INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS (GROUPS DIRECTIVE) 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 (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) in rule 4.2(1A)(b), the words "reduced … the *related undertaking*" come into force on 1 May 2003; and

(2) the remainder of this instrument comes into force on 1 December 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 Glossary

E. The Glossary is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Interim Prudential Sourcebook for Insurers (Groups Directive) Instrument 2002.

By order of the Board
21 November 2002

Annex A

Amendments to the Interim Prudential sourcebook for insurers (IPRU(INS))

In this Annex, underlining indicates new text and striking through indicates deleted text. In the case of the new Annex C of Guidance Note 4.1, section 20 of Guidance Note 9.1 and Guidance Note 10.1, the location in IPRU(INS) is indicated, but the text is not underlined.

Chapter 4 (Valuation of Assets) and Appendix 4.2 (Assets to be taken into account only to a specified extent)

Rule 4.2(1) is amended as follows:

(1) Notwithstanding rule 4.8, ~~The~~ the value of any *shares* held in a *group undertaking* which is an *insurance undertaking* or an *insurance holding company* may be taken as and, in any event, must not exceed ~~(a) where the shares held are in an *insurance undertaking* or *insurance holding company*~~ 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 the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)), of its *surplus assets*.

(1A) ~~(b) where the shares held are not in an *insurance undertaking* or *insurance holding company*~~ The value of any *shares* held in a *group undertaking* which is not an *insurance undertaking* or an *insurance holding company* must not exceed the greater of:

~~(i)~~(a) 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 the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)), of its *surplus assets*; and

~~(ii)~~(b) the value of those *shares* as determined under rule 4.8 reduced:

(i) 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 *insurer*,

(ii) by an appropriate amount, to the extent needed to exclude value attributable to goodwill generated from business with members of the *insurance group*, and

(iii) by the amount by which the value of any *shares* held by the *group undertaking* in a *related undertaking* of the *insurer* which is an *insurance undertaking* or an *insurance holding company* exceeds the value (or *proportional share*), determined in accordance with the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)), of the *surplus assets* of the *related undertaking*.

Rule 4.2(3) is amended as follows:

…

(c) in both cases, must not include:

(i) assets falling within (2)(b), or

(ii) assets falling within (2)(e) where the amount is due, or to become due, from a *group undertaking*; but

(d) notwithstanding (a) and (b), a liability of a *group undertaking* which is a *debt* due to the *insurer* is not required to be determined at an amount which is higher than the value placed on that *debt* as an asset of the *insurer*.

Rule 4.2(4)(b) is amended as follows:

(b) rules 4.14(1)(a) to (c) (or their equivalent in a *designated state or territory*) do not apply for the purpose of valuing *shares* in *group undertakings* that are not *dependants* or for the purpose of the *parent undertaking solvency calculation*.

Rule 4.3 is amended as follows:

The value of any *debt* due, or to become due, from a *group undertaking* must not exceed the amount reasonably expected to be recovered in respect of the *debt* taking into account only the value of:

(a) the assets identified in rule 4.2(2)(a); and

(b) any ~~*security*~~ security held in respect of the *debt*.

Rule 4.8(3) is amended as follows:

(3) Subject to (5) and (6) and rules 4.2 and 4.13, the value of an investment to which this rule applies is –

…

Rule (5A) is inserted after rule 4.14(5) as follows:

(5A) Assets of *dependants* of the *insurer* that are *debts* due or to become due from the *insurer* or from a *dependant* of the *insurer* must not be taken into account in any of the calculations described in (1).

Paragraphs 11A and 15A of Part I of Appendix 4.2 are amended as follows:

11A. Subject to 11B and 11C, ~~The~~ the amount of the *insurer's exposure* to assets arrived at under 4 to 11 must be increased by an amount representing the *exposure*, if any, of the *insurer's dependants* to assets of that description~~, calculating that exposure by applying 4 to 11 to~~

~~each dependant as if it were an insurer (whether it is or not)~~.

11B. For the purposes of 11A, the *exposure* of each *dependant* must be calculated by applying 4 to 11 to that *dependant* as if it were an *insurer* to which those provisions apply (whether it is or not).

11C. In relation to a *dependant*:

(a) which is an *insurance undertaking*; or

(b) for which rules 4.14(1)(a) to (c) have (notwithstanding rule 4.2(3)(b)) been applied when valuing the assets selected under rule 4.2(2)(a),

11A applies only in relation to the *dependant's surplus assets* (or *proportional share*).

15A. Subject to 15B, ~~The~~ the amount arrived at in accordance with 13 to 15 must be increased by the amount by which any *dependant* of the *insurer* is *exposed* to the same *counterparty*.

15B. In relation to a *dependant*:

(a) which is an *insurance undertaking*; or

(b) for which rules 4.14(1)(a) to (c) have (notwithstanding rule 4.2(3)(b)) been applied when valuing the assets selected under rule 4.2(2)(a),

15A applies only in relation to the *dependant's surplus assets* (or *proportional share*).

Chapter 5 (Determination of Liabilities)

Rule 5.3A is amended as follows:

(1) Except to the extent that provision for the deficit has been made (whether in the calculation of *surplus assets* or otherwise) in another *group undertaking* the value of whose *shares* is determined having regard to the value of its *surplus assets* (but only to the extent of the *insurer's proportional share* of that undertaking), ~~An~~ an *insurer* must make provision in respect of a *related undertaking* that is an *insurance undertaking* or *insurance holding company*:

(a) where the *related undertaking* is also a *subsidiary undertaking* of the *insurer*, for the whole of any ~~deficit in the assets available to cover liabilities or represent the *notional required minimum margin*~~ *solvency deficit;* and

(b) in any other case, for the *insurer's proportional share* of any such deficit.

(2) For the purposes of (1), the identification and valuation of assets available to cover liabilities and the *notional required minimum margin* must be determined in accordance with rule 4.2(3)~~, except that any liability which is a *debt* due to the *insurer* need not be valued at more than the value placed on that *debt* as an asset of the *insurer*~~.

Chapter 10 is amended as follows:

Chapter 10

PARENT UNDERTAKING SOLVENCY ~~MARGIN~~ CALCULATION

~~Information to be provided~~ Application and timing

10.1 (1) This chapter applies to an *insurer* (other than a *pure reinsurer*) that is a *subsidiary undertaking* of an *ultimate insurance parent undertaking* and whose head office is in the United Kingdom.

(2) The information and calculations required to be provided under this chapter must be:

(a) as at the end of the *financial year* of the *insurer*, as at the end of the financial year of the *ultimate EEA insurance parent undertaking*, or as at the end of the financial year of the *ultimate insurance parent undertaking*;

(b) following the relevant principles in Financial Reporting Standard 2 (issued by the Accounting Standards Board in June 1992), as at the same date for every member of the *insurance group* to which the information and calculations relate; and

(c) as at a date no later than 12 months from the day after the end of the financial year by reference to which the information and calculations were last provided under this chapter or its predecessor.

(3) Subject to (4), the information and calculations required under this chapter must be provided to the *FSA* no later than 4 months from the end of:

(a) the *financial year in question*; or

(b) the financial year of the relevant parent, where the information and calculations are provided as at the end of that financial year under (2)(a).

(4) Where the *parent undertaking solvency calculation* is provided in accordance with rule 10.2(4), the information and calculations required under this chapter must be provided to the *FSA* no later than:

(a) 6 months from the end of the financial year selected under (2)(a); or

(b) the date by which the *parent undertaking solvency calculation* is required in the *EEA State* of supplementary supervision or of the relevant head office under rule 10.2(4), as the case may be,

whichever is earlier.

Information to be provided to FSA

10.2 (1) ~~When it deposits its *return,*~~ An ~~an~~ *insurer* must ~~also~~ provide the *FSA* with a declaration of the following information in respect of itself and (subject to the exceptions in (2)) in respect of each member of the *insurance group* ~~(including itself) as at the end of the *financial year in question*~~:

(a) the name, location of head office and principal activity;

(b) the relationship with each other member of the *insurance group*, including the amounts and descriptions of holdings of *share* capital and voting rights;

(c) whether the member of the group is a *subsidiary undertaking* of

the *ultimate insurance parent undertaking* and, if different, of the *ultimate EEA insurance parent undertaking*;

(d) subject to (2), the *ultimate insurance parent undertaking's proportional share* of, or if the group member is a *subsidiary undertaking* of that parent the whole of, any ~~deficit in the assets available to cover the group member's liabilities and represent its *notional required minimum margin*~~ *solvency deficit;*

(e) subject to (2), the *ultimate EEA insurance parent undertaking's proportional share* of, or if the group member is a *subsidiary undertaking* of that parent the whole of, any ~~deficit in the assets available to cover the group member's liabilities and represent its *notional required minimum margin*~~ *solvency deficit;*and

(f) a statement that:

(i) the declaration has been properly prepared in accordance with this rule, and

(ii) proper records have been maintained and adequate information obtained by the *insurer* for the purpose of the declaration required by this rule ~~and the information required by rule 9.39, and~~

~~(iii) reasonable enquiries have been made by the insurer for the purpose of identifying material connected-party transactions~~.

(2) (1)(d) and (e) do not apply with respect to a group member (other than the *insurer*) where:

(a) the *parent undertaking solvency calculation* in relation to the *ultimate insurance parent undertaking* or the *ultimate EEA*

insurance parent undertaking, as the case may be, is positive;

(b) the group member is not a *parent undertaking* of the *insurer;*

(c) the group member is not a *participating undertaking* in the *insurer;*

(d) the group member is not a *related undertaking* of the *insurer*;

(e) the group member's *solvency deficit* does not exceed 5% of the positive *parent undertaking solvency calculation* in relation to the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking,* as the case may be; and

(f) the *insurer* has complied with (1)(d) or (e) (as the case may be) in relation to sufficient group members so that the sum of the *solvency deficits* in the remaining group members does not exceed 10% of the positive *parent undertaking solvency calculation* in relation to the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking,* as the case may be.

The parent undertaking solvency calculation

~~(2)~~ (3) Subject to (4), (5), (6) and (7), ~~The~~ the declaration required by (1) must also include ~~separate statements in respect of each of the *ultimate insurance parent undertaking* and *ultimate EEA insurance parent undertaking* of~~:

(a) calculations ("the parent undertaking solvency calculations") in respect of each of the *ultimate insurance parent undertaking* and *ultimate EEA insurance parent undertaking* of the value, ~~as~~ determined in accordance with the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)), of its *surplus assets*,

less:

(i) any provision for *related undertakings* valued on the basis of rule 5.3A (except to the extent already ~~included~~ allowed for in the value of *surplus assets*), and

(ii) where the *surplus assets* are valued at nil, the amount of any deficit in the assets available to cover:

(A) any liabilities not already provided for, and

(B) the *notional required minimum margin* (if any) of the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking*, as the case may be; and

(b) if ~~the result of the calculation in (a)~~ either of the *parent undertaking solvency calculations* is negative, a statement as to the reasons why such deficit or deficits has or have arisen and of any remedial action taken or planned.

(4) If the competent authority in an *EEA State* other than the United Kingdom has agreed to be the supervisor responsible for exercising supplementary supervision of the *insurer* under Article 4(2) of the *Insurance Groups Directive* or, where no such agreement has been reached, but:

(a) the head office of the *ultimate EEA insurance parent undertaking* is situated in an *EEA State* other than the United Kingdom and that parent is itself an *insurance undertaking* (other than a *pure reinsurer*); or

(b) where that parent is not an *insurance undertaking*, another member of the *insurance group* is an *insurance undertaking*

(other than *a pure reinsurer*) whose head office is situated in an *EEA State* other than the United Kingdom, and that member is:

(i) a *parent undertaking* of the *insurer*, or

(ii) has a *notional required minimum margin* which exceeds the *notional required minimum margin* of the *insurer*,

then the *insurer* may provide the information and calculations required under (1)(d) and (e) and the *parent undertaking solvency calculation* in relation to the *ultimate EEA insurance parent undertaking* prepared in accordance with the requirements in the *EEA State* of supplementary supervision or of the relevant head office for:

(c) the valuation of assets and the determination of liabilities of *insurance undertakings* and *insurance holding companies*; and

(d) the calculation of the required minimum solvency margin of *insurance undertakings*.

(5) If the head office of the *ultimate insurance parent undertaking* is situated in a *designated state or territory* other than an *EEA State,* then the *insurer* may provide:

(a) the *parent undertaking solvency calculation* in relation to the *ultimate insurance parent undertaking* prepared in accordance with accounting practice applicable for the purposes of the regulation of *insurance undertakings* in the state or territory of the head office:

(i) adapted as necessary to apply the general principles set out in paragraphs 1. B, C and D of Annex I of the *Insurance Groups Directive*, and

(ii) using the deduction and aggregation method or the accounting consolidation-based method set out in Annex I of the *Insurance Groups Directive*; and

(b) the *solvency deficits* under (1)(d) prepared in accordance with the requirements:

(i) for the valuation of assets and the determination of liabilities of *insurance undertakings* and *insurance holding companies*, and

(ii) for the calculation of the required minimum solvency margin of *insurance undertakings*,

in the state or territory where the *ultimate insurance parent undertaking's* head office is situated.

(6) If the head office of the *insurer's ultimate insurance parent undertaking* is not situated in the United Kingdom or in a *designated state or territory,* then the *insurer* may provide the *parent undertaking solvency calculation* in relation to the *ultimate insurance parent undertaking* prepared in accordance with the *Valuation of Assets Rules* (other than rule 4.14(1)(a) to (c)) and the *Determination of Liabilities Rules*:

(a) adapted as necessary to apply the general principles set out in paragraphs 1. B, C and D of Annex I of the *Insurance Groups Directive*; and

(b) using the deduction and aggregation method or the accounting consolidation-based method set out in Annex I of the *Insurance Groups Directive.*

(7) If the *ultimate insurance parent undertaking* or, as the case may be, the

ultimate EEA insurance parent undertaking of the *insurer* is itself an *insurer* to which chapter 4 of *IPRU(INS)* or *IPRU(FSOC)* applies, then the *insurer* is not required to provide a *parent undertaking solvency calculation* in relation to that parent.

Rules for determining surplus assets and deficits

~~(3)~~ 10.3(1) For the purposes of ~~(1) and (2)~~ rule 10.2, the amount of any deficit and the identification of *surplus assets* must be determined as though:

~~(a) all references in rule 4.2(2)(a), (c), (d), (e) and (3) to the "*group undertaking*" were references to the *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking*, as applicable;~~

(a) the phrase "except in the case of an *ultimate insurance parent undertaking* or an *ultimate EEA insurance parent undertaking* which is a *mutual* which carries on *long-term insurance business,"* was inserted in front of rule 4.2(2)(d);

~~(b) rule 4.2(2)(b) was replaced with "assets that are interests directly or indirectly held in the capital of the *ultimate insurance parent undertaking*s or *ultimate EEA insurance parent undertakings*, as applicable"; and~~

~~(c)~~ (b) rule 4.2(2)(f) was replaced with "assets that cannot effectively be made available or realised to make good any deficiency of assets of the *ultimate insurance parent undertaking*s or *ultimate EEA insurance parent undertakings*, as the case may be ~~applicable~~"; and

(c) notwithstanding rule 5.2(2), where the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking* has issued cumulative preference *shares*, liabilities

in respect of such *shares* may be left out of account:

(i) to the extent that they (taken with the *used notional group solvency margin*) do not exceed 50% of the *notional group solvency margin*, but

(ii) liabilities in respect of *shares* which are redeemable for the purposes of section 159 of the *Companies Act* may be left out of account only to the extent that they (taken with the total of liabilities in respect of redeemable cumulative preference *shares* and *subordinated debt* with a fixed maturity in the *used notional group solvency margin)* do not exceed 25% of the *notional group solvency margin.*

(2) In determining the *surplus assets* or *solvency deficit* of a *group undertaking* which is not a *related undertaking* of the *insurer,* appropriate approximations or generalisations may be applied where they are likely to provide the same, or a lower, amount of *surplus assets* or the same, or a higher, amount of *solvency deficit* to that which would otherwise have been required under rule 10.2.

Format of declaration required under rule 10.2(1)

10.4 ~~(4)~~ (1) The declaration required by rule 10.2(1) and (3):

(a) must ~~be made in writing and deposited with the *FSA* at the same time as the documents required by rules 9.3 and 9.4~~ comply with the requirements of *SUP* 16.3;

(b) subject to (d), must be signed by the persons described in rule 9.33(1)(a); ~~and~~

(c) subject to (2), must include a statement from the auditors of the

insurer (or of an *insurer* under (d)) that, in their opinion, it has been properly compiled in accordance with rule 10.2 from information provided ~~to the *insurer*~~ by ~~other~~ members of the *insurance group* and from the *insurer's* own records; and

(d) may be provided on behalf of the *insurer* (the first *insurer*) by any other *insurer* to which rule 10.2 applies and which is a member of the *insurance group* (the second *insurer*) where:

(i) it is signed by two *directors* of the second *insurer*, and

(ii) it contains a statement that it has been copied to the board of *directors* of the first *insurer*.

(2) The statement under (1)(c) is not required to include the *parent undertaking solvency calculation* or a calculation with respect to that parent under rules 10.2(1)(d) or (e):

(a) where the *parent undertaking solvency calculation* is provided in accordance with rule 10.2(4); and

(b) to the extent that a statement is provided from auditors qualified in the *EEA State* of supplementary supervision or of the relevant head office, that in their opinion the calculation complies with the requirements applicable in that state to the preparation of solvency calculations for insurance groups pursuant to the *Insurance Groups Directive*.

Chapter 11 (Definitions)

The definition of *Accounts and Statements Rules* in rule 11.1 is amended as follows:

rules 9.1 to 9.36E and rule 9.39 of Chapter 9.

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

a *subsidiary undertaking* the value of whose *shares* is taken to be the value of its *surplus assets* under rule 4.2(1) or (1A)(a).

The definition of *designated state or territory* in rule 11.1 is amended as follows:

any *EEA State* (other than the United Kingdom), Switzerland, a state in the United States of America, the District of Columbia, Puerto Rico, Canada or a province of Canada, Australia, South Africa, Singapore and Hong Kong.

A definition of *Insurance Groups Directive* is added to rule 11.1 as follows:

Directive of the European Parliament and of the Council of 27 October 1998 on the supplementary supervision of insurance undertakings in an insurance group (1998/78/EC).

A definition of *notional group solvency margin* is added to rule 11.1 as follows:

in relation to an *ultimate insurance parent undertaking* or an *ultimate EEA insurance parent undertaking*, the sum of:

(a) the *notional required minimum margin* (if any) of that parent; and

(b) the sum of that parent's *proportional shares* of the *notional required minimum margins* of its *related insurance undertakings*.

A definition of *parent undertaking solvency calculation* is added to rule 11.1 as follows:

the calculation required under rule 10.2(3)(a).

The definition of *profit reserves* in rule 11.1 is deleted:

~~has the same meaning as future profits~~.

The definition of *proportionate share* in rule 11.1 is deleted and replaced with the definition of *proportional share* as follows:

~~in the case of a *related undertaking* of an *insurer*, the percentage holding (directly or indirectly) of the *related undertaking* capital~~

in relation to a *related undertaking*, the percentage which is the percentage holding (directly or indirectly) in the *related undertaking's* capital.

The definition of *relevant regulatory requirements* in rule 11.1 is amended as follows:

~~for the purposes of rules 4.2(2)(b) and (3)(a):~~

(a) in the case of a *group undertaking* that is an *insurance undertaking*, *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* established in a *designated state or territory*, at the option of the *insurer*~~,~~ ~~either~~:

(i) the regulatory requirements of that state or territory applicable to an undertaking carrying on *direct insurance business* (even if it only carries on *reinsurance* business or is an *insurance holding company*), or

(ii) the requirements referred to in (b); and

(b) in the case of any other *insurance undertaking* or *insurance holding company,* the rules in *IPRU(INS)* applicable to an *insurer* with its head

office in the United Kingdom (whether or not it is such an *insurer*).

A definition of *solvency deficit* is added to rule 11.1 as follows:

deficit in the assets available to cover the undertaking's liabilities and represent its *notional required minimum margin* (if any).

A definition of *used notional group solvency margin* is added to rule 11.1 as follows:

in relation to an *ultimate insurance parent undertaking* or an *ultimate EEA insurance parent undertaking*, the sum of:

(a) in the case of a parent which is itself an *insurance undertaking*:

(i) all liabilities in respect of cumulative preference *shares* left out of account by it in accordance with rule 2.10(3), and

(ii) all liabilities in respect of *subordinated debt* left out of account by it in accordance with a direction under section 148 of the *Act*,

or, in either case, in accordance with the *relevant regulatory requirements* of the state or territory where the head office of the parent is situated, as the case may be;

(b) the parent's *proportional shares* of all liabilities in respect of cumulative preferences *shares* left out of account by its *related insurance undertakings* in accordance with rule 2.10(3) or the *relevant regulatory requirements* of the state or territory where the head office of the relevant *insurance undertaking* is situated, as the case may be; and

(c) the parent's *proportional shares* of all liabilities in respect of *subordinated debt* left out of account by its *related insurance*

undertakings in accordance with a direction under section 148 of the *Act* or the *relevant regulatory requirements* in the state or territory where the head office of the relevant *insurance undertaking* is situated, as the case may be.

Appendix 9.6 (Certificates by Directors and Actuary and Report of the Auditors)

Paragraph 1(bb) is inserted after paragraph 1(b) in Part 1 of Appendix 9.6 as follows:

(bb) that reasonable enquiries have been made by the *insurer* for the purpose of identifying *material connected-party transactions*;

Guidance Notes

Paragraph 3 of **Guidance Note 2.1** (Hybrid capital: admissibility for solvency) is amended as follows:

3. Restrictions on cumulative preference *share* capital under rules 2.10 and ~~2.10~~ 5.2(2) are not dealt with in this Guidance.

Paragraph 5.51 is added to **Guidance Note 4.1** as follows:

One effect of transactions between an *insurer* and other *group undertakings* may be to inflate the *business amount*. CP145 proposed amendments to the definition of *business amount* to restrict the effect of intra-group *debts* on the *business amount*. Although these amendments have not yet been implemented, in its response to CP145 the *FSA* stated that it intended to introduce a (possibly modified) form of the proposal in CP145 on 1 May 2003. In the meantime, if the *business amount* is inflated by intra-group transactions such that an *insurer* is able to a material extent to take advantage of higher asset and counterparty *exposure* limits than would otherwise apply, then this is a fact of which the *FSA* would expect notice. Accordingly, under such circumstances, the *insurer* should inform the *FSA*, under Principle 11 in the Principles for Businesses, of the situation and the approximate effect.

Annex C is inserted after Annex B of **Guidance Note 4.1** (Guidance for insurers and auditors on the Valuation of Assets Rules) as follows:

Annex C

Shares in and debts due to a group undertaking

Shares in a group undertaking (rule 4.2)

1. Rule 4.2 applies to the valuation of all *shares* held by the *insurer* in *group*

undertakings. *Group undertakings* are:

- the *insurer*;
- its *related undertakings* (undertakings in which the *insurer* has a holding of 20% or more of the voting rights or capital);
- its *participating undertakings* (an undertaking which has a holding of 20% or more in the *insurer*); and
- the *related undertakings* of its *participating undertakings*.

2. *Shares* in a *group undertaking* may be valued either as arms-length investments under rule 4.8 (see paras 4.63 to 4.76 of **Guidance Note 4.1**) or under rules 4.2 (1) to (4). *Shares* in *group undertakings* that are *insurance undertakings* or *insurance holding companies* (see paragraph 4 of **Guidance Note 10.1** for guidance on *insurance holding companies*) may not be given a higher value than the *surplus assets* in those undertakings calculated according to rules 4.2(2) to (4), but otherwise the *insurer* has the option whether or not to use rule 4.8. If rule 4.8 is used, then admissibility limits apply and from 1 May 2003 there must be a deduction for intra-group goodwill under rule 4.2(1A)(b)(ii) (see 5). When valuing *shares* in a *group undertaking*, rules 4.2 (2) to (4) require net asset value to be used with certain adjustments.

3. The purpose of the adjustments to the net asset value is to assess the regulatory solvency of an *insurer*:

- taking into account its proportional interest in excess assets of *group undertakings* (see 1.B on proportionality in Annex I of the *Insurance Groups Directive*);

- eliminating double-gearing whether arising from intra-group investment, reciprocal financing, intra-group holdings of unpaid *share* capital or otherwise;

- including only assets of *group undertaking*s to the extent they are

available to cover the liabilities and *required minimum margin* of the *insurer*; and

- ensuring that the liabilities and *notional required minimum margin* of *group undertakings* are only covered by assets that are available for this purpose.

Basic calculation

4. The method set out in rules 4.2 (2) to (4) for valuing *shares* in a *group undertaking* is in four stages.

    - First, assets of that undertaking are selected to cover its liabilities (and any *notional required minimum margin*). Rule 4.2(3) restricts the assets that may be used and how the assets and liabilities may be valued.

    - Second, rules 4.2(2)(b)-(f) require certain other assets to be excluded to arrive at *surplus assets*.

    - Third, the *surplus assets* are valued under the *Valuation of Assets Rules* (excluding any admissibility limits under rule 4.14(1)(a)-(c)). Admissibility limits are applied at a later stage (see 17).

    - Finally, a lower value than this may be used following rules 4.1(4) and 4.2(1).

    Where the liabilities (and any *notional required minimum margin*) cannot be covered, there are no *surplus assets* and the result will be zero. If the undertaking is a *related undertaking* which is an *insurance undertaking* or *insurance holding company*, then the *insurer* must make provision for the *proportional share*, and where the *related undertaking* is a *subsidiary* make provision for the full amount, of the deficit in the assets available to cover liabilities or represent the *notional required minimum margin* (see rule 5.3A). Where the responsibility of the *insurer* is strictly and

unambiguously limited to its share in the capital of a *related undertaking* which is a *subsidiary*, the *Insurance Groups Directive* allows a provision to be limited to the *proportional share* of the deficit. The *FSA* will consider an application for a modification of rule 5.3A under section 148 of the *Act* in such circumstance. Where a provision has been made by another member of the *insurance group*, the amount of the *insurer's* provision may be reduced by its proportionate interest in that other member of the *insurance group*. In particular, where a deficit in an intermediate *related undertaking* is due solely to a deficit in another *related undertaking* below it in the ownership chain, both being *insurance undertakings* or *insurance holding companies,* the *insurer* only needs to make provision once. Where an *insurer* is obliged to support a *group undertaking* or to meet its liabilities, a provision would be also be needed.

5. Where a *group undertaking* is not an *insurance undertaking* or *insurance holding company*, it may be valued at *market value* under rule 4.8 (see rule 4.2(1A)(b)). This allows goodwill in non-insurance *group undertakings* to count towards an *insurer's required solvency margin* where appropriate. However the value of any *shares* held in a *group undertaking* arrived at under rule 4.2 is a maximum value which may not always be the appropriate value. Under rule 4.2(1A)(b)(i), *market value* must not exceed the value that could effectively be made available or realised to meet losses (if any) arising in the *insurer*. The *FSA* considers that value relating to future income streams generated from business with other members of the *insurance group* may be impaired when one or more members of the group are facing problems, this being precisely a situation in which an *insurer* might wish to realise such value. From 1 May 2003, therefore, goodwill generated from business with members of the *insurance group* (which only includes *insurance undertakings* and *insurance holding companies*) must also be excluded (see rule 4.2(1A)(b)(ii)). It is clearly difficult to identify a single suitable methodology for calculating internal goodwill. But an *insurer* should be able to analyse the difference between the quoted price of the *group undertaking* and its net asset value applying an appropriate estimate of the proportion of the undertaking's

business which is intra-group. The basis for this will depend on the type of business of the undertaking but might, for example, be post-tax operating profits or turnover or funds under management. There may be further complications if, for example, provision is already made against elements of future profits. In such circumstances *insurers* may prefer to make a safe-side approximation for internal goodwill and may wish to highlight the impact of the deduction in a note to the *return*.

6. A similar point arises for direct or indirect holdings by the *group undertaking* in *shares* in a *related undertaking* of the *insurer* that is an *insurance undertaking* or *insurance holding company*. Valuation of the *group undertaking* at *market value* under rule 4.8 may mean that the *shares* in the *related undertaking* are valued at more than (the appropriate share of) its *surplus assets*. Any such excess will be eliminated by virtue of rule 4.2(1A)(b)(iii).

7. An *insurer* may value *shares* in a *group undertaking* which is not an *insurance undertaking* or an *insurance holding company* under one of the two permitted methods (that is, under rule 4.8 or rule 4.2 (2) to (4)) for the purposes of determining its *required margin of solvency* and the other method for the *parent undertaking solvency calculation* (see Guidance Note 10.1) in relation to the *insurance group* of which it is a member.

8. Where an *insurer* is valuing its *shares* in an *insurance holding company* which itself has *shares* in both *insurance* and non-*insurance related undertakings*, the *insurance holding company* should be valued applying rules 4.2(1) or 4.2(1A) to its *related undertakings*.

9. Rule 4.2(1) prescribes a maximum valuation of *shares* in a *group undertaking*. This allows approximate methods and shortcuts to be used if they can be reasonably relied on not to overstate the result. It also allows an *insurance undertaking* to be excluded from the solvency margin test by ascribing it a nil value. This shortcut may be used where a *group undertaking* is immaterial, its inclusion would be misleading or the information required is not readily

available. However, rule 5.3A requires that where a deficit exists in a *related undertaking* that is an *insurance undertaking* or an *insurance holding company,* a provision must be made and it may not simply be valued at nil.

10. The reference to rule 4.2(2)(a) in rule 4.3 means that *debts* due must not be valued at more that the assets available to the debtor to cover them. The effect of this is that the market valuation option is available for valuing *shares* in a *group undertaking* which is not an *insurance undertaking* or an *insurance holding company,* but not for valuing loans to such *group undertakings*. The reason for this is that while *shares* can normally be realised at the market price, a loan can only be repaid from the assets of the debtor and so its value for solvency purposes should not exceed the value of the assets available to repay the loan. Where these assets include *shares* in another *group undertaking* that is not an *insurance undertaking* or an *insurance holding company*, those *shares* may be valued in accordance with rule 4.2(1A).

11. Surplus assets (see rule 4.2(2)) are a *group undertaking's* total assets less:

    - the assets selected to cover its liabilities and its *notional required minimum margin.* As set out in rule 4.2(4)(a) for *insurance undertakings* located in a *designated state or territory* these assets may be identified as to value, admissibility, nature, location or matching either under the requirements of the *designated state or territory,* or the *Valuation of Assets Rules*. For any other *group undertaking,* assets must be valued according to the *Valuation of Assets Rules* which will require revaluation of assets and liabilities (in particular *long-term insurance business liabilities* will need to be valued on an actuarial basis in accordance with the *Determination of Liabilities Rules*) and for *insurance undertakings* carrying on *general insurance business*, *claims* equalisation reserves will need to be calculated as if the undertaking were an *insurer* with its head office in the United Kingdom;

    - assets that represent holdings in the *insurer's* and the *group*

undertaking's own capital, whether held directly or indirectly;

- profit reserves and future profits in an *insurer* carrying on *long-term insurance business.* (where profit reserves and future profits are treated as *implicit items* available to meet the *notional required minimum margin* by means of a direction under section 148 of the *Act* this applies only to any excess of value after the liabilities and *notional required minimum margin* of the undertaking have been covered);

- *long-term insurance funds* and other similar funds including a fund that represents amounts yet to be apportioned between *policyholders* and for other purposes. Such assets may nevertheless be used to cover liabilities and the *notional required minimum margin* of the fund referred to in the first bullet (This deduction does not apply to a life *mutual* that is the *ultimate insurance parent undertaking* for the purpose of the *parent undertaking solvency calculation*.);

- unpaid *share* capital (whether called or otherwise), other amounts that may become due on capital, and similar amounts if those amounts are or will become due from members of the *group undertaking*; and

- assets that cannot effectively be made available or realised to meet a *solvency deficit* in the *insurer*. Amounts subject to regulatory constraints (eg. regulatory capital requirements or dividend restrictions) and exchange control restrictions should be excluded. Tax liabilities or other costs might also affect the availability of assets.

12. Where a *group undertaking* which is an *insurance undertaking* is established in a *designated state or territory*, the *notional required minimum margin* may be either the actual *margin of solvency* that its home state requires it to hold (or, for a *pure reinsurer*, the amount that would be required if it were a direct *insurer* – in some territories *pure reinsurers* are not supervised) or the *required minimum margin*. In all other cases, the *notional required minimum margin* is the *required minimum margin* that would apply if the *group*

insurance undertaking were a UK *insurer* (whether it is or not). However an application may be made to the *FSA* for a direction under section 148 of the *Act* modifying its rules to allow application of the local regulatory requirements of another state or territory if the applicant can satisfy the tests in section 148 and demonstrate that the requirements in question are 'at least comparable' to the standards set out in the *First Life* and *First Non-Life Directives*.

13. For the purposes of rules 4.2(2) to (4), liabilities and the assets selected to cover them and the *notional required minimum margin* must be valued in the same manner as the *notional required minimum margin* is determined (that is, either under the requirements of the *designated state or territory*, or under the rules in *IPRU(INS)* applicable to an *insurer* with its head office in the United Kingdom, as the case may be). *Surplus assets* are valued under the *Valuation of Assets Rules*.

14. *Designated states and territories* are EEA states (excluding the UK), Switzerland, any state of the USA and Puerto Rico, Canada or a province of Canada, Australia, South Africa, Singapore and Hong Kong. Since the UK is not a designated state, the *notional required minimum margin* of a Lloyd's corporate name that is a *group undertaking* will be the *required minimum margin* applicable to a UK *insurer*. A consequence of this is that letters of credit, which can be used under Lloyd's rules to cover solvency, are disallowed assets.

15. In some *designated states and territories* there may not be an exact equivalent to the *FSA's required minimum margin*. In such circumstances the *notional required minimum margin* for any jurisdiction should be ascertained by reference to the trigger for regulatory intervention which is in effect most nearly equivalent to the *required minimum margin* which would apply if the undertaking were an *insurer*. In the case of a US state whose insurance regulation is based on the model published by the National Association of Insurance Commissioners, *FSA* considers that the *notional required minimum margin* will generally correspond to the highest point at which any

regulatory or corrective action is triggered. If an *insurer* considers that this is inappropriate in a particular case and intends to adopt a different approach, it should inform the *FSA* and explain the circumstances (see Principle 11 of the Principles for Businesses and *SUP* 15).

16. Where UK rules are applied to a non UK *group undertaking* not located in a *designated state or territory*, *implicit items* cannot be valued in the absence of a direction under section 148 of the *Act* waiving the rule (see rule 2.10(5)). The *FSA* will normally grant a waiver in cases which meet the criteria in **Guidance Note 2.2**. For a *group undertaking* in a *designated state or territory*, *implicit items* have the value that local requirements permit and no direction under section 148 is needed. For a *group undertaking* in the UK, the value would be determined under any direction to it under section 148 of the *Act*.

Admissibility limits for shares valued under rules 4.2(2) to (4)

17. When applying asset and *counterparty* concentration limits (under rule 4.14) to an *insurer* that holds *shares* in a *related undertaking*, it is necessary to ensure that *exposures* of both the *insurer* and its *related undertakings* are taken properly into account. For this purpose a distinction is drawn between *subsidiary undertakings* which are valued in relation to their *surplus assets* (*dependants*) and *related undertakings* which are either not *subsidiary undertakings* or which are valued under rule 4.8 (see 4.2(1A)). Because the former are valued in relation to their own assets and the *insurer* has a majority control over those assets we have considered it appropriate to add assets held by a *dependant* to assets of the same description held by the *insurer* in order to arrive at the aggregate *exposure* to which the concentration limits are applied. For other *related undertakings* we consider that it is more appropriate to apply concentration limits directly to the *insurer's* holdings in those undertakings.

18. Hence, if a *group undertaking* is a *dependant* (that is a *subsidiary* that is valued by reference to its *surplus assets*), rule 4.14(5)(f) disapplies admissibility limits on the value of *shares* held in it by the *insurer*.

Instead paragraphs 11A and 15A of **Appendix 4.2** require that the underlying assets of the *dependant* are taken into account when determining the admissible assets of the *insurer* under rule 4.14 (see table 4.12 – 7A-E**)**.

19. Where admissibility limits have been applied when arriving at the *dependant's surplus assets* paragraphs 11C and 15B of **Appendix 4.2** require only the *surplus assets* (or *proportional share*) of the *dependant* to be taken into account when determining the *admissible assets* of the *insurer* (See table – 7A, B & D). This applies in two cases:

    i) where the *dependant* is itself an *insurance undertaking*. In this case rule 4.2(3)(a) requires admissibility limits to be applied to the assets selected to cover the *dependant's* liabilities and the *notional required minimum margin (*see Table - 6A). If the *dependant* is established in a *designated state or territory*, the admissibility requirements would be those of its home state if the *insurer* has opted to use home state requirements when selecting assets to cover *liabilities* and the *notional required minimum margin* of the *insurance undertaking*. If the *insurer* has not opted to use home state requirements or the *dependant* is not established in a *designated state or territory*, rule 4.14 would apply. Because admissibility limits only apply to the assets selected to cover the *dependant's* liabilities and *notional required minimum margin* other assets which may be inadmissible at the level of the *dependant* (including assets that exceed admissibility limits in the *dependant insurance undertaking*) may be included within *surplus assets*, if they are not excluded by rules 4.2(2)(b)-(f). This enables the *insurer* to value as *surplus assets*, subject to its own admissibility limits, holdings of the *dependant* in an investment over and above the admissibility limits that apply to the *dependant*. This does not allow the *insurer* to include amounts arising from under-valuation imposed by home state requirements which would require a direction under section 148 of the *Act*. Any application for such a direction would need to demonstrate that in the circumstances of the *dependant* the home state requirements are over prudent as a whole and not just that there are hidden

reserves.

ii) where the *insurer* has chosen to apply admissibility limits (applicable to the non-insurance *dependant*) to the non-insurance *dependant* in arriving at its *surplus assets* despite the fact that it is not required to do so under rule 4.2(3)(b) (see Table - 6B&D). It may be advantageous to opt to apply admissibility limits in arriving at the *dependant's surplus assets* because if they have not been applied, all underlying assets of the *dependant* must be taken into account when determining the *admissible assets* of the *insurer* (see Table - 6C&E & 7C&E). Since admissibility limits are determined by reference to the *business amount* of the *insurer* only with no supplementary amount being added to reflect the *dependant's business amount* this may result in a greater (downwards) adjustment to the value of the *insurer's* assets. The objective of these rules is to avoid a situation in which admissibility limits are either applied to an excessive degree or not applied at all.

20. Paragraphs 11A and 15A of **Appendix 4.2** do not apply to *shares* in *subsidiary undertakings* which are not *dependants* or in *group undertakings* which are not *subsidiary undertakings* (see table – 7F-I). In such cases the *insurer's* admissibility limits will apply directly to these *shares* (see Table - 5F-I).

Intra-group debt

21. Except in the situation described in the next paragraph, where an *insurer* owes a *debt* to a *related company* or *group undertaking*, it should make full provision under rule 5.2(2) for all expenses that would arise if it had to make repayment of the *debt* either immediately or, if the *debt* is for a fixed term, on expiry of the term. These would include expenses, including taxes, that might be incurred on realising assets to meet the *debt*.

22. Where the *debt* is a long-term arrangement in lieu of payment of dividends or repayment of capital by a *subsidiary undertaking*, the *insurer* should provide for all the costs, including taxes, that would be incurred

on payment of a dividend or repayment of capital (including winding-up the *subsidiary undertaking* if it is dormant).

23. Under rule 4.2(3)(d) *debts* to the *insurer* need not be given a higher value than the value placed on that *debt* by the *insurer*. In certain circumstances it can be advantageous to restrict the value of a *debt*, so that a greater value can be placed on the equity holding in the *related undertaking* (for example, see 19).

Table: Treatment of shares in a group undertaking (rules 4.2, 4.3, 4.14 & 5.3A)

Relationship of the *group undertaking* to the *insurer*	Is the *group undertaking* an *insurance undertaking* or *insurance holding company*?	Basis of valuation	Is the *group undertaking a dependant?*	Is the investment itself restricted under rule 4.14?	Are admissibility limits applied when covering liabilities and *notional required minimum margin* (if any)?	Must the underlying assets be aggregated with the *insurer's exposure* for admissibility purposes?	Does provision need to be made by the *insurer* for any deficit?	
1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	
Subsidiary undertaking	*Insurance undertaking*	*Surplus assets* (cap)	yes	No	Yes	*Surplus assets* only	Yes (100%)	**A**
Subsidiary undertaking	*Insurance holding company*	*Surplus assets* (cap)	yes	No	Yes (optional)	*Surplus assets* only	Yes (100%)	**B**
Subsidiary undertaking	*Insurance holding company*	*Surplus assets* (cap)	yes	No	No (optional)	Yes	Yes (100%)	**C**
Subsidiary undertaking	No	*Surplus assets*	yes	No	Yes (optional)	*Surplus assets* only	No	**D**
Subsidiary undertaking	No	*Surplus assets*	yes	No	No (optional)	Yes	No	**E**
Subsidiary undertaking	No	Market value	No	Yes	No	No	No	**F**
Non-*subsidiary undertaking*	Yes	*Surplus assets* (cap)	No	Yes	No	No	Yes (pro-rata)	**G**
Non-*subsidiary undertaking*	No	*Surplus assets*	No	Yes	No	No	No	**H**
Non-*subsidiary undertaking*	No	Market value	No	Yes	No	No	No	**I**
Note 1		Notes 2 & 3		Note 4	Note 5	Note 6	Note 7	

Notes to the table:

1. Rules 4.2 and 4.3 apply to the value of *shares* in or *debt*s due from *group undertaking*s. *Group undertaking*s extend, under chapter 10, to the *insurer*, its *related undertaking*s, its *participating undertakings* and the *related undertaking*s of its *participating undertakings*.

2. Rule 4.2(1)(a) requires the value of *shares* in a *group undertaking* which is an *insurance undertaking* or *insurance holding company* to be based on its *surplus assets*, determined in accordance with the *Asset Valuation Rules* which require *exposure* in excess of the *permitted asset* and *counterparty exposure* limits to be deducted. For *shares* in any other *group undertaking* either the *surplus assets* can be used, or a market value arrived at by applying rule 4.8. *Insurers* have a free choice as to which to use (the higher may in overall terms be more costly because of the inter-relationship between this rule and the admissibility rules), and may make a different choice for the purpose of the *parent undertaking solvency calculation* (but under Principle 11the *FSA* would expect to be informed).

3. Although for a non-*insurance undertaking* there is a choice as to whether to use *surplus assets* or market value for the purpose of valuing *shares*, rule 4.3 requires the *surplus asset* approach to be taken for valuing *debt*s.

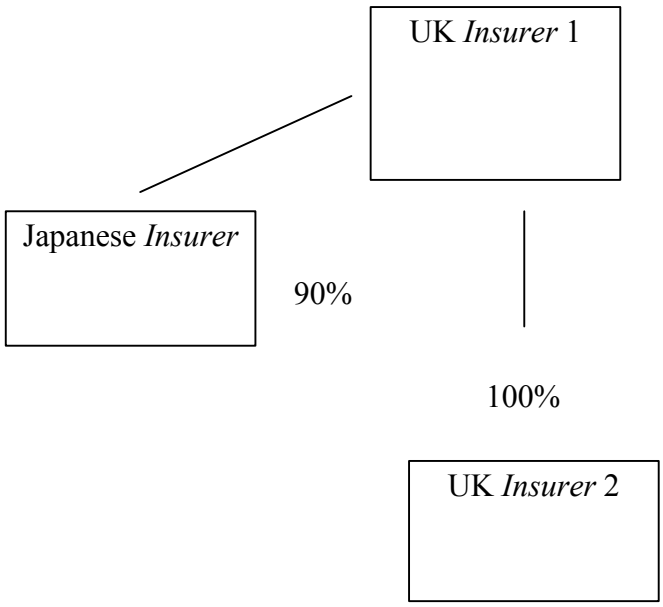
4. Rule 4.14(1) requires the *permitted asset* and *counterparty exposure limits* to be applied to all assets of an *insurer* that are not exempt under 4.14 (5) to (6). There is an exemption under rule 4.14(5)(f) for *shares* in or *debt*s due or to become due from a *dependant*. A *dependant* is defined in rule 11.1 as a *subsidiary undertaking*, the value of whose *shares* is taken to be its *surplus assets* under rule 4.2(1) or (1A)(a).

5. Admissibility limits are applied to *dependants* that are *insurance undertakings* when choosing assets covering the liabilities and *notional required minimum margin*. Application to other *dependants* is optional.

6. Paragraphs 11A and 15A of **Appendix 4.2** require the *insurer's* own *exposure* to assets of a particular description to be increased by an amount representing the asset *exposure* or the *surplus asset exposure*, if any, of the *insurer's dependant*s to assets of that description. The *surplus asset exposure* only applies if admissibility limits are applied to *dependants* when choosing assets covering liabilities and *notional required minimum margin*.

7. Rule 5.3A requires an *insurer* to make provision in respect of a *related undertaking* that is an *insurance undertaking* or *insurance holding company*, in the case of a *subsidiary undertaking* for the whole of any deficit in the assets available to cover liabilities or represent the *notional required minimum margin*, and in the case of a non-*subsidiary undertaking* for the *proportional share* of any such deficit to the extent that provision has not already been made elsewhere for such deficit. *Related undertaking* is defined in rule 11.1 as an undertaking in which a *participation* is held by another undertaking or which is a *subsidiary undertaking*.

Example: Calculation of Solvency Margin



UK *Insurers* 1 and 2 are required to meet the *required solvency margin* (UK *Insurer* 2 will not be required to submit a separate *parent undertaking solvency calculation* in respect of *Insurer* 1 because this calculation provides substantially the same information - see **Guidance Note 10.1**).

Proforma Solvency Margin Calculation:

Example assets and liabilities on regulatory *return* basis:

Company	Assets (excluding book value of subsidiaries)	Liabilities	RMM/Notional RMM
	£m	£m	£m
UK *Insurer* 1	150	80	50
UK *Insurer* 2	100	60	20
Japanese *Insurer*	50	40	20

Step 1 – Calculate the values of subsidiaries of Insurer 1

	UK *Insurer* 2*	Japanese I*nsurer*
	£m	£m
Assets	100	50
Less: liabilities	(60)	(40)
Net assets	40	10
RMM	(20)	(20)
Surplus/(deficit)	20	(10)

* This is the *margin of solvency* to be reported for *Insurer* 2 (assuming it has

no *group undertakings*).

Step 2 – Calculate the solvency position of Insurer 1

	£m	£m
Assets of *Insurer* 1 (excluding book value of subsidiaries)		150
Less: liabilities & RMM of *Insurer* 1		(130)
Net assets of *Insurer* 1 (excluding subsidiaries)		20
Add: surplus value of UK *Insurer* 2*	20	
Less: full deficit for Japanese *Insurer***	(10)	
		10
Solvency surplus (deficit) for *Insurer* 1		30

* Admissibility limits are not applied at this level but in this example, where the *group undertaking* is a *dependant*, *surplus assets* would have be added to any assets of the same description/to the same *counterparty* held by *Insurer* 1 in order to calculate the admissibility of assets held by *Insurer* 1 (according to paragraphs 11A & 15A of Appendix 4.2).

** Where a *subsidiary undertaking* which is an *insurance undertaking* or *insurance holding company* has a *solvency deficit*, its full value must be brought in as a notional liability, even where the *subsidiary undertaking* is less than 100% owned.

If in the above example UK *Insurer* 2 were an overseas *insurer* which in turn had an *insurance subsidiary undertaking*, step 1 would be to calculate the value of the *subsidiary undertaking* of *Insurer* 2. If *Insurer* 2 were located in a

designated state or territory this could either be done according to the local requirements of the *designated state or territory* or according to UK rules, at the option of *Insurer* 1. The former may produce a different outcome from the latter. If *Insurer* 2 were located outside the *designated states or territories FSA* rules would apply. If its *insurance subsidiary undertaking* were located in a *designated state or territory*, this would give *Insurer* 1 the option of using *FSA* or local requirements in determining the assets required to cover liabilities and the *notional required minimum margin* in that subsidiary.

Paragraph 5.5(12) of **Guidance Note 9.1** (Preparation of returns) is amended as follows:

(12) ~~Two~~ Three supplementary notes are specified:

…

(c) the amount of each provision made under rule 5.3A in respect of a deficit in a *related undertaking* which is an *insurance undertaking* or *insurance holding company* and the identity of the undertaking should be stated (code 1403). Such provisions should be included in line 22 of **Form 14**.

Paragraph 5.6(15) of Guidance Note 9.1 is amended as follows:

(15) ~~Three~~ Four supplementary notes are specified:

…

(d) the amount of each provision made under rule 5.3A in respect of a deficit in a *related undertaking* which is an *insurance undertaking* or *insurance holding company* and the identity of the undertaking should be stated (code 1504). Such provisions should be included in line 22 of **Form 15**.

Paragraph 10.1(7) of Guidance Note 9.1 is amended as follows:

(7) ~~Six~~ Seven notes are specified:

…

(g) details of any *material connected-party transactions* as required under rule 9.39 should be stated (code 2007).

Paragraph 14.1(10) of Guidance Note 9.1 is amended as follows:

(10) Eight supplementary notes are specified to **Form 40**:

…

(j) details of any *material connected-party transactions* as required under rule 9.39 should be stated (code 4009).

The following section 20 is added at the end of Guidance Note 9.1 as follows:

20. **MATERIAL CONNECTED-PARTY TRANSACTIONS (rule 9.39)**

Supplementary notes to Forms 20 and 40

20.1 Rule 9.39 requires an *insurer* that has agreed to, or carried out, a *material connected party transaction* to provide a supplementary note describing it to **Form 40** (for a transaction relating to *long-term insurance business*) or **Form 20** (for other transactions). The reference codes should be 4009 and 2007, respectively.

Openness with regulators

20.2 (1) The duty to report *material connected-party transactions* should be seen in the context of Principle 11 of the Principles

for Businesses:

"A *firm* must deal with its regulators in an open and cooperative way, and must disclose to the *FSA* appropriately anything relating to the *firm* of which the *FSA* would reasonably expect notice."

(2) The *FSA* will therefore expect *insurers* to inform them about transactions with other *group* members who are significant for regulatory purposes even if they do not strictly fall within the reporting requirement under rule 9.39.

Connected-party transactions

20.3 (1) The scope of the phrase '*connected* party' is wider than that of the *insurance group* to which *the parent undertaking solvency calculation* applies. A *connected* party includes:

- the *related undertakings* of the *insurer*;
- the immediate, intermediate and ultimate *parent* and *participating undertaking*s of or in the *insurer;* and
- the *related undertakings* of *participating undertakings* in the *insurer*.

A *connected* party may also be a natural person who holds a *participation* in any of the undertakings noted above (see definitions in rule 11.1 of *IPRU(INS)*).

(2) A *connected-party transaction* is defined as "the transfer of assets or liabilities or the performance of services by, to or for a *connected* person irrespective of whether or not a price is charged". As such it includes (but is not limited to):

- loans and similar advances to or from a *connected* person**,** including inter-company balances and other

such operating arrangements,

- investments in the *securities* or *shares* of the *connected* person purchased by the *insurer*,

- investments in the s*ecurities* or *shares* of the *insurer* purchased by the *connected* person,

- guarantees issued to the *connected* person by the *insurer* (and other similar off-balance sheet transactions), or vice versa,

- *reinsurance* cessions to and acceptances from the *connected* person,

- agreements to share the costs of the *connected* person, or to share the costs of the *connected* person with a third party,

- payment of commission (including profit-commission and commission on *reinsurance* premiums) and other acquisition costs to the *connected* person,

- transfer of property to or from the *connected* person, including investments, land, equipment and *debts***,** and

- transfer of liabilities to or from the *connected* person, including transfers of business under section 105 of the *Act*.

(3) Dividends payable are not intended to be covered by the disclosure requirement unless they are part of a wider transaction (because they are already disclosed in the *return*).

(4) A series of transactions that may include intermediate stages with third parties, but are in substance a transaction involving a *connected-party transaction*, are likely to be a *connected-party transaction*.

Materiality

20.4 (1) The materiality of transactions is determined by reference to the *long-term insurance business amount* for transactions relating to *long-term insurance business,* and the *general insurance business amount* for all other transactions. The price or consideration paid or received is not necessarily determinative of value for the purposes of assessing whether the transaction is a *material connected-party transaction*, since the real value of an inter-group transaction may be greater (see definition of *material connected-party transaction*).

(2) Similar transactions, taken together, are material (for the purposes of rule 9.39) if when combined they exceed 5% (in terms of price or value) of the *long-term insurance business amount* or *general insurance business amount*, as applicable. For this purpose the measurement should be done at the time or times the transactions take place. Rather than make a precise measurement, an estimate may be used that is likely to be an underestimate of the *business amount* to avoid the risk of not reporting transactions that should be reported. In general similar transactions will include those of the same type with the same or another *connected* party. Transactions would normally be considered to be of the same type if they were combined in the same heading in the *profit and loss account*, balance sheet or note to the financial statements of the *insurer*, or form part of a connected series of transactions. However, other groups of transactions may be considered as similar even if they do not meet the above criteria.

Aggregation of disclosure

20.5 (1) Rule 9.39(3) allows (but does not require) transactions with the same *connected* person to be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effects of the transactions upon the financial position or profitability of the *insurer*.

(2) Similar transactions (as described in 20.4(2)) with the same *connected* person may be aggregated, for instance all *reinsurance* premiums paid to a *connected* person may be aggregated. However, different types of transaction may not be appropriate for aggregation. For instance it would not in general be appropriate to aggregate loans to a *connected* person with equipment sold to that *connected* person.

(3) Transactions with different *connected* persons of the same type should not be aggregated. For instance, commissions paid to two or more *connected* persons should not be aggregated, even if they need to be taken together to establish materiality, since separate disclosure will normally be necessary for a proper understanding (rule 9.39(3)).

(4) Rule 9.39 does not allow an exemption from disclosure similar to that offered under Financial Reporting Standard No 8 'Related Party Disclosures' where the results of the *insurer* and *connected* persons are reported in consolidated financial statements. *Insurance groups* may have a direction under section 148 of the *Act* allowing preparation of a consolidated **Form 20**. *Insurers* will nevertheless still need to disclose *material connected-party transactions* separately for each *insurer* member of the group. As this is a requirement of Article 8 of the *Insurance Groups Directive*, it is unlikely that the *FSA* would be able to waive the requirement of individual

disclosure.

Disclosure

20.6 (1) The information to be disclosed is set out in rule 9.39(2). The disclosure should be adequate to allow the reader of the *returns* to understand the nature of the relationship of the *insurer* with the *connected* person, and the nature of the transaction and its effect upon the financial position and the performance of the *insurer*.

(2) Therefore, disclosure should include the transactions during the period and any amounts unpaid or outstanding in respect of those transactions at the end of the period.

(3) Consistent descriptions of transactions should be used in subsequent *returns*.

(4) The name of each *connected* person should be stated in full.

(5) Where disclosures under this rule would merely duplicate disclosures reported under other supplementary notes (e.g. large *counterparty exposures*) a cross-reference to the other supplementary notes should fulfil the requirement.

Guidance Note 10.1 is added as follows:

GUIDANCE NOTE 10.1

THE PARENT UNDERTAKING SOLVENCY CALCULATION

Introduction

1. This guidance relates to the *parent undertaking solvency calculation* required by the *Insurance Groups Directive* and implemented in Chapter 10 of

IPRU(INS). The calculation is formulated on a basis analogous to the basis on which *shares* in *group undertakings* are valued for the *required solvency margin* (see paragraphs 4.7 to 4.12 of **Guidance Note 4.1**), but in contrast the *parent undertaking solvency calculation* is applied to an *insurer's ultimate insurance parent undertaking* and its *ultimate EEA insurance parent undertaking*, if different. Valuation of *shares* in *group undertakings* at the solo level focus "downwards" on the *insurer's* holdings in *group undertakings*, whereas the *parent undertaking solvency calculation* focuses "upwards" towards the ultimate parent of the *insurance group* of which it is a member.

Application and scope

2. Under rule 10.1 the *parent undertaking solvency calculation* applies only to an *insurer* whose head office is in the UK (other than a *pure reinsurer*) which is a *subsidiary undertaking* of an *insurance undertaking* (whether engaged in *direct insurance business* or a *pure reinsurer*) or an *insurance holding company* (either of these would be an *insurance parent undertaking*). If an *insurer* has no such parent it is not required to do the *parent undertaking solvency calculation* although it is required to report *material connected-party transactions* (see section 20 of **Guidance Note 9.1**).

3. The information and calculations to be provided under Chapter 10 are in respect of the *insurer* and each member of its *insurance group*. The *insurance group* consists of the *insurer's ultimate insurance parent undertaking* and its *related undertakings* which are *insurance undertakings* or *insurance holding companies*.

4. An *insurance holding company* is an undertaking whose main business is to acquire holdings in *subsidiary undertakings* that are wholly or mainly *insurance undertakings.* In interpreting ‘main business’ and ‘mainly *insurance undertakings*’ the factors which should be taken into account include:

    - whether the main activity of the undertaking is to acquire or hold *shares* and *securities* of *insurance undertakings* or *insurance holding*

companies;

- the proportion of the gross assets of the undertaking represented by its *participations* in *insurance undertakings*;

- the proportion of the net assets of the undertaking represented by its *participations* in *insurance undertakings*;

- the proportion of income (being gross written premiums, turnover or other similar items) of the group from *insurance business*; and

- the risk to capital within the group from the *insurance business* carried on within the group.

An *insurance holding company* under the *Insurance Groups Directive* cannot normally also be a *financial holding company* under *the Banking Co-ordination Directive* and Capital Adequacy Directive (93/6/EEC). Where there is doubt, *firms* should consult their supervisor.

5. Where an *insurer* to which Chapter 10 applies has several *insurance parent undertakings,* the *parent undertaking solvency calculation* applies only to the *ultimate* (worldwide) *insurance parent undertaking* and the *ultimate EEA insurance parent undertaking*, if different. Thus parent calculations do not have to be performed for intermediate parents. Where it is unclear who the *ultimate insurance parent undertaking* is (e.g. in the case of a joint venture), the *insurer* should discuss the issue with the *FSA* well in advance of the time when the calculation is to be provided.

6. Article 3 of the *Insurance Groups Directive* allows *group undertakings* to be excluded from supplementary supervision in certain circumstances including where the undertaking is of negligible interest with respect to the objectives of supplementary supervision or where inclusion would be inappropriate or misleading. Circumstances under which the *FSA* will consider applications for a waiver under section 148 of the *Act* to exclude undertakings under this

provision include *group undertakings* which are in run-off or liquidation. For instance if the *ultimate insurance parent undertaking* or *the ultimate EEA insurance parent undertaking* is in liquidation and the *insurer* is ring-fenced from any claims in respect of that parent, the *FSA* may consider an application to waive the requirements of Chapter 10 in respect of that parent; a condition of waiver may be that another company is treated as the *ultimate insurance parent undertaking* or *the ultimate EEA insurance parent undertaking*.

Timing

7. The *parent undertaking solvency calculation* must be provided within four months of the end of the financial year to which it relates except in the circumstances described in 11 and 12. Under rule 10.1(2), the calculation will generally be made by reference to the last *financial year* (the *financial year in question*) of the *insurer* and will thus be provided within one month from the end of the period for filing the *insurer's return* (or one and a half months where the *return* is not deposited electronically). However rule 10.1(2) allows the calculation to be provided in appropriate cases by reference to the financial year end of the *ultimate insurance parent undertaking* or the *ultimate EEA insurance parent undertaking*. An *insurer* wishing to change the reference date of its group solvency report from its own year end to that of its parent or vice versa should ensure that this does not result in the period between reports being greater than 12 months. If this causes difficulty the *FSA* will consider a modification if the criteria of section 148 of the *Act* are met.

8. Although the information and calculations required under Chapter 10 do not form part of the annual *return*, the *FSA* will adopt a similar enforcement approach to non-compliance with all aspects of Chapter 10, including the timing of submissions, as it does for the annual *return*.

Calculation and reporting responsibilities

9. Where several *insurers* to which Chapter 10 applies have the same *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking*

or both, the *parent undertaking solvency calculation* requirement applies to all of them. In these circumstances, under rule 10.4(1)(d), one *insurer* may submit the information required in Chapter 10 on behalf of the other *insurers* in the *insurance group*. This should consist of one package of the relevant information with confirmation that the *insurer* submitting the information has made it available to the Boards of directors of the other *insurers* in the *insurance group.* The purpose of this requirement is to ensure that all the *insurers* in the group are aware of the relevance of the group information to themselves.

10. Where the requirements of rule 10.2(4) are met (in most cases where an EEA competent authority has agreed to be responsible for exercising supplementary supervision or the head office of the *insurer's ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* is situated in another *EEA State*), the UK *insurer* may, instead of complying with rules 10.2(1)(d) and (e) and 10.2(3), provide a *parent undertaking solvency calculation* and the information required under rule 10.2(1)(d) and (e) prepared under the requirements of that other State.

11. In these circumstances, it will remain the *insurer's* responsibility to ensure that the calculation is submitted to the *FSA*. This must done within the period set by the relevant competent authority or within six months of the relevant year-end date, whichever is the earlier.

12. Rules 10.2(5) and 10.2(6) allow the method of preparing the *parent undertaking solvency calculation* to be adapted where the head office of the *ultimate insurance parent undertaking* is outside the EEA.

13. Where the *parent undertaking solvency calculation* and deficit details required under rules 10.2(1)(d) and (e) have been prepared according to the requirements of another *EEA State*, an audit statement by a local auditing firm to that effect should fulfil the requirement in rule 10.4(1)(c) in respect of that calculation. Where such an audit statement is supplied and has been included in a declaration under Chapter 10 submitted by an *insurer*, the UK auditor

should exclude the information from the scope of its review.

14. Where an *insurance group* consists of an *ultimate insurance parent undertaking* which is itself an *insurer* whose head office is in the UK and which has a UK *insurance subsidiary* or *subsidiaries* which is or are themselves *insurers*, the *parent undertaking solvency calculation* will cover the same *group undertakings* as the parent's own adjusted solvency requirement. The results may differ because admissibility limits will not apply to the *parent undertaking solvency calculation* (and hence that calculation will often produce a higher result). The subsidiary *insurer* need not in these circumstances deposit the *parent undertaking solvency calculation*. However, this does not affect the requirement to provide information under rule 10.2(1).

15. As with the solo *firm* rules, accounts drawn up according to local accounting standards and requirements may be used for *designated states or territories*, adjusted if necessary to meet the regulatory requirements in Chapter 10. *Insurers* may apply for a direction under section 148 of the *Act* modifying *FSA* rules to allow them to use other relevant local requirements. In that event it will generally be necessary to establish that they are at least equivalent to UK standards (and see *SUP* 8).

16. Under rule 10.1(2)(b), where a member of an *insurance group* has a different year end to that by reference to which the Chapter 10 information and calculations are provided, the principles of Financial Reporting Standard 2 should be followed; that is:

    - where the period difference is three months or less, the most recently completed financial statement should be used;

    - where the period difference is greater than three months, adjustments should be made for material differences.

17. Even where the *group* of which the *insurer* is a member holds interests in *insurance undertakings* through a corporate structure which does not

constitute an *insurance group* as defined, the *FSA* may need full information about the *group* of which the *insurer* is a member in order to exercise effective supervision over the *insurer*. In these circumstances the *FSA* may, under its powers in Part XI of the *Act*, require information about that *group* to be supplied in broadly equivalent terms to that provided for under Chapter 10. Similarly where an *insurance group* is part of a wider *group*, the *FSA* may require information about that wider *group*.

Basic requirements

18. Rule 10.2(1) (a) to (c) requires information about each member of an *insurance group* and the relationship between them. This may be provided in the form of the example at the end of this Guidance Note or by means of an annotated structure chart together with a list of cross-holdings of *shares* by class and voting rights in each *insurer* and *insurance holding company* in the *insurance group*. Where an *insurer* submits an annual close links report under *SUP* 16.5, a cross-reference to information in that report may be sufficient to the extent that it also satisfies the information requirements in rule 10.2(1)(a) to (c) (in these circumstances auditors should include the close links report in the scope of their statement). Principal activity is not included in the close links report and so must be disclosed here.

19. Rule 10.2(1)(d)&(e) require details of the *ultimate*, and *ultimate EEA*, *insurance parent undertaking's* share of any *solvency deficits* in certain members of the *insurance group*. These requirements apply to deficits in *insurance group* members which are *participating* undertakings in the *insurer* and *related undertakings* of the *insurer*, to individual deficits of more than 5% of the positive *relevant parent undertaking solvency calculation* and to sufficient deficits as may be necessary to ensure that deficits not reported do not exceed 10% of the relevant positive *parent undertaking solvency calculation*. Where information on deficits is provided by one member of the *insurance group* on behalf of other members, it must cover the *participating undertakings* in and *related undertakings* of all those other members. The *insurer* will need to perform sufficient analysis on *insurance group*

members outside the direct ownership chain for whom it is not reporting deficits to ascertain that these limits are not breached. Where the relevant *parent undertaking solvency calculation* is negative, all deficits must be reported. The *FSA* considers this minimum level of information on deficits in members of an *insurance group* to be essential for identification of potential risks to an *insurer* arising from its membership of an *insurance group*.

20. The valuation of members of an *insurance group* for the purposes of the *parent undertaking solvency calculation* in rule 10.2(3) is the same as for valuation of *group undertakings* for solvency purposes in rule 4.2 except that the admissibility limits in rule 4.14(1)(a) to (c) are not applied. Thus the *ultimate insurance parent undertaking's surplus assets* and the *ultimate EEA insurance parent undertaking's surplus assets* include their *proportional share* of *surplus assets* of each member of the *insurance group* (*insurance holding companies* being treated as if they were *insurers* with a nil *required minimum margin*), but with excluded excess assets added back in. Once *surplus assets* have been identified at the level of the *ultimate insurance parent undertaking* and the *ultimate EEA insurance parent undertaking*, they must be restated according to *FSA* valuation rules (except where rules 10.2(4) and (5) otherwise provide – these set out the conditions under which the *parent undertaking solvency calculation* and information on deficits may be prepared in accordance with local requirements, namely, where the parent is located in an *EEA State* or in another *designated state or territory)*.

21. Rule 10.2(3) requires a statement of the group *surplus assets* position and an explanation of any deficit, including information on any remedial action taken or planned. The *parent undertaking solvency calculation* is only a requirement to provide information rather than a formal test. If there is a negative result, the explanation should include sufficient information for the *FSA* to determine whether there is a threat to the financial position of the *insurance group* and the *insurers* within it. This may not necessarily be the case. Equally a positive result may not necessarily indicate the absence of such a threat. The objective is that the *FSA* should have sufficient information to

determine whether it should investigate further or take other action. *Insurers* should therefore be ready to provide the *FSA* with background documentation on the calculation if required.

22. Notwithstanding 21, a positive result from the calculation is the standard that an *insurance group* is in normal circumstances expected to achieve. During the life of the interim prudential rules, the *FSA* will consider each case according to its particular facts and will consider using its own-initiative or other power under the *Act* where it considers a threat to the financial position of an *insurer* exists. A potential threat may be indicated, inter alia, by a deficit in the *parent undertaking solvency calculation*, a deficit in the solvency position of individual members of the *insurance group* and by certain intra-group exposures. The *FSA* intends to harden the *parent undertaking solvency calculation* into a requirement in the Integrated Prudential Sourcebook (see CP 97). Details of this will be consulted on in mid-2003 in the context of the implementation of the proposed Financial Groups Directive due to be adopted by the end of this year which will introduce supplementary supervision for financial conglomerates and amend certain aspects of the European directives governing supplementary supervision of insurance groups and financial groups. Financing arrangements which are likely to outlast the expected life span of the Interim Prudential Sourcebook should be made with this in mind.

23. The *Valuation of Assets Rules* permit *shares* in non-*insurance group undertakings* to be valued at *market value* as determined under rule 4.8 (see rule 4.2(1A)(b)). This allows goodwill in non-insurance *group undertakings* to count towards an *insurer's required solvency margin* where appropriate. However the value of any *shares* held in a *group undertaking* arrived at under rule 4.2 is a maximum value which may not always be the appropriate value. Under rule 4.2(1A)(b)(i), *market value* must not exceed the value that could effectively be made available or realised to meet losses (if any) arising in the *insurer*. The *FSA* considers that value relating to future income streams generated from business with other members of the *insurance group* may well be impaired when one or more members of the group are facing problems, this

being precisely a situation in which an *insurer* might wish to realise such value. From 1 May 2003, therefore, goodwill generated from business with members of the *insurance group* (which only includes *insurance undertakings* and *insurance holding companies*) must also be excluded (see rule 4.2(1A)(b)(ii)). It is clearly difficult to identify a single suitable methodology for calculating internal goodwill. But an *insurer* should be able to analyse the difference between the quoted price of the *group undertaking* and its net asset value applying an appropriate estimate of the proportion of the undertaking's business which is intra-group. The basis for this will depend on the type of business of the undertaking but might, for example, be post-tax operating profits or turnover or funds under management. There may be further complications if, for example, provision is already made against elements of future profits. In such circumstances *insurers* may prefer to make a safe-side approximation for internal goodwill and may wish to highlight the impact of the deduction in a note to the *return*.

Hybrid capital

24. The *FSA* may, in appropriate cases, by a direction under section 148 of the *Act* modifying its rules, allow an *insurer* to count the value of certain types of hybrid capital instruments which are issued by a member of the *insurance group* that is not an *insurer* towards a proportion of their group's *notional group solvency margin,* thus enhancing the result of the *parent undertaking solvency calculation*. The type of instruments that will normally be eligible for such treatment and the terms which such instruments should meet in order to qualify are in general the same as those which would apply had the instrument been issued by the *insurer*. These criteria are set out in **Guidance Note 2.1** (and see *SUP* 8).

25. The basis on which a direction under section 148 of the *Act* may permit hybrid capital to count as pure capital, as set out in paragraph 25 of **Guidance Note 2.1**, is different in the case of an issue by an *insurance parent undertaking* from the basis on which hybrid capital is dealt with at the level of *insurers* within the *insurance group.* In the case of parents, the hybrid capital

position is viewed on a group-wide basis. The 50% and 25% limits which, in the case of *insurers*, apply by reference to the *required margin of solvency*, apply, in the case of the parent, by reference to the *insurance group's notional group solvency margin*. This is calculated as the sum of the group's *proportional shares* of the *notional required minimum margins* of the *insurance undertakings* in the group. The limits are reduced by the amount of any hybrid capital issued by members of the *insurance group* (whether in that case those members are *insurance undertakings* or not) and left out of account in determining the liabilities of those members (the *insurance parent undertaking* may itself have a *notional required minimum margin* if it is an *insurance undertaking* in its own right). (See the definitions of *notional group solvency margin* and *used notional group solvency margin* in rule 11.1).

26. If an *insurer* guarantees, directly or indirectly, the issue of hybrid capital instruments by its *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking,* such a guarantee will be taken into account by the *FSA* when determining whether to allow *insurers* in the group to count any part of the hybrid capital issued by the relevant *insurance parent undertaking* towards the *notional group solvency margin* (such guarantees should be disclosed in the annual *return* in supplementary note 1402 or 1502). If the guarantee counteracts the effect of any subordination in that hybrid capital, then it is unlikely that the *FSA* would allow the hybrid capital to count towards the *notional group solvency margin*.

27. The procedure that an *insurer* should follow to support an application for a direction under section 148 of the *Act* in respect of its liability arising from the issue of hybrid debt by an *insurance parent undertaking* varies from the procedure set out in **Guidance Note 2.1** and *SUP* 8 only insofar as the application should be made by the relevant *insurer* or *insurers* in respect of the *parent undertaking solvency calculation* in rule 10.2(2) rather than the *Determination of Liabilities Rules* in chapter 5 of *IPRU(INS)* (one *insurer* may submit a declaration under Chapter 10 on behalf of itself and other *insurers* in its *insurance group*).

28. A proportion of liabilities in respect of cumulative preference *shares* issued by an *ultimate insurance parent undertaking* or *ultimate EEA insurance parent undertaking* may also be left out of account for the purpose of enhancing the result of the *parent undertaking solvency calculation* in accordance with rule 10.3(1)(c).

29. The *FSA* will expect to be consulted at an early stage on plans by *insurance groups* to raise hybrid capital.

EU co-ordination

30. A working group of EEA competent authorities has been meeting on an occasional basis with a view to developing a protocol on co-operation for the purposes of the application of the *Insurance Groups Directive*. This has involved allocating responsibility for co-ordinating the parent undertaking solvency requirements on a group by group basis to the supervisors in the state in which most of a group's business is conducted. That supervisor is responsible for selecting the calculation method and administering the *parent undertaking solvency calculation* in co-ordination with other relevant EEA supervisors of the *insurance group*.

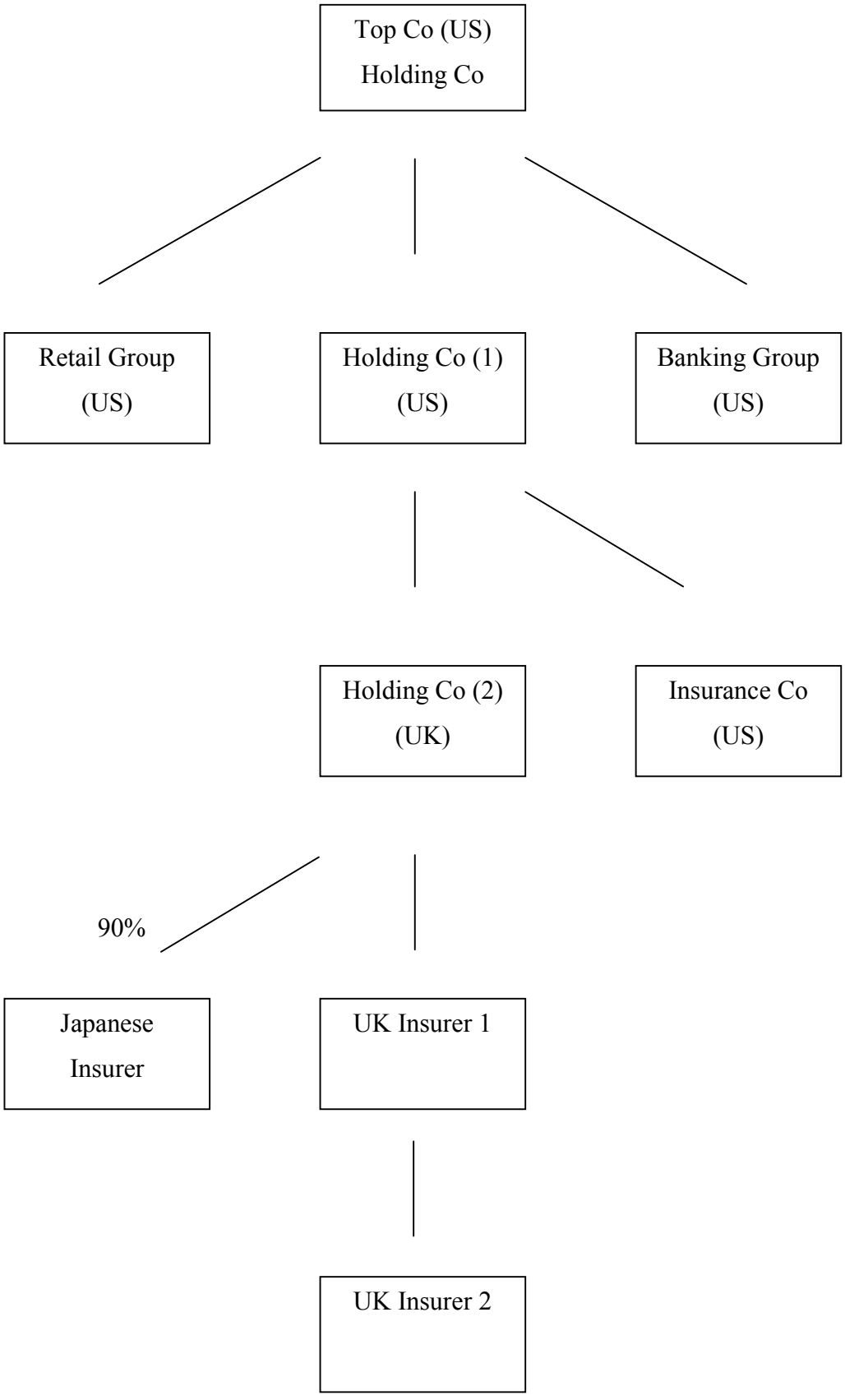
31. The *FSA* will inform *insurers* which are members of an EEA *insurance group* about agreements made with other EEA competent authorities regarding responsibility for the parent undertaking calculation. If that responsibility lies with the UK, then the *insurer* should prepare its *group's parent undertaking solvency calculation* in accordance with *FSA* rules and this Guidance Note. If that responsibility lies with another *EEA State,* the *insurer*:

    a) may be required by a member of its *insurance group* in that other member state to provide local information for the preparation of the group *parent undertaking solvency calculation* under the requirements of that other *EEA State*; and

    b) may submit the *parent undertaking solvency calculation* prepared under

that other state's requirements in lieu of the calculation set out in rule 10.2(3) (see rule 10.2(4)).

A. Example: Calculation of Parent Undertaking Solvency Margin



Note: All companies are 100% owned unless otherwise indicated.

UK *Insurers* 1 and 2 will be required to submit *parent undertaking solvency calculations* in respect of:

- Holding Co (1) – which is the *ultimate insurance parent undertaking*, and
- Holding Co (2) – which is the *ultimate EEA insurance parent undertaking*.
- No *parent undertaking solvency calculation* is required in respect of Top Co as this is a "mixed activity" holding company, i.e. a *parent undertaking* which is not itself an *insurer* or an *insurance holding company* (an undertaking whose main activity is the holding of *participations* in *insurance undertakings*). If, however, the insurance activities of the Top Co group significantly outweighed the retail and banking activities, the *ultimate insurance parent undertaking* calculation would be carried out at the Top Co level.

Proforma Solvency Margin Calculation

Example balance sheets:

Company	Assets (excluding book value of investments in other insurance group members)	Liabilities	RMM/Notional RMM
	£m	£m	£m
Holding Co (1)	100	90	nil
Insurance Co (US)	200	120	40

Holding Co (2)	10	60	nil
Japanese Insurer	50	40	20
UK Insurer 1	150	80	50
UK Insurer 2	100	60	20

The parent solvency position needs to be calculated from the bottom of the group upwards.

Step 1 – Calculate the values of subsidiaries of Holding Co (2)

	UK Insurer 2	UK Insurer 1 excluding UK Insurer 2	UK Insurer 1 including UK Insurer 2	Japanese Insurer
	£m	£m	£m	£m
Assets	100	150	170*	50
Less: liabilities	(60)	(80)	(80)	(40)
Net assets	40	70	90	10
RMM	(20)	(50)	(50)	(20)
Surplus(deficit)**	20	20	40	(10)

* Assets of UK *Insurer* 1 of £150m plus surplus in UK *Insurer* 2 of £20m.

** Asset and counterparty limits are dis-applied in the parent calculation. When excess assets have been excluded in the surpluses of *Insurer* 1 and 2 they should be added back in.

Step 2 – Calculate the solvency position of Holding Co (2)

	£m	£m
Assets of Holding Co (2) (excluding book value of investments in other *insurance group* members)		10
Less: liabilities of Holding Co (2)		(60)
Net assets of Holding Co (2) excluding *participations*		(50)
Add: *surplus assets* of UK *Insurer* 1 (incl. *Insurer* 2)	40	
Less: Full deficit for Japanese *Insurer**	(10)	
		30
Solvency surplus / (deficit) for Holding Co (2)		**(20)**

*Where an *insurance subsidiary undertaking* has a *solvency deficit*, the full value of that *solvency deficit* must be brought in as a notional liability, even where the subsidiary is less than 100% owned.

Step 3 – Calculate the values of the immediate subsidiaries of Holding Co (1)

	Holding Co (2) (see above)	US Insurer
	£m	£m
Assets	50*	200
Less: liabilities	(70)**	(120)
Net assets	(20)	80

RMM	nil	(40)
Surplus / (deficit)	(20)	40

*Assets of Holding Co 2 of £10m plus values of *participations* of £40m.

** Liabilities of Holding Co 2: £60m plus deficits in *participations* of £10m.

Step 4 – Calculate the solvency position of Holding Co (1)

	£m	£m
Assets of Holding Co (1) (excluding book value of investments in other *insurance group* members)		100
Less: liabilities of Holding Co (1)	(90)	
Net assets of Holding Co (1) excluding *participations*		10
Add: surplus value of US Insurer	40	
Less: deficit for Holding Co (2)	(20)	
		20
Solvency surplus / (deficit) Holding Co (1)		**30**

B: Example: Parent Undertaking Reporting Format

Declaration under IPRU (INS) Chapter 10

Firm's name:

FSA reference number:

Date:

- **IPRU(INS) 10.2R (1)***

A	B	C	D	E	F	G
Company Name **10.2R (1)(a)**	Location of Head Office **10.2R (1)(a)**	Principal Activity **10.2R(1)(a)**	Relationship with other members of Insurance Group **10.2R(1)(b) & 10.2R(1)(c)**		Ultimate insurance parent's share of solvency deficit in company (if any) **10.2R(1)(d)*** **	Ultimate EEA insurance parent's share of solvency deficit in company (if any) **10.2R(1)(e)*** **
			Amount / description of shareholding **	Amount / description of shareholding directly held **		

* The information in columns A to E may alternatively be provided in the form of an annotated group structure chart. Also information already provided in an Annual Close Links Report (see *SUP* 16.5R) need not be duplicated here.

** including classes of shares and voting rights.

*** where deficits have or may have been excluded as a result of the exemptions in (d) or (e), this should be disclosed (it is not necessary to disclose the number or amounts of such deficits).

IPRU(INS) 10.2R (3)

	Rule	Ultimate Insurance Parent Undertaking	Ultimate EEA Insurance Parent Undertaking
		£	£
Surplus assets	**10.2R (3)(a)**	**A**	**A**
Less			
Any provision for related undertaking	**10.2R (3)(a)(i)**	**B**	**B**
Any deficit in assets available to cover:			
- any liabilities not already provided for	**10.2R (3)(a)(ii)(A)**	**C**	**C**
- the notional minimum margin (if any) of the ultimate			
(ultimate EEA) insurance parent	**10.2R (3)(a)(ii)(B)**	**D**	**D**
Surplus /deficit (**E= A-B-C-D**)		**E**	**E**

Annex B

In the Glossary of Definitions in the FSA Handbook, the definition of *designated State or territory* is amended as follows:

> any *EEA State* (other than the *United Kingdom*), Australia, Canada or a province of Canada, Hong Kong, ~~New Zealand,~~ Singapore, South Africa, Switzerland, ~~the USA~~ a State in the United States of America, the District of Columbia or Puerto Rico.