

**INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES
(REPORTING OF FINANCIAL ENGINEERING) INSTRUMENT 2002**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the "Act"):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 31 December 2002.

Amendments to the Interim Prudential sourcebook for friendly societies

- D. IPRU(FSOC) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Interim Prudential Sourcebook for Friendly Societies (Reporting of Financial Engineering) Instrument 2002.

By order of the Board
19 December 2002

Annex

Amendments to the Interim Prudential sourcebook for friendly societies

In this Annex, except in the case of the new Form 9A and new Annex 8, underlining indicates new text and striking through indicates deleted text.

Rule 5.6 (Balance sheet) is amended as follows:

- (1) The balance sheet must consist of Forms 9, 9A, 13, 14, 15 and 17 (as appropriate) prepared in accordance with the instructions in Appendix 6.

(1A) Form 9A must be completed by every *directive friendly society* in respect of its *long-term insurance business assets*.

...

Paragraph 12 of Appendix 9 (Abstract of actuarial investigation) is amended as follows:

...

- (2) For each treaty of reinsurance where the *friendly society* is the cedant and under which business is in force at the *valuation date* -
 - (a) the name of the reinsurer;
 - (b) whether the reinsurer is authorised to carry on *insurance business* in the United Kingdom;
 - (c) whether the *friendly society* and the reinsurer are connected;
 - (d) an indication of the nature and extent of the cover given under the treaty, including a description of any material contingencies, such as credit risk or legal risk, to which the treaty is subject;
 - (e) the *premiums* payable by the *friendly society* under the treaty during the period;
 - (f) the amount deposited at the *valuation date* in respect of the treaty under any *deposit back arrangements*;
 - (g) the extent to which provision has been made for any liability of the *friendly society* to refund any amounts of reinsurance commission in the event of lapses or surrender of the contract; and

(h) whether the treaty is closed to new business.

(3) For each 'financing arrangement' -

(a) the amount of any undischarged obligation of the *friendly society* and a brief description of the conditions for the discharge of such obligation; and

(b) a description of how, if at all, all such undischarged obligations have been taken into account in the valuation, including a description of the impact of the arrangement on the reported valuation result and any allowance made for material contingencies, such as credit risk or legal risk, associated with the financing arrangement for the purposes of the return.

(4) In this paragraph -

(a) financing arrangement means any contract entered into by the *friendly society*, in respect of *contracts of insurance* of the *friendly society*, which has the effect of increasing the amount of assets included at line 34 of Form 9, representing assets of the *friendly society* which are available to meet its *required minimum margin for long-term insurance business*, and which includes terms for -

(i) the transfer of assets to the *friendly society*, the creation of a *debt* to the *friendly society* or the transfer of liabilities to *policyholders* from the *friendly society* (or any combination of these), and

(ii) an obligation on the *friendly society* to return (with or without interest) some or all of such assets, a provision for the diminution of such *debt* or a provision for the recapture of the liabilities, in each case, in specified circumstances; and

(b) a reinsurer is connected with a *friendly society* if it is a *related undertaking* of the *friendly society*.

In Appendix 10 (Prudential Reporting Forms), the following new Form 9A is inserted after Form 9 (Statement of solvency):

FSC 1 - FORM 9A

Returns under the Friendly Societies Prudential Rules

Analysis of the effect of financial engineering on long-term available assets

Name of Society

Period ended 31 December

| | | |
|--|--|--|
| | Reg No | Units £/£000 |
| <input style="width: 80%; height: 25px;" type="text"/> | <input style="width: 80%; height: 25px;" type="text"/> | <input style="width: 80%; height: 25px;" type="text"/> |

| | | 1 As at the end of the year | 2 As at the end of the previous year |
|--|----|---|---|
| Required minimum margin for long term insurance business (Note 2) | 11 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Excess (deficiency) of available assets and implicit items over the required minimum margin (Note 3) | 12 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Total available assets and implicit items (11+12) | 13 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Analysed as follows: | | | |
| Value of implicit items (Note 5) | 14 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Financial reinsurance – ceded (Note 6) | 15 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Financial reinsurance – accepted (Note 7) | 16 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Outstanding contingent loans (Note 8) | 17 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Any other charges on future profits (Note 9) | 18 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Sum of financial engineering adjustments (14+15-16+17+18) | 19 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Other assets (13-19) | 20 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |
| Total available assets and implicit items (19+20) | 21 | <input style="width: 100%; height: 30px;" type="text"/> | <input style="width: 100%; height: 30px;" type="text"/> |

FSC1 - Notes to Form 9A

1

Under rule 5.6(1A), Form 9A must be completed by every *directive friendly society* for the total of its *long-term insurance business*.

2

The *required minimum margin* must equal line 41 of Form 9 as at the end of the *financial year*.

3

The excess (deficiency) of available assets and *implicit items* over the *required minimum margin* at line 12 must equal line 44 of Form 9 as at the end of the *financial year*.

4

Any arrangement which is not entered in lines 14 – 18, but which falls within the definition of a financing arrangement in paragraph 12(4) of Appendix 9 (Abstract of actuarial investigation) must be disclosed in a supplementary note to this Form.

5

The entry at line 14 (*implicit items*) must equal the sum of lines 31 to 33 of Form 9.

6

The entry at line 15 must equal the gross amount of any contingent liability to repay a *debt* to or recapture a liability from a reinsurer not already recognised in the balance sheet. The *friendly society* must provide in a supplementary note to this Form the following information on each material reinsurance arrangement:-

- the amount of any reinsurance offset (i.e. the amount of the difference between the *mathematical reserves* at the end of the *financial year* were that reinsurance to be ignored and the amount of the *mathematical reserves* after deducting the *mathematical reserves* reinsured);
- the amount of the contingent liability for payment to the reinsurer; and
- the commutation value at the end of the *financial year* of the reinsurance arrangement.

7

The entry at line 16 must equal the amount of any contingent asset receivable from a cedant not already recognised in the balance sheet. The *friendly society* must provide in a supplementary note to this Form the following information on each material outgoing reinsurance arrangement:-

- the amount of any reinsurance liability (i.e. the amount of the difference between the *mathematical reserves* at the end of the *financial year* including the *mathematical reserves* reinsured ‘in’, and the amount of the *mathematical reserves* were that reinsurance to be ignored);
- the amount of the contingent asset for payments from cedants; and
- the commutation value at the end of the *financial year* of the reinsurance arrangement.

- 8** The amount to be shown for contingent loans at line 17 must be the amount, including any interest accrued, still to be repaid from future profits under the arrangements, as at the end of the *financial year*, not already recognised in the balance sheet.
- 9** Line 18 must include the potential charge against future profits in respect of any other types of financial engineering not included in lines 14 to 17 where the gross amount of any contingent liability is not already recognised in the balance sheet.
- 10** The *friendly society* must provide an explanation of the nature of the adjustments in lines 17 and 18 in a supplementary note to this Form, together with the amount of the adjustment for each material arrangement. As part of this note, the commutation value of each of the items included at lines 17 and 18, to the extent that value is not already a component of line 13, must be disclosed.
- 11** Details of any promises to *policyholders* conditional upon future profits (other than bonuses not yet declared), or other charges to future profits not already disclosed, must be provided in a supplementary note to this Form.

The following new Annex 8 is inserted after Annex 7:

Annex 8

GUIDANCE ON THE BALANCE SHEET (Forms 9 to 17)

Financial engineering

1. The statement of solvency in **Form 9**, for *directive friendly societies* carrying on *long-term insurance business*, is calculated on the basis of prudent *technical provisions*. These provisions include margins (or economic reserves) which can be released as ‘future profits’. *Firms* can use, to differing extents, a variety of alternative financing techniques based on the release of future profits to meet their *required minimum margin*.
2. **Form 9A** sets out the effects of these arrangements at the *firm* level. This gives an indication of how much solvency relief the *firm* has obtained in the solvency calculation by using its economic reserves. It therefore aims to provide clearer and more directly comparable information on a *friendly society’s* ability to meet its liabilities.
3. **Form 9A** is required to be completed by every *directive friendly society* which carries on *long-term insurance business* (see rule 5.6(1A)) in accordance with the instructions to the Form.