.
- (5E) If the requirements in (5B) and (5C) are not, or cannot be, met, then the relevant amount is zero.

In Appendix 9.4 (Abstract of valuation report prepared by appointed actuary), in the 'Instructions for completion of Form 48', paragraph 7 is amended as follows and the following paragraphs 10 and 11 are added after paragraph 9:

7. The entries at 48.12.3, 48.13.3, 48.14.3 and 48.15.3 must be equal to 49.19.2, 49.29.2, 49.19.5 and 49.29.5 respectively. Subject to paragraphs 10 and 11, the yields to be inserted in column 3 for other categories of asset must be the running yields determined in accordance with rules 5.11(3) to (6A). The entry at 48.29.3 must be the weighted average of the yields in column 3, where the weight given to each asset is the value of that asset applicable for entry into column 1. Assets not producing income must be included in the calculation.
10. To the extent that rule 5.11(5A) has not been, or would otherwise not be required to be, applied to calculate the yield on equity *shares* or holdings in *collective investment schemes*, that rule may be ignored (in which case rule 5.11(5) will apply) for an amount up to the higher of £5 million or 5% of the value of equity *shares* and holdings in *collective investment schemes* required to be reported in Form 48.
11. To the extent that a yield greater than zero on equity *shares* or holdings in *collective investment schemes* is not needed for the purpose of determining rates of interest under rule 5.11, rules 5.11(5) and (5A) may be ignored for an amount of up to 1% of the value of equity *shares* and holdings in *collective investment schemes* required to be reported in Form 48, and the relevant yield will be taken as zero.

Paragraph 3.5 of Guidance Note 4.4 (Linked contracts) is amended as follows:

Material excesses (such as where an *insurer* holds its otherwise non-linked equity portfolio as excess assets in its equity-linked fund) would need to be revalued in accordance with the *Valuation of Asset Rules*. Yields may require to be calculated in accordance with the more complex rule 5.11(5A), rather than rule 5.11(5) (but see paragraphs 10 and 11 of the Instructions for completion of Form 48). (The revaluation is on the proportionate holdings the excess represents and can be performed on an approximate basis if the linked fund is broadly invested.) A material excess is one which satisfies either of the following tests:

- (i)(a) the value of the assets of the fund materially exceeds the unit liability of that fund; or
- (ii)(b) the total excess is material in the context of the *long-term insurance business amount*.

EBRD

In rule 11.1, the definition of *approved financial institution* is amended as follows:

approved financial institution means any of the following –

the European Central Bank;
the central bank of an *EEA State*;
the International Bank for Reconstruction and Development;
the European Bank for Reconstruction and Development;
the International Finance Corporation;
the International Monetary Fund;
the Inter-American Development Bank;
the African Development Bank;
the Asian Development Bank;
the Caribbean Development Bank;
the European Investment Bank;
the European Community;
the European Atomic Energy Community;
and the European Coal and Steel Community.

Accountant General

In rule 11.1, the definition of *approved credit institution* is amended as follows:

an institution recognised or permitted under the law of an *EEA State* to carry on any of the activities set out in Annex 1 to the *Banking Co-ordination Directive* and, for the purposes of a deposit made before 1 December 2001, the Accountant General of the Supreme Court.

Margins of solvency, adequacy of assets and reporting

Rules 2.1 (2) and (3) are amended as follows:

(2) Subject to (3), every *insurer* whose head office is not in ~~an EEA State~~ the United Kingdom must maintain –

(a) a *margin of solvency*; and

(b) a *UK margin of solvency*,

in accordance with the *Margins of Solvency Rules*.

(3) Rule 2.1(2) does not apply to an *insurer* if –

(a) its business in the United Kingdom is restricted to *reinsurance*;

(b) it is a *Swiss general insurer*; ~~or~~

(c) ~~rule 8.1(2) applies to it~~ ~~(1)~~ it is an EEA-deposit insurer; or

(d) it is a UK-deposit insurer which has made a deposit under rule 8.1(2),

but a *UK deposit insurer* which has made a deposit under rule 8.1(2) must maintain –

~~(d)~~(e) an *EEA margin of solvency*; and

~~(e)~~(f) a *margin of solvency*,

in accordance with the *Margins of Solvency Rules*.

Rule 2.3 is amended as follows:

(1) ~~An A-UK~~ An *insurer* must secure –

(a) that its liabilities under *contracts of insurance* ~~entered into by it~~, other than liabilities in respect of ‘linked benefits’, are covered by assets of appropriate safety, yield and marketability having regard to the classes of business carried on; and

(b) without prejudice to the generality of (a), that its investments are appropriately diversified and adequately spread and that excessive reliance is not placed on investments of any particular category or description.

(2) ~~A UK~~ A UK *insurer* which ~~has entered into~~ is carrying out a ‘linked long-term contract’, and an *insurer* whose head office is not in the United Kingdom (other than a *pure reinsurer* or a *non-directive insurer*) which is carrying out a ‘linked long-term contract’ in the United Kingdom, must secure that, as far as practicable, its liabilities under the contract in respect of ‘linked benefits’ are covered as follows –

(a) if those benefits are linked to the value of units in an undertaking for collective investments in transferable *securities* or to the value of assets contained in an internal fund, by those units or assets; and

- (a) if those benefits are linked to a share index or other reference value not mentioned in (a), by units which represent that reference value, or by assets of appropriate safety and marketability which correspond, as nearly as may be, to the assets on which that reference value is based.
- (3) ~~A UK~~ An insurer which has entered into a ‘linked long term contract’ to which (2) applies must also secure that those of its liabilities under the contract in respect of ‘linked benefits’ which are not covered by contracts of *reinsurance* are covered by assets of a description contained in rule 3.7.

Paragraphs 3 to 6 of the ‘Instructions for completion of Form 13’ in Appendix 9.1 (Balance sheet and profit and loss account) are amended as follows:

- 3 (a) In the case of the United Kingdom branch ~~return~~ *return* of an *external insurer* (other than a *pure reinsurer*) Form 13 must be completed for the following categories of assets -

Category	Code - other than long-term insurance business assets	Code - long-term insurance business assets
<u>In the case of a non-EEA insurer, assets deposited</u> <u>deposited</u> under rule 8.1 <u>8.1(1)</u>	2	6
Assets maintained in the United Kingdom	3	7
Assets maintained in the United Kingdom and the other <i>EEA States</i>	4	8

- (b) In the case of an EEA branch *return* of a *UK-deposit insurer* which has made a deposit under rule 8.1(2), Form 13 must be completed for the following categories of assets -

Category	Code – other than long-term insurance business assets	Code – long-term insurance business assets
Assets deposited under rule 8.1 <u>8.1(2)</u>	2	6
Assets maintained in the United Kingdom and the other <i>EEA States</i>	4	8
Assets maintained in the United Kingdom and the <i>EEA States</i> where <i>insurance business</i> is carried on	5	9

4. In lines 11 to 86 -

- (a) for the purpose of classifying (but not valuing) assets, headings and descriptions used above, wherever they also occur in the balance sheet format in Schedule 9A to the *Companies Act*, must have the same meaning as in that Schedule,

- (b) assets must be valued in accordance with rule 9.10, and
- (c) assets of any particular description must be shown after deduction of assets of that description which (for any reason) fall to be left out of account under rule 4.14 (2) (a).

5. The aggregate value of those investments which are:

- (i) (a) *unlisted* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with rule 4.8;
- (ii) (b) *listed* investments falling within any of lines 41, 42, 46 or 48 which have been valued in accordance with rule 4.8 and which are not ~~ready~~ readily *realisable*;
- (iii) (c) units or other beneficial interests in *collective investment schemes* falling within rule 4.9(1)(c); or
- (iv) (d) reversionary interests or remainders in property other than land or buildings,

must be stated by way of a supplementary note to this Form, together with a description of such investments.

6. The aggregate value of those investments falling within lines 46 or 48 which are ~~hybrid~~ hybrid *securities* are to be stated by way of a supplementary note to this Form.

Paragraph 2.2(1) of Guidance Note 9.1 (Preparation of returns) is amended as follows:

- (1) The following table summarises the types of *return* which *insurers* are required to prepare.

Type of company	Location of Head Office		
	United Kingdom	An <i>EEA State</i> (other than U.K.)	Rest of the World ⁽¹⁾
<i>Pure reinsurer</i>	Global <i>return</i>	Global <i>return</i>	Global <i>return</i>
<i>UK- deposit insurer making a deposit under rule 8.1(2)</i>			Global <i>return</i> and EEA branch <i>return</i>
<i>EEA-deposit insurer</i>			UK branch <i>return</i>

All other <i>insurers</i> (1)	Global <i>return</i>	Exempt <u>Exempt (2)</u>	Global <i>return</i> and UK branch <i>return</i> .
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(1) Special rules apply to Swiss general insurers for Switzerland. ~~A Swiss general insurer reports as for an insurer with its head office in the EEA. Other Swiss companies' report as for companies with their head office in the 'rest of the world'.~~

(2) Except that insurers which do not qualify for authorisation under Schedules 3 or 4 to the Act must provide a global return and a UK branch return.

Directors' certificate

Paragraph 4(b) of Part I of Appendix 9.6 (Certificates of directors etc) is amended as follows:

- (b) that any amount payable from or receivable by the *long-term insurance business fund or funds* in respect of services rendered by or to any other business carried on by the *insurer* or by a person who, for the purposes of rule 3.4, is ~~connected~~ 'connected' with it or is a ~~subsidiary undertaking~~ 'subordinate company' of it has been determined and where appropriate apportioned on terms which are believed to be no less than fair to that fund or those funds, and any exchange of assets representing such fund or funds for other assets of the *insurer* has been made at fair *market value*.

Regulated markets

Paragraph 2 of Annex D of Guidance Note 4.1 (Guidance for insurers and auditors on the valuation of assets rules) is amended as follows:

2. The FSA maintains and publishes a list of regulated markets in the United Kingdom on its web site. There is no official list of For regulated markets outside the UK, Instead the directors (and auditors) must should be satisfied that the criteria set out in the definition have been met. Art 16 of the Investment Services Directive requires that each Member State draw up a list of the regulated markets for which it is the home Member State, and that the Commission publish the lists and updates in the Official Journal of the European Communities at least once a year. Annex 5G of SUP 17 lists the regulated markets notified to the Commission as at a specified date, but it may not be up-to-date.

Guidance Note 9.1 of IPRU(INS)

Paragraph 5.4(16) of Guidance Note 9.1 is amended as follows:

- (16) Line 73 (salvage and subrogation recoveries) should only be used for such recoveries which fall to be classified as debtors arising from insurance operations. Occasionally some salvage or subrogation recoveries may be classified under other headings in the

Companies Act accounts in which case the same heading should be used in **Form 13**, but a supplementary note [Code 1303] is required. If salvage and subrogation recoveries are shown in the *Companies Act* accounts as a deduction from liabilities rather than as an asset, the same treatment should be adopted in the *returns*. That is, line 73 should be left blank and the amount of liabilities shown on **Form 14** **Form 15** should be shown net of the salvage and subrogation recoveries.

Paragraph 8.1(3) of Guidance Note 9.1 is amended as follows:

- (3) Run off of risks should be reported on the underwriting year basis if these risks were previously reported on the underwriting year Forms (24 and 25). The run off of risks previously reported on the annual accounting Forms (21 to 23) should now be reported on the accident year basis.

Paragraph 8.2(2) of Guidance Note 9.1 is amended as follows:

- (2) In particular contracts of financial (re)insurance whether inward or outward should be classified for inclusion in the forms in accordance with Financial Reporting Standard 5 'Reporting the Substance of Transactions' ~~and the statement 'FRAG 35/94: The Application of FRS 5 to Non-Life Insurance Transactions'~~². Thus where the consideration receivable and payable for transactions which have the legal form of *contracts of insurance* or *reinsurance* would not be accounted for as premiums and *claims* in the preparation of *Companies Act* accounts, they should not be included as premiums and *claims* in **Forms 20** to **39**. Instead they should be accounted for in the *return* using the same principles as are applied in the preparation of *Companies Act* accounts. (But see 5.3(7) and 5.3(11) for the different treatment in **Forms 11** and **12**).

Minor drafting errors

Rule 2.10(2)(a) is amended as follows:

- (a) an *insurer* has issued ~~shares~~ *shares* some or all of which are not 'fully paid' and the total paid up value of all the *shares* is equal to or greater than one quarter of their nominal value or, in the case of *shares* issued at a premium, of the aggregate of their nominal value and the premium.

The definition of *collector* in rule 11.1 is amended as follows:

includes every person, howsoever remunerated, who, by himself or by any deputy or substitute, makes house to house visits for the purpose of receiving premiums payable on ~~policies~~ *policies* of insurance on human life, or holds any interest in a *collecting book*, and includes such a deputy or substitute.

Annex B

Amendments to the Enforcement manual

In this Annex, underlining indicates new text and striking through indicates deleted text.

13.6.3G ~~*IPRU(INS) rule 3.5(3) prohibits a long-term insurer (including a firm*~~
~~*qualifying for authorisation under Schedule 3 or 4 to the Act), which is not a*~~
~~*mutual, from paying a financial penalty from a long-term insurance fund.*~~