INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS (SOLVENCY I DIRECTIVE) INSTRUMENT 2003

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 on 1 January 2004 and:

(1) except as provided in (2), applies to insurers, in each case for and from the first day of their respective financial years beginning on 1 January 2004 and during that calendar year;

(2) IPRU(INS) rule 9.6(1B) applies to insurers for their respective financial years ending on dates between 31 December 2003 and 30 December 2004, inclusive.

Amendments to the Interim Prudential sourcebook for insurers

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

Amendments to the Supervision manual

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

Amendment to the Glossary

F. The Glossary is amended in accordance with Annex C to this instrument.

Citation

G. This instrument may be cited as the Interim Prudential Sourcebook for Insurers (Solvency I Directive) Instrument 2003.

By order of the Board
18 September 2003

Annex A

Amendments to the Interim Prudential sourcebook for insurers

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

VOLUME 1

2.4 (1) Subject to (2) to ~~(5)~~ (8), the *margin of solvency* to be maintained by an *insurer* must be determined –

(a) as regards *long-term insurance business,* in accordance with rules 2.5 to 2.8; and

(b) as regards *general insurance business*, by taking the greater of:

(i) the higher of the two sums resulting from the application of the method of calculation set out in **Appendix 2.1,** and

(ii) the ~~two sums~~ sum resulting from the application of the ~~two methods~~ method of calculation set out in ~~**Appendices 2.1**~~ ~~and~~ **Appendix 2.2**.

…

(3) For a *contract of insurance* (to which rule 11.8(a) applies), the ~~*required*~~ *margin of solvency* must be determined by taking the aggregate of the results arrived at by applying –

(a) in the case of so much of the contract as is within any ~~class~~ *class* of *long-term insurance business*, the appropriate method determined by the *Margins of Solvency Rules* for that ~~class~~ *class*; and

(b) in the case of so much of the contract as is within *general insurance business class* 1 or 2, the method of calculation set out in ~~**Appendix 2.1**~~ ~~(excluding paragraphs 6, 7 and 8)~~ (1)(b).

…

(6) Subject to (7), in each case in which (1)(b) applies - including under (3) and rule 2.7(1) - if the *margin of solvency* under (1)(b) is lower than the *required margin of solvency* of the prior *financial year*, then the *margin of solvency* must be adjusted so that it is at least equal to the *required margin of solvency* of the prior *financial year* multiplied by the ratio of the amount of the *technical provisions* for *claims* outstanding at the end of the prior *financial year* and the amount of the *technical provisions* for *claims* outstanding at the beginning of the prior *financial year.*

(7) For the purpose of (6) -

(a) *technical provisions* must not be discounted, or reduced, to take account of investment income, unless -

(i) they relate to risks in *classes* 1 or 2;

(ii) they are reduced to reflect the discounting of annuities; or

(iii) they are established by a *pure reinsurer* that does not have *permission* under the *Act* to effect *contracts of insurance*; and

(b) *technical provisions* must be calculated net of reinsurance; but

(c) the ratio must not be higher than 1.

(8) Where the nature or quality of *reinsurance* relied on to reduce the *required margin of solvency* changes significantly during the *financial year*, an *insurer* must notify the *FSA* forthwith of the change.

2.5 …

(2) For the *first calculation* –

(a) a sum equal to 4% of the *mathematical reserves* for *direct insurance business* and *reinsurance* acceptances without any deduction for *reinsurance cessions* must be taken;

(b) the amount of the *mathematical reserves* at the end of the ~~*preceding*~~ prior *financial year* after the deduction of *reinsurance cessions* must be expressed as a percentage of the amount of those *mathematical reserves* before any such deduction; and

(c) the sum mentioned in (a) must be multiplied –

(i) where the percentage arrived at under (b) is greater than 85% (or, in the case of a *pure reinsurer*, 50%), by that greater percentage, and

(ii) in any other case, by 85% (or, in the case of a *pure reinsurer*, 50%).

(3) For the *second calculation* –

(a) subject to (4), (5) and (6), a sum equal to 0.3% of the ‘capital at risk’ for contracts on which the ‘capital at risk’ is not a negative figure must be taken;

(b) the amount of the ‘capital at risk’ at the end of the ~~*preceding*~~ prior *financial year* for contracts on which the ‘capital at risk’ is not a negative figure, after the deduction of *reinsurance cessions*, must be expressed as a percentage of the amount of that ‘capital at risk’ before any such deduction; and

(c) the sum arrived at under (a) must be multiplied –

(i) where the percentage arrived at under (b) is greater than 50%, by that greater percentage, and

(ii) in any other case, by 50%.

(8) When the amount of the *mathematical reserves* referred to in (2)(a), or the amount of the ‘capital at risk’ referred to in (3)(a), is calculated for the purposes of determining the *margin of solvency*, the day as on which that amount is calculated must be the same as that as on which the *margin of solvency* is determined; and the *mathematical reserves* referred to in (7) must also be calculated as on that day when the ‘capital at risk’ in question is that referred to in (3)(a), but must be calculated as at the end of the ~~*preceding*~~ prior *financial year* when the ‘capital at risk’ in question is that referred to in (3)(b).

2.6 …

(3) In so far as -

(a) an *insurer* bears no investment risk; and

~~(b) the total expired and unexpired term of the relevant contract exceeds five years; and~~

~~(c)~~(b) the allocation to cover *management expenses* in the relevant contract has a fixed upper limit which is effective as a limit for a period exceeding five years,

the *first calculation* must be applied, but as if rule 2.5(2)(a) contained a reference to 1% instead of 4%.

~~(4) If neither (2) nor (3) applies (2), (3) or (3A) does not apply, then, subject to (5), the *required margin of solvency* is zero.~~

(4) In so far as -

(a) an *insurer* bears no investment risk; and

(b) the allocation to cover *management expenses* in the relevant contract does not have a fixed upper limit which is effective as a limit for a period exceeding five years,

the *margin of solvency* is an amount equivalent to 25% of the prior *financial year's* net administrative expenses pertaining to such business.

(5) Where an *insurer* covers a death risk, a sum arrived at by applying the *second calculation* (disregarding rules 2.5(4) and 2.5(5)) must be added to any *margin of solvency*, including a ~~*required*~~ *margin of solvency* of zero, arrived at under (2), (3) or (4).

2.7 (1) For *long-term insurance business* of *class* IV ~~or VI~~, the *margin of solvency* must be determined by applying the *first calculation* plus the sum arrived at by treating the business as *general insurance business* of *class* 2 and applying rule 2.4(1)(b) to it.

(2) For *long-term insurance business* of *class* VI, the *margin of solvency* must be determined by applying the *first calculation.*

(3) If both (1) and rule 2.4(3)(b) apply, a single combined *margin of solvency* must be calculated under rule 2.4(1)(b) in respect of the *class* IV and supplementary *class* 1 and 2 *insurance business*.

…

2.9 (1) An *insurer* must ensure that its *margin of solvency* does not fall below the 'guarantee fund'.

(2) Subject to (3), ~~and~~ to (6), one-third of the *required margin of solvency* constitutes the **guarantee fund**.

(3) The 'guarantee fund' must not be less than an amount (the **minimum guarantee fund**) arrived at in accordance with **Appendix 2.3**, whether the *required margin of solvency* is greater or less than that amount.

(4) In the case of *long-term insurance business*, items that are not *implicit items* must be at least large enough to cover either the 'minimum guarantee fund' or 50% of the 'guarantee fund', whichever is the greater.

(5) In the case of *general insurance business*, unpaid *share* capital (or initial fund of a *mutual*) and any claim which a *mutual* with variable contributions has against its members by way of a call for supplementary contributions for a *financial year* may not be taken into account in complying with (1).

(6) In the case of *long-term insurance business*, unpaid *share* capital (or initial fund of a *mutual*) and *implicit items* which relate to future profits and *zillmerising* may not be taken into account in complying with (1).

2.10 (1) Where an *insurer* has assets equal to or in excess of its liabilities, then, in addition to any other applicable rules, (2) to (~~5~~ 8) have effect for determining the extent to which the value of the assets exceeds the amount of liabilities in connection with the *margin of solvency*, the *required margin of solvency*, the *guarantee fund* and the *minimum guarantee fund*.

(2) ~~Where -~~

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

~~(b) at least one quarter of the fund of a *mutual* is paid up,~~

~~an amount not greater than half the total value of the amounts unpaid may be taken into account as an asset~~ Unpaid or *share* capital or an unpaid amount on partly paid *share* capital (or initial fund of a *mutual*) has no value, and for the purposes of this paragraph a *share* ~~must not~~ is to be regarded as ~~fully~~ partly paid if there are any amounts due but unpaid on it.

(3) Notwithstanding rule 5.2(2), where an *insurer* has issued cumulative preference *shares*, liabilities in respect of such *shares* may be left out of account, in aggregate up to 50% of the lesser of the *margin of solvency* and the *required margin of solvency,* save that liabilities in respect of *shares* which are redeemable for the purposes of section 159 of the *Companies Act* may be left out of account, in aggregate only up to 25% of the lesser of the *margin of solvency* and the *required margin of solvency*.

(4) In the case of a *mutual* with variable contributions carrying on *general insurance business*, any claim which the *mutual* has against its members by way of a call for supplementary contributions for a *financial year* has no value ~~must have its full value for that *financial year*, but the value must not exceed the lesser of -~~

~~(a) 50% of the difference between the maximum contributions and the contributions called in; or~~

~~(b) 50% of the required margin of solvency~~.

(5) The *implicit items* (which relate to future profits, *zillmerising* and hidden reserves) have no value. An *insurer* which applies for a waiver of this rule under section 148 of the *Act* with respect to future profits must submit with the application for waiver:

(a) an actuarial report substantiating the likelihood of the emergence of the future profits in the future; and

(b) a plan as to how it intends to comply with the future limits on, and termination of use of, implicit items for future profits required by the Life Directive (2002/83/EC).

(6) The *margin of solvency* must be reduced by the amount of own *shares* directly held by an *insurer*.

(7) Subject to (8), in the case of an *insurer* which discounts or reduces its *technical provisions* for *claims* outstanding to take account of investment income as permitted by article 60(1)(g) of the *Insurance Accounts Directive*, the *margin of solvency* must be reduced by the difference between: -

(a) the undiscounted technical *provisions* for *claims* outstanding or the *technical provisions* for *claims* outstanding before deductions as disclosed in the notes to the accounts; and

(b) the discounted *technical provisions* for *claims* outstanding or the *technical provisions* for *claims* outstanding after deductions.

For these purposes, *technical provisions* must be calculated net of *reinsurance*.

(8) (7) does not apply to a *pure reinsurer* which does not have permission under the *Act* to effect *contracts of insurance*, risks of *classes* 1 or 2 ,or in respect of the discounting of annuities.

~~(6)~~ (9) For the purposes of the *Margins of Solvency Rules* and the definition of *non-directive insurer*, the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Communities.

…

9.6 …

(1B) (a) An *insurer* must, in respect of any *financial year* ending from 31 December 2003 to 30 December 2004 (inclusive) send to the *FSA*, in addition to the documents in (1), the documents and information in (b).

(b) The documents and information are: -

(i) **Forms 11**, **12** and **60** as amended by the Interim Prudential Sourcebook for Insurers (Solvency I Directive) Instrument 2003, provided that the amended **Form 60** need not be submitted if it contains no information different to the information in the un-amended **Form 60**; and

(ii) the amounts at line 12 of amended **Form 15** and line 61 of amended **Form 13**, if these lines contain amounts different from the amounts at the same lines of the un-amended forms.

(c) The documents and information in (b) must be submitted to the *insurer's* normal supervisory contact at the *FSA* within four months of the end of the *financial* year

…

11.1 Definitions

gross premiums earned	in respect of a *financial year*, ~~means~~ such proportion of *gross premiums written* or *gross premiums receivable*, as the case may be, as is attributable to risk borne by the *insurer* during that *financial year*.

gross premiums written	the amounts required by the insurance accounts rules to be shown in the profit and loss account of a company at general business technical account item I.1.(a), or for *class* IV *insurance business*, at *long-term business* technical account item II.1(a).

margin of solvency	the excess of the value of assets over the amount of liabilities, that value and amount being determined in accordance with the *Valuation of Assets Rules*, ~~and~~ the *Determination of Liabilities Rules* and rule 2.10

non-directive insurer	(1) an *insurer* whose *insurance business* is restricted to the provision of benefits which vary according to the resources available and in which the contributions of the members are determined on a flat-rate basis; (2) an *insurer* whose *long-term insurance business* is restricted to the provision of benefits for employed and self-employed persons belonging to an undertaking or group of undertakings, or a trade or group of trades, in the event of death or survival or of discontinuance or curtailment of activity (whether or not the *commitments* arising from such operations are fully covered at all times by *mathematical reserves*); (3) an *insurer* which undertakes to provide benefits solely in the event of death where the amount of such benefits does not exceed the average funeral costs for a single death or where the benefits are provided in kind; (4) a *mutual* (carrying on *long-term insurance business*) – (a) whose articles of association contain provisions for calling up additional contributions from members or reducing their benefits or claiming assistance from other persons who have undertaken to provide it; and

	(b) whose annual *gross premium* income (other than from contracts of *reinsurance*) has not exceeded ~~500,000~~ <u>5 million</u> Euro for each of the *financial year in question* and the two *previous financial years*; (5) a *mutual* (carrying on *general insurance business*) whose – (a) articles of association contain provisions for calling up additional contributions from members or reducing their benefits; (b) business does not cover liability risks, other than *ancillary risks*, or credit or suretyship risks; (c) *gross premium* income (other than from contracts of *reinsurance*) for the ~~*preceding*~~ *financial year* <u>*in question*</u> did not exceed ~~1,000,000~~ <u>5 million</u> Euro; and (d) members provided at least half of that *gross premium* income; (6) an *insurer* whose *insurance business* (other than *reinsurance*) is - (a) restricted to the provision of assistance for persons who get into difficulties while travelling, while away from home or while away from their permanent residence; (b) carried out exclusively on a local basis and consists only of benefits in kind; and (c) such that the *gross premium* income from the provision of assistance in the *financial year in question* did not exceed 200,000 Euro; or (7) a *mutual* whose liabilities in respect of *general insurance contracts* are fully reinsured with or guaranteed by other *mutuals* (including *friendly societies*), and whose *insurance business* is limited to that described in paragraphs (1) to (7)

Appendix 2.1

GENERAL INSURANCE BUSINESS SOLVENCY MARGIN

FIRST METHOD OF CALCULATION (PREMIUM BASIS)

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1. The *gross premiums receivable* (or contributions, as the case may be) in respect of the *insurer's* entire *general insurance business* for the *financial year in question* must be aggregated and the method of calculation in (1B) to 14 applied.

1A. The *gross premiums earned* (or contributions, as the case may be) in respect of the *insurer's* entire *general insurance business* for the *financial year in question* must be aggregated and the method of calculation in (1B) to 14 applied.

1B. Except in the case of a *pure reinsurer* which does not have permission under the *Act* to effect *contracts of insurance*, premiums in respect of *classes* 11, 12 and 13 must be increased by 50%. Statistical methods may be used to allocate the premiums in respect of these *classes*.

2. From each of the aggregates arrived at under 1 and 1A there must be deducted-

   (a) any taxes included in the *gross premiums* ~~*receivable*~~; and

   (b) any levies that are related to premiums and are recorded in the *insurer's* books as payable in the *financial year in question* in respect of *general insurance business*.

3. The amount arrived at under 2 must be multiplied by 12 and divided by the number of months in the *financial year*.

4. Subject to paragraph 12 of **Appendix 2.3**, if ~~If~~ the amount arrived at under 3 is more than ~~10~~ 50 million Euro, it must be divided into two portions, the former consisting of ~~10~~ 50 million Euro and the latter comprising the excess.

5. Where there has been a division into two portions pursuant to 4, there must be calculated and added together 18% and 16% of the two portions respectively; and where there has been no such division, there must be calculated 18% of the amount arrived at under 3.

6. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 5 applies with the substitution of 6% for 18% and 5

and one-third % for 16%, but only if all the 'necessary conditions' are satisfied.

7. For the purposes of 6, the **necessary conditions** are -

(a) the *gross premiums* ~~*receivable*~~ are calculated on the basis of sickness tables appropriate to the *insurance business*;

(b) the reserves include provision for increasing age, or in the case of *class* IV, either the reserves include provision for increasing age, or the business is conducted on a group basis;

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

(d) the contract does not allow ~~it is not possible for~~ the *insurer* to cancel the contract after the end of the third year of the contract; and

(e) the contract provides for the possibility of increasing premiums or reducing payments during its currency.

8. Where 6 applies to an *insurer* whose *general insurance business* consists partly of health insurance based on actuarial principles and partly of other business, the procedure provided in 1 to 6 must operate separately for each part of the *general insurance business*, so as to produce a sum under 6 for the health insurance and a sum under 5 for the other business.

9. (1) If the 'provision for *claims* outstanding' at the end of the ~~*preceding*~~ *financial year in question* exceeds the provision for *claims* outstanding at the beginning of ~~that year~~ the *financial year* two years prior to the *financial year in question*, then the amount of the excess must be added to the 'amount of ~~claims~~ *claims* paid' in the ~~*preceding financial year*~~ 3 year period.

(2) If the 'provision for *claims* outstanding' at the beginning of the ~~*preceding*~~ *financial year* two years prior to the *financial year in question* exceeds the provision for *claims* outstanding at the end of ~~that year~~ the *financial year in question*, then the amount of the excess must be deducted from the 'amount of *claims* paid' in the ~~*preceding financial year*~~ 3 year period.

10. (1) For the purposes of 9, the **amount of claims paid** in each *financial year*, is the amount that is recorded in the *insurer's* books as at the end of the *financial year* -

(a) in relation to *general insurance business classes* 1 to 17, as paid by the *insurer* (whether or not payment has been effected in that year) in full or partial settlement of the '*claims*' described in (2) and the 'expenses' described in (3); or

(b) in relation to *general insurance business class* 18, as being the costs borne by the *insurer* (whether or not borne in that year) in respect of the assistance given,

less (in either case) any 'recoverable' amounts within the meaning of (4).

(2) The **claims** mentioned in (1) are *claims* under *contracts of insurance* including *claims* relating to business accounted for over a longer period than a *financial year*.

(3) The **expenses** mentioned in (1) are expenses (such as legal, medical, surveying or engineering costs) which are incurred by the *insurer*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).

(4) **Recoverable** amounts for the purposes of (1) are amounts recoverable by the *insurer*, in respect of the '*claims*' mentioned in (1) or other *claims*, including amounts recoverable by way of salvage, amounts recoverable from third parties and amounts recoverable from other *insurers* but excluding amounts recoverable in respect of *reinsurance ceded* by the *insurer*.

11. (1) For the purposes of 9, the **provision for *claims* outstanding**, is (subject to the *Valuation of Asset Rules* and *Determination of Liabilities Rules*) the amount set aside by the *insurer* as at the beginning or end of the period of 3 *financial* ~~*year*~~ *years* as being an amount likely to be sufficient to meet -

(a) the '*claims*' described in (2); and

(b) the 'expenses' described in (3),

less any 'recoverable' amounts within the meaning of (4).

(2) The **claims** mentioned in (1) are *claims* under *contracts of insurance* in respect of incidents occurring -

(a) in the case of an amount set aside as at the beginning of the ~~financial year~~ *financial year*, before the beginning of that year; and

(b) in the case of an amount set aside as at the end of the *financial year*, before the end of that year,

being *claims* which have not been treated as *claims* paid including *claims* relating to business accounted for over a longer period than a *financial year*, *claims* the amounts of which have not been determined and *claims* arising out of incidents that have not been notified to the *insurer*.

(3) The **expenses** mentioned in (1) are expenses (such as legal, medical, surveying or engineering costs) which are likely to be incurred by the *insurer*, whether through the employment of its own staff or otherwise, and are directly attributable to the settlement of individual *claims*, whether or not the individual *claims* in question are those mentioned in (1).

(4) **Recoverable** amounts for the purposes of (1) are amounts estimated by the *insurer* to be recoverable by it in respect of the '*claims*' mentioned in (1), including amounts recoverable by way of salvage, amounts recoverable from third parties and amounts recoverable from other *insurers* but excluding amounts recoverable in respect of *reinsurance ceded* by the *insurer*.

12. From the amount determined under 9(1) or (2) there must be deducted the total sum recoverable in respect of that amount under *reinsurance* contracts *ceded* <u>during the relevant period.</u>

13. The amount determined under 12 must be expressed as a percentage of the amount determined under 9(1) or (2).

14. The sum arrived at under 5 or 6 or the aggregate of the sums arrived at under those paragraphs, as the case may be, must be multiplied -

(a) where the percentage arrived at under 13 is greater than 50% but not greater than 100%, by the percentage so arrived at;

(b) where the percentage so arrived at is greater than 100%, by 100%; and

(c) in any other case, by 50%.

Appendix 2.2

GENERAL INSURANCE BUSINESS SOLVENCY MARGIN

SECOND METHOD OF CALCULATION (CLAIMS BASIS)

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1. In this Appendix **reference period**, in relation to an *insurer*, means either -

(a) the *financial year* ~~which last ended~~ <u>*in question*</u> and the two *previous financial years*; or

(b) the *financial year in question* and the six ~~previous~~ <u>*previous*</u> *financial years* if more than one-half of the *gross premiums* ~~*receivable*~~ in that period were in respect of all or any of the following, namely, storm (as included in *general insurance business* class 8), hail (as included in *general insurance business class* 9), frost (as included in *general insurance business class* 9) and credit (as included in *general insurance business class* 14).

2. If an *insurer* has not been in existence long enough to acquire a 'reference period', this Appendix must be treated as giving a lower result than that given by **Appendix 2.1** and does not otherwise apply to the *insurer*.

<u>2A. Except in the case of a *pure reinsurer* which does not have permission under the *Act* to effect *contracts of insurance*, *claims*, provisions and recoveries in respect of *classes* 11, 12 and 13 must be increased by 50%. Statistical methods may be used to allocate the c*laims*, provisions and recoveries in respect of these *classes*.</u>

3. (1) If the 'provision for *claims* outstanding' at the end of the 'reference period' exceeds the 'provision for *claims* outstanding' at the beginning of the 'reference period', the amount of the excess must be added to the 'amount of *claims* paid' in the 'reference period'.

(2) If the 'provision for ~~claims~~ <u>*claims*</u> outstanding' at the beginning of the 'reference period' exceeds the 'provision for ~~claims~~ <u>*claims*</u> outstanding' at the

end of the ‘reference period’, the amount of the excess must be deducted from the ‘amount of ~~claims~~ *claims* paid’ in the ‘reference period’.

(3) For the purposes of this paragraph, the expressions **amount of claims paid** and **provision for claims outstanding** have, in relation to a ‘reference period’, the same meaning as they have in paragraph 9 of **Appendix 2.1**.

4. The aggregate obtained under 3(1) or (2) must be divided by the number of months in the ‘reference period’ and multiplied by 12.

5. Subject to paragraph 12 of **Appendix 2.3**, if ~~If~~ the amount arrived at under 4 is more than ~~7~~ 35 million Euro, it must be divided into two portions, the former consisting of ~~7~~ 35 million Euro and the latter comprising the excess.

6. Where there has been a division into two portions pursuant to 5, there must be calculated and added together 26% and 23% of the two portions respectively; and where there has been no such division, there must be calculated 26% of the amount arrived at under 4.

7. In the case of *general insurance business* consisting of health insurance based on actuarial principles, 6 applies with the substitution of 8 and two-thirds % for 26% and 7 and two-thirds % for 23%, but only if all the ‘necessary conditions’ are satisfied.

8. The **necessary conditions** for the purposes of 7 are the same as those set out in paragraph 7 of **Appendix 2.1**.

9. In a case of the kind mentioned in 8 of **Appendix 2.1**, that paragraph applies (with the necessary modifications) so as to produce separate sums under 6 and 7.

10. The sum arrived at under 6 or 7 or the aggregate of the sums arrived at under those paragraphs, as the case may be, must be multiplied by the same percentage as is applicable for the purposes of paragraph 14 of **Appendix 2.1**.

Appendix 2.3

MINIMUM GUARANTEE FUND

Long-term business

1. Subject to ~~7~~ 6, 11 and 12, the *minimum guarantee fund* for *long-term insurance business* is -

(a) in the case of a *pure reinsurer* which -

(i) is the wholly-owned *subsidiary* of an *insurer* carrying on *long-term insurance business*, and

(ii) carries on only such *reinsurance* business as is *ceded* to it by that *insurer*,

200,000 Euro;

(b) in the case of a *mutual*, ~~600,000~~ 2,250,000 Euro; and

(c) in any other case, ~~800,000~~ 3 million Euro.

General business

2. Subject to 3 to 7 and 12, the *minimum guarantee fund* for *general insurance business* is 2 million Euro. ~~the amount shown in the table below as applicable to the *general insurance business class* for which the *insurer* has permission under the *Act* (or the highest such amount if the *insurer* has permission for more than one *class*).~~

~~**General Business**~~	~~**Amount**~~
~~*Class* 10, 11, 12, 13, 14, or 15~~	~~400,000 Euro~~
~~*Class* 1, 2, 3, 4, 5, 6, 7, 8, 16, or 18~~	~~300,000 Euro~~
~~*Class* 9 or 17~~	~~200,000 Euro~~

3. ~~In the case where the risks covered fall within *class* 14 and where the annual amount of premiums or contributions of the *insurer* due in respect of that *class* for each of the *financial year in question* and two *previous financial years* exceeded 2,500,000 Euro or 4% of the total amount of premiums or contributions receivable by the *insurer*, for the amount of Euro given in the table in 2 there must be substituted the amount of 1,400,000 Euro.~~ Where *insurance business* is carried on in respect of some or all of the risks included in *classes* 10 to 15, the *minimum guarantee fund* is 3 million Euro.

~~4.~~ ~~Where an *insurer* carrying on *credit insurance business* is required to increase the amount of Euro pursuant to 3, the *insurer* has -~~

~~(a) a period of three years in which to bring the fund up to 1,000,000 Euro;~~

~~(b) a period of five years to bring the fund up to 1,200,000 Euro; and~~

~~(c) a period of seven years to bring the fund up to 1,400,000 Euro,~~

~~such periods to run from the date on which the criteria set out in 3 are fulfilled.~~

~~5.~~ ~~An *insurer* which has permission limited to part of a *class* is, for the purposes of 2, treated as having permission for the whole of the *class*.~~

~~6.~~ 5. In the case of a *mutual*, the *minimum guarantee fund* for general insurance business ~~required by 2 to 5~~ is reduced by 25%.

Long-term and general insurance business

~~7.~~ 6. In relation to a *UK margin of solvency* or *EEA margin of solvency* maintained under rule 2.1(2)(b) or (3)(e), the *minimum guarantee fund* for *long-term* or *general insurance business* is one-half of the amount arrived at by applying (1) to (5) ~~the provisions of this Appendix~~.

Non-directive insurers

7. For *non-directive insurers*, subject to 8 to 10, the *minimum guarantee fund* for *general insurance business* is the amount shown in the table below as applicable to the *general insurance business class* for which the *insurer* has permission under the *Act* (or the highest such amount if the *insurer* has permission for more than one *class*).

General Business	Amount
Class 10, 11, 12, 13, 14, or 15	400,000 Euro
Class 1, 2, 3, 4, 5, 6, 7, 8, 16, or 18	300,000 Euro
Class 9 or 17	200,000 Euro

8. In the case where the risks covered fall within *class* 14 and where the annual amount of premiums or contributions of the *insurer* due in respect of that *class* for each of the *financial year in question* and the two *previous financial years* exceeded 2,500,000 Euro or 4% of the total amount of premiums or contributions receivable or earned by the *insurer*, for the amount of Euro given in the table in 8 there must be substituted the amount of 1,400,000 Euro.

9. An *insurer* which has permission limited to part of a *class* is, for the purposes of 7, treated as having permission for the whole of the *class*.

10. In the case of a *mutual*, the *minimum guarantee fund* required by 7 to 9 is reduced by 25%.

11. For *non-directive insurers*, the *minimum guarantee fund* for *long-term insurance business* is-

    (a) in the case of a *pure reinsurer* which -

        (i) is the wholly-owned *subsidiary* of an *insurer* carrying on *long-term insurance business*, and

        (ii) carries on only such *reinsurance* business as is *ceded* to it by that *insurer*, 200,000 Euro;

    (b) in the case of a *mutual*, 600,000 Euro; and

    (c) in any other case, 800,000 Euro.

Increases to reflect consumer price index

12. Subject to 13 and 14, the base amounts in Euro specified in 1 and 2 and **Appendices 2.1 and 2.2** will increase each year, starting on the first review date of 20 September 2003 (and annually after that), by the percentage change in the European index of consumer prices (comprising all EU member states as published by Eurostat) from 20 March 2002 to the relevant review date, rounded up to a multiple of 100,000 Euro.

13. In any year, if the percentage change since the last increase is less than 5%, then there will be no increase.

14. The increase will take effect 30 days after the EU Commission has informed the European Parliament and Council of its review and the relevant percentage change.

Form 11 of Appendix 9.1 (Balance sheet and profit and loss account) is replaced and Form 12 is amended as follows:

Form 11
(Sheet 1)

General insurance business : Calculation of required margin of solvency - first method and brought forward

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

	Company registration number	GL/UK/CM	Period ended day	Period ended month		Units
R11						£000

				This financial year 1	Previous year 2
Gross premiums receivable			11		
Premium taxes and levies (included in line 11)			12		
Premiums receivable net of taxes and levies (11-12)			13		
Premiums for classes 11, 12 or 13 (included in line 13)			14		
Sub-total A (13 + ½ 14)			15		
Adjusted Sub-total A if financial year is not a 12 month period to produce an annual figure			16		
Division of Sub-total A (or adjusted Sub-total A if appropriate)	Other than health insurance	Up to and including sterling equivalent of 50M EURO x 0.18	17		
		Excess (if any) over 50M EURO x 0.16	18		
	Health insurance	Up to and including sterling equivalent of 50M EURO x 0.06	19		
		Excess (if any) over 50M EURO x 0.16 / 3	20		
Sub-total B (17+18+19+20)			21		
Gross premiums earned			22		
Premium taxes and levies (included in line 22)			23		
Premiums receivable net of taxes and levies (22-23)			24		
Premiums for classes 11, 12 or 13 (included in line 25)			25		
Sub-total H (24 + ½ 25)			26		
Adjusted Sub-total H if financial year is not a 12 month period to produce an annual figure			27		
Division of Sub-total H (or adjusted Sub-total H if appropriate)	Other than health insurance	Up to and including sterling equivalent of 50M EURO x 0.18	28		
		Up to and including sterling equivalent of 50M EURO x 0.18	29		
	Health insurance	Up to and including sterling equivalent of 50M EURO x 0.06	30		
		Excess (if any) over 50M EURO x 0.16 / 3	31		
Sub-total I (28+29+30+31)			32		

Form 11
(Sheet 2)

General insurance business : Calculation of required margin of solvency - first method and brought forward

Name of insurer

Global business/UK branch business/EEA branch business

Financial year ended

	Company registration number	GL/UK/CM	Period ended day	month		Units
R11						£000

			This financial year 1	Previous year 2
Sub-total J (greater of sub-total B and Sub-total I)		40		
Claims paid in period of 3 financial years		41		
Claims outstanding carried forward at the end of the 3 year period	For insurance business accounted for on an underwriting year basis	42		
	For insurance business accounted for on an accident year basis	43		
Claims outstanding brought forward at the beginning of the 3 year period	For insurance business accounted for on an underwriting year basis	44		
	For insurance business accounted for on an accident year basis	45		
Sub-total C (41+42+43-44-45)		46		
Amounts recoverable from reinsurers in respect of claims included in Sub-total C		47		
Sub-total D (46-47)		48		
First result $\text{Sub-total J} \times \frac{\text{Sub-total D}}{\text{Sub-total C}}$ (or, if ½ is a greater fraction, x ½)		49		
Provisions for claims outstanding (before discounting and net of reinsurance)		50		
Brought forward amount (12.43.2 x 50.1 / 50.2 or, if less, 12.43.2)		51		
Greater of lines 49 and 51		52		

General insurance business : Calculation of required margin of solvency - second method, and statement of required minimum margin

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
R12						£000

				This financial year 1	Previous year 2	Source Form	Line	Column
Reference period (No. of financial years) Insert "0" if there Is no reference period otherwise insert "3" or "7"			11			See instruction 1		
Claims paid in reference period			21					
Claims outstanding carried forward at the end of the reference period		For insurance business accounted for on an underwriting year basis	22					
		For insurance business accounted for on an accident year basis	23					
Claims brought forward at the beginning of the reference period		For insurance business accounted for on an underwriting year basis	24					
		For insurance business accounted for on an accident year basis	25					
Sub-total E (21+22+23-(24+25))			29					
Sub-total F - Conversion of Sub-total E to annual figure (Multiply by 12 and divide by number of months in reference period)			31					
Division of Sub-total F	Other than health insurance	Up to and including sterling equivalent of ~~7M~~ 35M EURO x 26/100	32					
		Excess (if any) over ~~7M~~ 35M EURO x 23/100	33					
	Health insurance	Up to and including sterling equivalent of ~~7M~~ 35M EURO x 26/300	34					
		Excess (if any) over ~~7M~~ 35M EURO x 23/300	35					
Sub-total G (32 to 35)			39					
Second result Sub-total G x $\frac{\text{Sub-total D}}{\text{Sub-total C}}$ (or, if ½ is a greater fraction, x ½)			41					

Higher of First result and Brought forward amount	42			11	.	52	
Required margin of solvency (the higher of lines 41 and 42)	43						

Minimum guarantee fund	44						

Required minimum margin (the higher of lines 43 and 44)	49						

Instructions for completion of Form 11

1. Entries in column 2, lines 17-20 and lines 28-31 must be the corresponding entries in column 1 of the form for the previous *financial year*, even if the amount in Euro in the description of the form has changed.

2. 51.2 must be 11.51.1 from the previous year's *return*.

3. If the *financial year* began before 1/1/2004, then the entries in column 2, lines 14, 22-32 and 51 must be blank, and the amounts in column 2, lines 41-45 must relate to a period of 1 *financial year*.

4. Entries in column 2, lines 17-20 and 28-31 must be the corresponding entries in column 1 of the form for the previous *financial year*, even if the amount in Euro in the description of the lines has changed.

Instructions for completion of Form 12

1. Entries in column 2, lines 32-35 must be the corresponding entries in column 1 of the form for the previous *financial year*, even if the amount in Euro in the description of the lines has changed.

2. If the *insurer* has not been in existence long enough to acquire a reference period, lines 21 to 41 must be ignored.

3. *Claims*, provisions and recoveries included in lines 21 to 25 in respect of *classes* 11,12 and 13 must be increased by 50%. Statistical methods may be used to allocate the *claims*, provisions and recoveries in respect of these *classes*. If the *financial year* began before 1 January 2004, then this instruction does not apply to column 2.

Instructions for completion of Forms 11 and 12

1. In the case of a *marine mutual* completing an abbreviated *return* under rule 9.36A, units must be the same as those used in Form M1. If units are in US$ or US$000, then references to the sterling equivalent of Euro in lines 15 to 17 of Form 11 and lines 32 to 35 of Form 12 must be taken to be references to the US$ equivalent of the specified amount of Euro and the Forms must be amended to reflect the use of US$. The bases of conversion adopted must be stated by way of a supplementary note to the Forms. 2. If the *insurer* has not been in existence long enough to acquire a reference period, lines 21 to 41 must be ignored.

~~2. If the *insurer* has not been in existence long enough to acquire a reference period, lines 21 to 41 must be ignored.~~

Form 13 of Appendix 9.1 (Balance sheet and profit and loss account) is amended as follows:

Instructions for completion of Form 13

…

13. Since the *technical provisions* for *claims* outstanding shown in **Form 15** may only be discounted or reduced to take account of investment income in limited circumstances, the amount shown at line 12 of **Form 15** may need to be increased (see instruction 4 to **Form 15**). In such cases, the *reinsurers'* share shown at line 61 must be adjusted to be consistent with the amount shown in line 12.

Form 15 of Appendix 9.1 (Balance sheet and profit and loss account) is amended as follows:

Instructions for completion of Form 15

…

4. The amount shown in line 12 may only be discounted or reduced to take account of investment income:

   (a) for *Class* 1 or 2 business; or

   (b) in respect of annuities; or

   (c) if the *insurer* is a *pure reinsurer* which does not have permission under the *Act* to effect *contracts of reinsurance*.

   So, if the *technical provisions* for *claims* outstanding for other business are discounted or reduced to take account of investment income, then they must be increased by the difference between the undiscounted and the discounted provisions. If *technical provisions* are increased the amount of the increase must be shown by way of a supplementary note to this form, together with the corresponding increase in the *reinsurer's* share shown in line 61 of **Form 13**.

Appendix 9.4

ABSTRACT OF VALUATION REPORT PREPARED BY APPOINTED ACTUARY (FORMS 46 TO ~~61~~60)

All the Forms included in the part of the *return* to which this Appendix relates **(Forms 46** to **49**, **51** to **5**8~~,~~ and **60** ~~and 61~~) are to be laid out as shown in the Appendix, except that the instructions to Forms need not be reproduced.

…

23. (1) A statement of the *required minimum margin* for *long-term insurance business* in the form set out in **Form 60** and of the *required margin of solvency* for Class IV business and supplementary accident and sickness insurance in the form set out in **Forms** ~~**60**~~ **11** and **12**, in accordance with instruction 8 for completion of **Form 60**. When completing **Forms 11** and **12**, the accounting conventions appropriate for *general insurance business* should be followed, but reasonable approximations may be used if they are unlikely to result in an underestimate of the *required margin of solvency*.

(2) If the gross annual office premiums for *Class* IV business and supplementary accident and sickness insurance in force on the 'valuation date' do not exceed 1% of the gross annual office premiums in force on that date for all *long-term insurance business*, **Forms 11** and **12** ~~**61**~~need not be completed as long as it can be stated that the entry in line 10 of **Form 60** exceeds the amount that would be obtained if **Forms 11** and **12** ~~**61**~~ were to be completed. In this circumstance, the method of estimating the entry in line 10 of **Form 60**, together with a statement of the gross annual office premiums in force at the 'valuation date' in respect of *Class* IV business and supplementary accident and sickness insurance, must be given.)

FORMS

[**Forms 46 –** ~~**61**~~ **60** to follow]

…

Instructions for completion of Forms 51, 52, 53 and 54

…

8. …

and particulars must also be shown of any supplementary provisions within *general insurance business class* 1 or 2 which by virtue of ~~the Authorisation Manuary~~ *AUTH* are to be taken to be included in *long-term insurance business* of any *class* (Supplementary *accident* and sickness insurance~~ see **Form 61**~~).

Form 61 of Appendix 9.4 (Abstract of valuation report prepared by appointed actuary) is deleted and form 60 is amended as follows:

Form 60

Long term insurance business: Required minimum margin

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
R60						£000

Class			Classes I, II and IX	Class III business with relevant factor of					Class IV	Class VI	Classes VII and VIII business with relevant factor of					Unallocated additional mathematical reserves with relevant factor of		Total for all classes	
																		The financial year	The previous year
Relevant factor (Instruction 1)			4% 1	4% 2	1% 3	~~Nil~~ Expense related 4	Total 5	4% 6	6A	4% 7	1% 8	~~Nil~~ Expense related 9	Total 10	4% 11	1% 12	13	14
Mathematical reserves before deduction of reinsurance	Reserves before distribution of surplus	11															
	Reserves for bonus allocated to policyholders	12															
	Reserves after distribution of surplus	13															
Mathematical reserves after deduction of reinsurance	Reserves before distribution of surplus	14															
	Reserves for bonus allocated to policyholders	15															
	Reserves after distribution of surplus	16															
Ratio of 16 to 13 or 0.85 if greater (see Instruction 2)		17															
Required margin of solvency - first result = (line 13) * (line 17) * relevant factor		19															
Required margin of solvency based on net administrative expenses (see Instruction 7)		20															
Non negative capital at risk before reinsurance (see Instruction 3)	Temporary assurances with required margin of solvency of 0.1%	21															
	Temporary assurances with required margin of solvency of 0.15%	22															
	All other assurances with required margin of solvency of 0.3%	23															
	Total (21 to 23)	29															
Non negative capital at risk after reinsurance (all contracts) (see Instruction 3)		31															
Ratio of line 31 to line 29, or .50 if greater		32															
Required margin of solvency - second result (see Instruction 4)		39															
Sum of first and second results and line 20 (19+20+39)		49															
Required margin of solvency for supplementary Accident and Sickness Insurance and Class V business and the additional margin for Class IV business		51															
Total required margin of solvency for long term insurance business (49+51)		59															
Minimum guarantee fund		61															
Required minimum margin (greater of lines 59 and 61)		69															

Instructions for completion of Form 60

1. The appropriate factors must be as specified in rules 2.5(2)(a) and 2.6(3) and (4).

2. For a *pure reinsurer*, the factor of 0.85 is replaced by 0.50.

3. Capital at risk must be shown after distribution of surplus.

4. Line 39 equals line 32 x [line 21 x 0.1% + line 22 x 0.15% + line 23 x 0.3%] for *classes* I, II and IX or line 32 x line 29 x 0.3% for *class* III, VII and VIII.

5. Any additional *mathematical reserves* ~~referred to~~ shown in ~~the supplementary note to~~ Form 14 line 63 (made in accordance with instruction 7 ~~paragraph 4 of the instructions~~ for completion of that Form) must be included at columns 11 or 12, as appropriate.

6. For *class* V business, the amount of the *required margin of solvency* must be stated in a supplementary note to the Form and must be included in line 51.

7. For business of *classes* III, VII and VIII, as specified in rule 2.6(4), the entry at line 20 is 25% of the *financial year's* net administrative expenses pertaining to business for which the *insurer* bears no investment risk and the allocation to cover *management expenses* is not fixed for a period exceeding five years.

8. For supplementary accident and sickness insurance and *class* IV business taken together, Forms 11 and 12 must be completed and appended to Form 60 (unless the Forms would be blank or paragraph 23(2) of Appendix 9.4 permits the firm not to complete the Forms). Lines 44 and 49 of Form 12 should be left blank. For the purposes of these Forms "health insurance" is health insurance based on actuarial principles that meets the conditions set out in paragraph 7 of Appendix 2.1. The entry at line 51 of Form 60 must equal the entry at line 43 of Form 12 plus the amount to be included for *class* V business (see instruction 6).

VOLUME 3

Guidance Note 2.1

HYBRID CAPITAL: ADMISSIBILITY FOR SOLVENCY

…

5. The ~~*Third Life* and *Third Non Life Directives*~~ Insurance Directives allow the value of ~~four~~ six types of hybrid capital to count as cover for the ~~*required*~~ *margin of solvency*. They are the following -

- subordinated members' accounts (in the case of a *mutual*);
- unpaid *share* capital (or initial fund of a *mutual*);
- in the case of a *mutual* which is a *general insurer* with variable contributions, claims against its members by way of calls for supplementary contributions;
- dated subordinated loan capital;
- perpetual subordinated loan capital; and
- perpetual *securities* with defined characteristics.

…

13. The instruments must at a minimum be compatible with the provisions in Article 16~~(1)~~ of the *First Non-Life Directive* and Article ~~18(1)~~ 27 of the ~~*First Life Directive*~~ Life Directive (2002/83/EC) as appropriate.

14. ~~Indent 1 of~~ Article 16(~~1~~2) sets out the terms relevant for subordinated members' accounts (relevant only to *mutuals* and referred to in this Guidance as the **member's account**). ~~Indent 7~~ Paragraph 3 of the same article specifies the minimum conditions for subordinated loan capital; ~~indent 8~~ and defines the basic terms for the perpetual security. The latter two forms of hybrid capital can be issued by all *insurers*. The terms of Article 18~~(1)~~ are identical in this respect. Paragraph 4 of both articles sets out the minimum requirements for unpaid *share* capital (or initial fund) some of which may be counted once the paid-up part amounts to 25% of the *share* capital or fund, up to 50% of the lesser of the *margin of solvency* and the *required margin of solvency*. For *general insurers*, under Article 16(4), in the case of *mutuals* with variable contributions, claims by way of calls for supplementary contributions within the *financial year* may be taken into account up to ½ of the difference between the maximum contributions and the contributions actually called in, subject to a limit of 50% of the lesser of the *margin of solvency* and the *required margin of solvency*.

14A. (a) Accordingly, a waiver from rule 2.10(2) may be granted where -

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

(ii) at least one quarter of the initial fund of a *mutual* is paid up; but

(b) the value of the waiver cannot exceed the lesser of –

(i) 50% of the total value of the amounts unpaid; and

(ii) 50% of the lesser of the *margin of solvency* and the *required margin of solvency*.

14B. In the case of a *mutual* with variable contributions carrying on *general insurance business*, a waiver from rule 2.10(4) may be granted for claims which the *mutual* has against its members by way of calls for supplementary contributions for a *financial year,* but the value cannot exceed the lesser of -

(a) 50% of the difference between the maximum contributions and the contributions called in; and

(b) 50% of the lesser of the *margin of solvency* and the *required margin of solvency*.

…

25. As far as hybrid capital is concerned, *insurers* will probably be permitted to count the value of loan capital instruments (the aggregate value of all such instruments) as cover for solvency up to 50% of the lesser of their *margin of solvency* and their *required margin of solvency*. Within this overall limit, the value of term stocks (in aggregate) may count for a maximum of 25% of the lesser of the *margin of solvency* and the *required margin of solvency*. An issue the value of which is in excess of this is unlikely to be permitted to count for the purposes of solvency and should continue to be treated as liabilities under the *Determination of Liabilities Rules*.

26. The above should apply in respect of the *long-term* and *general insurance business* of a composite *insurer*, the limits applying to each margin separately where the funds are applied exclusively for the benefit of one or other type of business. Where such an *insurer* wishes to apply the funds raised to its business as a whole (*general* and *long-term insurance business*), the limits set out in the previous paragraph may be permitted to apply to the aggregate of the lesser of the *margins of solvency* and required margins for both types of business.

Guidance Note 2.2

GUIDANCE ON (SET OUT AS PER IPRU (INS)APPLICATIONS FOR WAIVERS RELATING TO IMPLICIT ITEMS)

…

5. The ~~proposed~~ ~~Solvency I~~ Life Directive (2002/83/EC) ~~was published by the EU Commission in October 2000 and a final directive has now been adopted (Directive 2002/12/EC of 5 March 2002, OJ L 77/11, 20.3.2002).~~ ~~This directive~~ requires member states to end a *firm's* ability to take into account future profits *implicit items* by (at the latest) 31 December 2009. Until then, from ~~a time to be established by member states under transitional provisions in the directive~~ 20 March 2007, the maximum amount of these economic reserves that can count will be limited to 25% of the lesser of the ~~available solvency~~ ~~margin~~ *margin of solvency* and the ~~required solvency margin~~ *required margin of solvency*, and the 'average period to run' will be limited to 6 years. This guidance does not anticipate the new limits. ~~The *FSA* will consult on the implementation of new limits in due course.~~ However, waivers will typically only be granted for a maximum of 12 months and *firms* will need to consider the potential impact of these future changes when engaging in future capital planning. Under rule 2.10(5), the *FSA* requires an *insurer* applying for a waiver to submit a plan as to how it intends to comply with the new limits.

…

8. Hidden reserves are net reserves resulting from the underestimation of assets ~~and overestimation of liabilities (other than *mathematical reserves*)~~ in so far as such reserves are not of an exceptional nature.

…

18A. An actuarial report is required to be submitted under rule 2.10(5). The Life Directive (2002/83/EC) prohibits the *FSA* from allowing *implicit items* for future profits to be valued unless:

- an actuarial report is submitted to the *FSA* substantiating the likelihood of emergence of these profits in the future; and

- that part of future profits emerging from hidden net reserves has not already been taken into account.

…

41. The *FSA* will grant waivers permitting *implicit items* due to hidden reserves only in very exceptional circumstances. These items relate to hidden reserves resulting from the underestimation of assets ~~and overestimation of liabilities~~ (other than *mathematical reserves*). The *Valuation of Assets Rules* ~~and *Determination of Liabilities Rules* which apply to assets and liabilities other than *mathematical reserves*~~ are based on current value with adjustments for regulatory prudence such as concentration limits for large holdings, and would not normally be expected to contain hidden reserves.

…

After Guidance note 2.2, insert the following new guidance note:

Guidance Note 2.3

SOLVENCY MARGIN: IMPLEMENTATION OF SOLVENCY 1 DIRECTIVES

1. Rule 2.10(7) does not cover unexpired risk reserves and does not apply to *long-term insurance business.*

2. Some *insurers* carrying on *long-term insurance business* write or have written contracts that combine *Class* IV insurance business with another *Class* of *long-term insurance business*: for instance they might offer critical illness benefits in conjunction with a *Class* I contract. For the purpose of calculating their *required margin of solvency*, such *insurers* will need to allocate their *premiums* and *claims* between *Class* IV and other *Classes*. As stated in paragraph 23(1) of **Appendix 9.4**, reasonable approximations may be used if they are unlikely to result in an underestimate of the *required margin of solvency*.

Guidance Note 9.1

PREPARATION OF RETURNS

…

Calculation of required margins of solvency (Forms 11 and 12)

Margins of Solvency

5.3 …

(6) The *Margin of Solvency Rules* lay down that the *required margins of solvency* ~~margins of solvency~~ are to be calculated as the highest result from the application of ~~three~~ four alternative methods. These are the premium basis, the brought forward amount, the claims basis and the *minimum guarantee fund*. The first two methods ~~is~~ are shown on **Form 11** and the latter two methods together with the comparison of all ~~three~~ methods are shown on **Form 12**.

Form 11: the first method (i.e. the premium basis**)**

(7) Lines 11 and 22: determine the ***gross premium receivable*** and ***gross premiums earned*** in the *financial year*.

(a) ‘gross premium’ means premiums after deduction of discounts, refunds and rebates of premium and before deduction of premiums for *reinsurance* ceded and of commission payable. It includes premiums receivable from *reinsurance* contracts accepted by the *insurer*. In effect, this has the same meaning (subject to one important exception described in (d)) as *gross premiums written* as it occurs in the other forms in the *return*.

(b) the amount of gross premium to be taken is limited by the words 'receivable' and means recorded in the company's books as due to the *insurer* in respect of risks incepted in the *financial year*. Policies transferred to an *insurer* under Part VII of the *Act* (or a transfer under the equivalent law of another *EEA State*) should be considered to be incepted on the date of transfer.

(c) as a result subject to the exception described in (d), gross premiums receivable may be treated as being the same as that portion of *gross premiums written* which is in respect of risks incepted in the *financial year*. This may be derived from the other forms in the *return* as follows: take the sum of the entries in columns 1 and 2 for lines 13 to 15 on all **Forms 21** and of the entry at line 11 for the current underwriting year on all **Forms 24**. In algebraic notation this is: Σ (21.13.1 + 21.13.2 + 21.14.1 + 21.14.2 + 21.15.1 + 21.15.2) for all **Forms 21** + Σ 24.11.(mm-yy) for all **Forms 24**; where mm-yy is the current *financial year*.

(d) the exception in (c) occurs where premiums receivable are excluded from *gross premiums written* as shown in **Forms 21** and **24** by virtue of the rule in paragraph 26 of **Appendix 9.2**. This says that amounts in respect of inwards and outwards *contracts of insurance* must be classified for inclusion in **Forms 20** to **39** according to their economic substance in accordance with generally accepted accounting practice. This, in effect, means that the accounting treatment for so-called financial reinsurances is to be the same in these *return* forms as in the *Companies Act* accounts. This is explained more fully in 8.2.2. The point to note here is that even where, under this rule, the consideration receivable under a *contract of insurance* is not classified as *gross premiums written* for the purposes of those *FSA* forms, it must be included as premiums receivable on **Form 11**. The **Form 11** premiums receivable should include all consideration receivable in respect of contracts which constitute carrying on *insurance business* under the *Act*, and which therefore require authorisation.

(8) Lines 12 and 23: deduct premium taxes and levies, but only to the extent that: (i) in the case of taxes they are included in premiums and (ii) in respect of levies they are related to premiums and are recorded in the *insurer's* books as payable in the appropriate ~~last preceding~~ *financial year* or *years* in respect of *general insurance business* - see paragraph 2 of **Appendix 2.1**. Under generally accepted accounting practice the UK Insurance Premium Tax is excluded from the amount shown for premiums. It should not, therefore, be deducted at line 12 on the form. The anticipated Financial Services Compensation Scheme levy in respect of business written or earned during the

year may be deducted, but only to the extent that a provision for that anticipated liability has been established.

(8A) Lines 14 and 25: statistical methods may be used to allocate the premiums in respect of *classes* 11, 12 and 13.

(9) Lines ~~14~~16 and 27: adjust the sub-total derived from the above to an annual figure if the *financial year* runs for more or less than 12 months.

(10) Lines ~~15~~ 17to ~~19~~20 and 28 to 31: (i) analyse the amount arrived at in lines ~~14~~ 16 and 27 between other and health insurance based on actuarial principles; (ii) in the case of each amount, if appropriate, if the amount arrived at is more than 50 million Euro, divide into two portions of ~~10~~ 50 million Euro~~s~~ and the excess over ~~10~~ 50 million ~~such units~~ and (iii) apply the appropriate percentages (18, 16, 6 or $5^{1}/_{3}$, as the case may be) to the totals arrived at, and add together the resultant sums to determine the *Sub-total B* - see paragraphs 4 to 8 of **Appendix 2.1.** The *FSA* will advise, if requested, whether business carried on under a particular policy falls within the definition of health insurance based on actuarial principles. The £/Euro rate of exchange to be used is that prevailing at the previous 31 October and is advised to *insurers* each year in an *FSA* market letter.

(11) Lines ~~21 to 29~~41 to 46: Determine (i) gross *claims* ~~*paid*~~ paid in the relevant period of 3 *financial* ~~*year*~~ *years*; (ii) gross *claims* ~~*outstanding*~~ outstanding carried forward; and (iii) gross *claims* ~~*outstanding*~~ outstanding brought forward. Determine the gross ~~claims~~ *claims* incurred, *Sub-total C*, as (i) plus (ii) less (iii).

(a) *claims* paid and *claims* outstanding are defined in detail by paragraphs 10 to 11 of **Appendix 2.1**. In essence they refer to the amounts recorded in the *insurer's* books as -

(i) paid in full or partial settlement of or set aside as likely to be sufficient to meet *claims* under *contracts of insurance*; or as

(ii) expenses incurred or set aside as likely to be incurred which are directly attributable to the settlement of individual *claims*; less

(iii) related salvage recoveries, recoveries from third parties and recoveries from other *insurers* (but not *reinsurance* recoveries).

(b) the definition of *claims* outstanding includes the provision for *claims* incurred but not reported.

(c) although the rules are not expressed in these terms, the definitions in (11) of *claims* paid and *claims* outstanding are equivalent (subject to one important exception described in (f)) to the corresponding amounts included in **Forms 22** and **25**, but excluding the *claims* management costs.

(d) for *claims* paid, the equivalent amount is the sum of the amounts at lines 11 and 15 in column 2 in all **Forms 22** and of the amounts line 21 of the total column in all **Forms 24**. In algebraic notation this is: Σ (22.11.2 + 22.15.2) for all **Forms 22** + Σ 24.21.(99-99) for all **Forms 24**.

(e) for *claims* outstanding, the equivalent amount is the sum of the amounts at lines 11 and 15 in column 3 in all **Forms 22** and of the amounts lines 11 and 13 of the total column in all **Forms 25**. In algebraic notation this is: Σ (22.11.3 + 22.15.3) for all **Forms 22** + {25.11.(99-99) + 25.13.(99-99)} for all **Forms 24**. (NB. for an *insurer* which discounts its *claims* outstanding this requires that the undiscounted provision be taken.) If necessary the brought forward amount (here and on **Form 12**) should be restated as undiscounted.

(f) the exception referred to in (c) arises for the same reason as described in 7(d). Amounts are classified for inclusion in **Forms 22**, **24** and **25** according to their economic substance in accordance with generally accepted accounting practice. However in **Forms 11** and **12** *claims* paid and *claims* outstanding should include all amounts paid or set aside for *claims* under contracts which constitute carrying on *insurance business* under the *Act*, and which therefore require authorisation, even where such amount are not classified as *claims* paid under generally accepted accounting practice.

(12) Lines ~~30 to 39~~ <u>47 and 48</u>:determine the net claims incurred, *Sub-total D*, by deducting from the gross *claims* incurred, *Sub-total C*, the total sum recoverable in respect of that amount under *reinsurance* contracts ceded, see paragraph 12 of **Appendix 2.1**. Line ~~30~~ <u>47</u> should only include amounts classified for inclusion as *reinsurance* in **Forms 22**, **24** and **25** according to their economic substance in accordance with generally accepted accounting practice except that where gross premium has been included in line 11 only by virtue of 11(1), all *reinsurance* of that gross premium (whatever its economic substance) may be included in *Sub-total C.*

(13) Line ~~41~~ <u>49</u>: determine the *first result* by multiplying the *Sub-total* ~~*B*~~ <u>*J*</u> by the ratio of the *Sub-total D* to the *Sub-total C*, (or if that fraction is less than one half, by one half; or if the fraction is more than one, by one). See paragraph 13 and 14 of **Appendix 2.1**.

<u>Form 11 (the brought forward amount)</u>

<u>(13A) The provisions for *claims* outstanding shown in line 50 are to be net of *reinsurance*. The guidance in sub-paragraphs (11) and (12) applies, except that despite (11)(e), claims that are discounted will not need to be restated as undiscounted if they are in respect of *class* 1 or 2 business or for annuities or if the firm is a *pure reinsurer* that does not have *permission* to effect *contracts of insurance*. The brought forward amount in line 51 is then the lower of the</u>

required margin of solvency that applied during the *financial year in question* and that amount multiplied by the ratio of the *claims* outstanding at the end of that *financial year* to the *claims* outstanding at the beginning of that *financial year*.

Form 12: the second (i.e. the claims basis)

(14) Determine the reference period. If an *insurer* has not been in existence long enough to acquire a reference period this should be indicated by entering a zero at the box in line 11 and lines 21 to 41 ignored. For the majority of *insurers* the reference period will be the last three *financial years*. See paragraphs 1 and 2 of **Appendix 2.2**.

(15) Establish the amount of claims incurred in a similar way to that explained in (11)~~, but related throughout to the reference period rather than to the *financial year*~~. For example where the reference period is the last three *financial years* the *claims* incurred should be derived (using the formulae described in (11)) from the amounts reported in the *returns* for those last three years - see paragraph 3 of **Appendix 2.2**. However it is acceptable to restate amounts of *claims* incurred for currency movements.

(16) *Claims*, provisions and recoveries in respect of *classes* 11, 12 and 13 must be increased by 50%. Statistical methods may be used to allocate the c*laims*, provisions and recoveries in respect of these *classes*. Reduce the sum derived to an annual figure by multiplying by 12 and dividing by the number of months in the reference period.

(17) Lines 32 to 39: (i) analyse *Sub-total F* between other and health insurance based on actuarial principles ; (ii) in the case of each amount, if ~~appropriate~~ the amount is more than 35 million Euro, divide into two portions of ~~7~~ 35 million Euro~~s~~ and the excess over ~~7~~ 35 million Euro~~s~~ and (iii) apply the appropriate percentages (26, 23, 8.66 or 7.66, as the case may be) to the totals arrived at and add together the resultant sums to determine *Sub-total G* - see paragraphs 5 to 9 **Appendix 2.2**. The definition of health business and the £/Euro rate of exchange are the same as apply in (10).

(18) Line 41: determine the *second result* by multiplying *Sub-total G* by the ratio of *Sub-total D* to *Sub-total C*, (or if that fraction is less than one half, by one half; or if the fraction is more than one, by one). See paragraphs 13 and 14 of **Appendix 2.1**.

Analysis of admissible assets (Form 13)

Different types of Form 13

5.4 (1) …

Completion of the Form

…

(15A) The amount at line 61 will need to be adjusted to remove any discount to take account of investment income on business where this adjustment has been made to the gross provision (see instruction 13 to **Form 13** and paragraph 5.6(6)).

…

Liabilities – other than long term business (Form 15)

Completion of the Form

5.6 (1) …

Determination of liabilities

…

(6) The requirement in (4)(a) that generally accepted accounting concepts be used means, in effect, that the liabilities at lines 11 to 59 are to be valued for the *returns* in the same way as for the *Companies Act* accounts, except in relation to the *technical provisions* for *claims* outstanding. For *technical provisions* this is indeed explicitly stated by rule 5.4, which refers to the rules in Section D of Chapter II of Schedule 9A to the *Companies Act*. Rule 2.10(7), however, requires that (with certain exceptions) the *margin of solvency* be reduced by the difference between the discounted (to take account of investment income) and undiscounted *technical provisions* for *claims* outstanding. Instruction 4 to the form (and instruction 13 to **Form 13**) therefore requires the amounts at line 12 of **Form 15** and line 61 of **Form 13** to be increased to show amounts that are undiscounted. The adjustment is not required for *pure reinsurers* which do not have *permission* under the *Act* to effect *contracts of insurance*. Nor is it required in relation to annuities or *Class* 1 or 2 business.

…

Supplementary notes

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

…

(e) Where *technical provisions* for *claims* outstanding have to be increased in accordance with instruction 4 to **Form 15** to remove discounting, the amount of the increase, together with the corresponding increase in the *reinsurer's* share shown in line 61 of **Form 13**, must be shown. [Code 1505].

…

Paragraph 23 - Forms 60, 11 and 12 ~~to 61~~

15.10 (1) **Forms 60** ~~and **61**~~, together with **Forms 11** and **12** if required, set out the calculation of the *required minimum margin* (i.e. the greater of the *required margin of solvency* and the *minimum guarantee fund*) for *long-term insurance business*. The legislation provides for a solvency margin in respect of an *insurer's long-term insurance business* as a whole and where more than one *long-term insurance business* fund is maintained the information in ~~**Forms 60** and **61**~~ these forms will relate to all funds combined, including industrial business where this is transacted. Provision is made for the *mathematical reserves* and the calculation of the solvency margin to be shown separately for the main classes of *long-term insurance business* and, for the purposes of reconciliation, *mathematical reserves* ~~attracting a nil rate of~~ where the solvency margin is related to expenses are to be included. *Class* III includes contracts where the benefits are partially linked to investment funds or indices and any reserves for non-linked benefits under such contracts, including those relating to *accumulating with profits* benefits, should be included under *Class* III business in the appropriate column in **Form 60**. The presence of non-linked benefits, including *accumulating with-profits* benefits, does not generally alter the appropriate column for linked benefits.

(2) In **Form 60**, line 51 should equal the figure in line 59 of **Form 61**, together with any class V margin included in the note under instruction 6. Where supplementary accident and sickness insurance or *Class* IV business is written, they should be taken together for the purposes of **Forms 11 and 12**, and determining whether the de minimis limit in paragraph 23(1) is exceeded. It is recognised that accurate completion of **Forms 11 and 12** may not be easy or possible because the accounting conventions for *general insurance business* should be followed. We therefore expect reasonable approximations to be used, if they are unlikely to result in an underestimate of the *required margin of solvency*.

…

Annex B

Amendments to the Supervision manual

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

Issue of a consent notice to the Host State regulator

13.3.5 G …

(3) If the *FSA* has required a financial recovery plan of a *UK firm* of the kind mentioned in paragraph 1 of article 38 of the Life Directive (2002/83/EC) or paragraph 1 of article 20a of the *First Non-Life Directive*, the *FSA* will not give a *consent notice* for so long as it considers that *policyholders'* rights are threatened within the meaning of paragraph 1.

…

Issuing a consent notice or notifying the Host State regulator

13.4.4 G …

(3) If the *FSA* has required of a *UK firm* a financial recovery plan of the kind mentioned in paragraph 1 of article 38 of the Life Directive (2002/83/EC) or paragraph 1 of article 20a of the *First Non-Life Directive*, the *FSA* will not give a *consent notice* for so long as it considers that *policyholders'* rights are threatened within the meaning of paragraph 1.

…

…

18.2.25 G (1) If the transferee is (or will be) an *EEA firm* (authorised in its *Home State* to carry on *business* under the *Insurance Directives*) …

(2) If the transferee is *authorised* in the *United Kingdom*, the *FSA* will need to certify that the transferee will meet its solvency margin requirements after the transfer. If the *FSA* has required of a *UK firm* a financial recovery plan of the kind mentioned in paragraph 1 of article 38 of the Life Directive (2002/83/EC) or paragraph 1 of article 20a of the *First Non-Life Directive*, the *FSA* will not issue a certificate for so long as it considers that *policyholders'* rights are threatened within the meaning of paragraph 1.

…

Appendix 2 (Insurers: Scheme of operations)

…

2.12 Financial Recovery Plan

2.12.1G When:

(1) the *FSA* has required a financial recovery plan within the meaning of article 20a of the *First Non-Life Directive*;

(2) the *FSA* is of the view that *policyholders'* rights are threatened because the financial position of the *insurer* is deteriorating; and

(3) the *FSA* decides to require the *insurer* to hold more capital than would otherwise be required under the *Handbook* to ensure that the *insurer* will be able to fulfil the *required margin of solvency* in the near future;

any such higher capital requirement will be based on the financial recovery plan.

…

Annex C

Amendments to the Glossary

Amend the following definition as shown (underlining indicates new text and striking through indicates deleted text).

non-directive friendly society

…

(d) a *friendly society* (carrying on *long-term insurance business*):

  (i) whose articles of association contain provisions for calling up additional contributions from members or reducing their benefits or claiming assistance from other *persons* who have undertaken to provide it; and

  (ii) whose annual gross premium income (other than from contracts of reinsurance) has not exceeded ~~euro 500,000~~ 5 million Euro for each of the three preceding financial years;

(e) a *friendly society* (carrying on *general insurance business*) ~~whose~~:

  (i) whose registered rules contain provisions for calling up additional contributions from members or reducing their benefits; ~~and~~

  (ii) whose *gross premium* income (other than from contracts of *reinsurance*) for the preceding *financial year* did not exceed ~~1,000,000 Euro~~ 5 million Euro; and

  (iii) whose members provided at least half of that *gross premium* income;

(f) a *friendly society* whose liabilities in respect of *general insurance contracts* are fully reinsured with or guaranteed by other mutuals (including *friendly societies)*;

and in each case whose *insurance business* is limited to that described in any of (a) to (f).