INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS (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 insurers

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

Citation

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

By order of the Board
19 December 2002

Annex

Amendments to the Interim Prudential sourcebook for insurers

In this Annex, except in the case of the new Form 9A and new paragraphs 5.1A and 5.1B in Guidance Note 9.1, underlining indicates new text and striking through indicates deleted text.

VOLUME ONE

Rule 9.6 (Deposit of accounts etc. with the FSA) is amended as follows:

(1) <u>Subject to (1A),</u> ~~Every~~ <u>every</u> 'account', 'balance sheet', abstract or statement required by rules 9.3, 9.4 and 9.36A and any report of the auditor of the *insurer* made in pursuance of rules 9.5 or 9.36E must be printed, and the 'required copies' must be deposited with the *FSA* within the periods set out in the table below.

	deposit period following the *financial year* end	
***financial year* ending on or after**	**where the deposit is made electronically or under rule 9.36A**	**otherwise**
31 December 2001	4 months	3 months and 15 days
31 December 2002 and following years	3 months	2 months and 15 days

<u>(1A) For a *financial year* ending on a date from 31 December 2002 to 30 December 2003, the deposit periods for the 'required copies' of **Form 9A** set out in (1) are extended by 1 month.</u>

…

Rule 9.12 (Balance sheet) is amended as follows:

…

(2) …

<u>(2A) **Form 9A** must be completed by every *long-term insurer* in respect of the *long-term insurance business* carried on by the *insurer.*</u>

...

VOLUME TWO

In Appendix 9.1 (Balance Sheet and Profit and Loss Account), the following new Form 9A is inserted after Form 9 (Statement of solvency):

Form 9A

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

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

	Company registration number	GL/UK/CM	Period ended day	month	year	Units
R9A						**£000**

		As at the end of this financial year 1	As at the end of the previous year 2	Source
Required minimum margin for long term insurance business	11			See instruction 2
Excess (deficiency) of available assets and implicit items over the required minimum margin	12			See instruction 3
Total available assets and implicit items (11+12)	13			
Analysed as follows:				
Value of implicit items	14			See instruction 5
Financial reinsurance- ceded	15			See instruction 6
Financial reinsurance- accepted	16			See instruction 7
Outstanding contingent loans	17			See instruction 8
Any other charges on future profits	18			See instruction 9
Sum of financial engineering adjustments (14+15-16+17+18)	19			
Other assets (13-19)	20			
Total available assets and implicit items (19+20)	21			

Instructions for completion of Form 9A

1. Form 9A must be completed for the total *long-term insurance business* of the *insurer* (see rule 9.12).

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

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 in question.*

4. Any arrangement which is not entered in lines 14 to 18, but which falls within the definition of financing arrangement in paragraph 12(4) of Appendix 9.4 (Abstract of valuation report) 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 *insurer* 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 in question* 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 in question* 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 *insurer* 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 in question* 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 in question* 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 in question,* 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 *insurer* 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 *policy holders* 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.

Paragraph 12 of Appendix 9.4 (Abstract of valuation report prepared by appointed actuary) is amended as follows:

…

(2) For each treaty of *reinsurance* where the *insurer* 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~~ <u>*insurance business*</u> in the United Kingdom;

(c) whether the *reinsurer* is a *connected company* of the *insurer*;

(d) an indication of the nature and extent of the cover given under the treaty<u>, including a description of any material contingencies, such as credit risk or legal risk, to which the treaty is subject</u>;

(e) the premiums payable by the *insurer* under the treaty during the 'report 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 *insurer* 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 insurer 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<u>, including a description of the impact of the arrangement on the reported valuation result and any allowance made for contingencies, such as credit risk or legal risk, associated with the financing arrangement for the purposes of the return</u>.

(4) In this paragraph -

(a) **financing arrangement** means any contract entered into by the *insurer*, in respect of *contracts of insurance* ~~effected by~~ <u>of</u> the *insurer,* which has the effect of increasing the amount of assets included at line 34 of **Form 9**, representing assets of the *insurer* 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 *insurer*, ~~or~~ the creation of a *debt* to the *insurer* ~~(or both)~~ or the transfer of liabilities to *policy holders* from the *insurer* (or any combination of these), and

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

(b) paragraphs (1), (2) and (3)(a) of rule ~~9.32~~ 9.28 (which relate to connected persons) have effect for the purposes of this paragraph as they have effect for the purposes of those rules.

VOLUME THREE

In Guidance Note 9.1 (Preparation of annual returns), the following new paragraphs 5.1A and 5.1B are inserted after paragraph 5.1:

5.1 …

Analysis of the effect of financial engineering on long-term available assets (Form 9A)

5.1A (1) The statement of solvency in **Form 9**, for *insurers* 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'. *Insurers* can use, to differing extents, a variety of financial engineering arrangements 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 *insurer* has obtained in the solvency margin calculation by using its economic reserves. It therefore aims to provide clearer and more directly comparable information on an *insurer's* ability to meet its liabilities.

Completion of the Form

5.1B (1) **Form 9A** is required by rule 9.12(2A) to be completed by every *insurer* which carries on *long-term business*.

(2) The instructions to **Form 9A** in **Appendix 9.1** contain requirements for completion of the Form.