PRUDENTIAL REQUIREMENTS FOR INSURERS (AMENDMENT) INSTRUMENT 2006

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) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force as follows:

(1) The amendments in Annex A to the Glossary of definitions come into force on 31 December 2006.

(2) The remainder of this instrument comes into force on 30 December 2006.

Amendments to the Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

Amendments to FSA Instruments

E. Annex B (Chapters 1 and 2 of GENPRU) to the General Prudential Sourcebook Instrument 2006 (FSA 2006/40) is amended in accordance with Annex B to this instrument.

F. Annex B (Text of INSPRU) to the Prudential Sourcebook for Insurers Instrument 2006 (FSA 2006/42) is amended:

(1) by substituting for INSPRU 7.1 the version of INSPRU 7.1 set out in Annex C to this instrument;

(2) by deleting INSPRU 7 Annex 1G; and

(3) otherwise in accordance with Annex D to this instrument.

G. The General Prudential Sourcebook (Transitional Provisions and Schedules) Instrument 2006 (FSA 2006/51) is amended as follows:

(1) Paragraph C (Commencement) is amended by substituting for sub-paragraph (1) the following:

"(1) The following provisions of the General Prudential Sourcebook (GENPRU) come into force on 31 December 2006:

(a) GENPRU TP 1 to GENPRU TP 6, GENPRU TP 10 to GENPRU TP 13 and GENPRU TP 15;

(b) Schedules 1 to 6 to GENPRU."; and

(2) Annex A (Chapter TP of GENPRU and GENPRU Schedules) is amended in accordance with Annex E to this instrument.

H. Annex A (Amendments to the Glossary) to the CRD (Consequential Amendments) Instrument 2006 (FSA 2006/53) is amended in accordance with Annex F to this instrument.

Citation

I. This instrument may be cited as the Prudential Requirements for Insurers (Amendment) Instrument 2006.

By order of the Board
15 December 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Where new definitions are being inserted, the text is not underlined.

Part 1: New definitions

Insert the following new definitions in the appropriate alphabetical position:

ICA	*individual capital assessment.*
individual capital assessment	(in *INSPRU* and *COB* 6.12) an assessment by a *firm* of the adequacy of its capital resources undertaken as part of an assessment of the adequacy of the *firm's* overall financial resources carried out in accordance with *GENPRU* 1.2.

Part 2: Amended definitions

Amend the following definitions as shown:

realistic excess capital	(in relation to a *with-profits fund*) ~~the excess, if any, of the *realistic value of assets* for the *with-profits fund* over the sum of the *realistic value of liabilities* and the *risk capital margin* for that fund, calculated in accordance with~~ <u>has the meaning set out in</u> *PRU* 7.4.32R.

Annex B

Amendments to Annex B (Chapters 1 and 2 of GENPRU) to the General Prudential Sourcebook Instrument 2006 (FSA 2006/40)

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

…

1.3.41 R (1) For the purposes of *GENPRU* and *INSPRU*, an *insurer* or a *UK ISPV* must apply *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, Adjustments or reserves) to account for:

(a) investments that are, or amounts owed arising from the disposal of:

…

(iv) *units* in *UCITS schemes*, *non-UCITS retail schemes*, *recognised schemes* and any other *collective investment scheme* falling within paragraph(1)(A)(d)(iv) of *GENPRU* 2 Ann 7R~~that invests only in *admissible assets* (including any *derivatives* or *quasi-derivatives* held by the scheme)~~; and

(b) …

(2) …

…

2.1.18 R The *CRR* for any *insurer* to which this *rule* applies (see *GENPRU* 2.1.19R and *GENPRU* 2.1.20R) is the higher of:

(1) the *MCR* in *GENPRU* 2.1.~~25~~24AR; and

(2) the *ECR* in *GENPRU* 2.1.38R.

…

2.1.24 R Subject to *GENPRU* 2.1.26R, for an *insurer* carrying on *general insurance business*, the *MCR* in respect of that business is the higher of…

2.1.24A R Subject to *GENPRU* 2.1.26R, for an *insurer* carrying on *long-term* *insurance business* to which *GENPRU* 2.1.18R applies the *MCR* in respect of that business is the higher of:

(1) the *base capital resources requirement* for *long-term insurance business* applicable to that *firm*; and

(2) the *long-term insurance capital requirement*.

2.1.25 R Subject to *GENPRU* 2.1.26R, for an *insurer* carrying on *long-term insurance business*, but to which *GENPRU* 2.1.18R does not apply, the *MCR* in respect of that business is the higher of:

(1) the *base capital resources requirement* for *long-term insurance business* applicable to that *firm*; and

(2) the sum of:

(a) the *long-term insurance capital requirement*; and

(b) the *resilience capital requirement.*

2.1.27 G … The *resilience capital requirement* is an *FSA* requirement for *regulatory basis only life firms* that is additional to the EC minimum requirement for *long-term insurance business.*

…

2.1.38 R For an *insurer* carrying on *long-term insurance business* the *ECR* in respect of that business is the sum of:

(1) the *long-term insurance capital requirement*; and

~~(2) the *resilience capital requirement;* and~~

(~~3~~2) the *with-profits insurance capital component*.

…

GENPRU 2 Annex 7R

Admissible assets in insurance

(1) (~~1~~A) Investments that are, or amounts owed arising from the disposal of:

…

(d) *units* in:

(i) *UCITS schemes*~~,~~;

(ii) *non-UCITS retail schemes*~~,~~;

(iii) *recognised schemes*; and

(iv) any other *collective investment scheme* where the *insurer's* investment in the scheme is sufficiently small to be consistent with a prudent overall investment strategy, having regard to the investment policy of the scheme and the information available to the *insurer* to enable it to monitor the investment risk being taken by the scheme~~that invests only in *admissible assets* (including any *derivatives* or *quasi-derivatives* held by the scheme)~~;

…

(~~2~~B) Debts and claims

…

(~~3~~C) Other assets

…

(e) for *long-term insurance business* only, reversionary interests.

* ~~A *firm*~~An *insurer* may treat amounts recoverable from an *ISPV* as an *admissible asset* if it obtains a *waiver* under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.

(2) Subject to (3), where an asset would, but for this paragraph, be capable of falling into paragraph (1)(A)(d) above and one or more other categories in paragraph (1) above, that

asset is only capable of falling into paragraph (1)(A)(d).

(3) Where an asset would, but for this paragraph, be capable of falling into paragraph (1)(A)(f) above and one or more other categories in paragraph (1) above, that asset is only capable of falling into paragraph (1)(A)(f).

…

Annex C

INSPRU 7.1

The following section is all new text, and is not underlined. This replaces the previous version of INSPRU 7.1

7.1 Individual Capital Assessment (ICA)

Application

7.1.1 R *INSPRU* 7.1 applies to an *insurer* unless it is:

(1) a *non-directive friendly society*; or

(2) a *Swiss general insurer*; or

(3) an *EEA-deposit insurer*; or

(4) an *incoming EEA firm*; or

(5) an *incoming Treaty firm*.

7.1.2 R Subject to *INSPRU* 7.1.3R, *INSPRU* 7.1 applies to *managing agents* and to the *Society* in accordance with:

(1) for *managing agents*, *INSPRU* 8.1.4R; and

(2) for the *Society*, *INSPRU* 8.1.2R.

7.1.3 R *Managing agents* must carry out assessments of capital adequacy for each *syndicate* they manage by reference to all *open syndicate years* taken together.

Purpose

7.1.4 G *Principle* 4 requires a *firm* to maintain adequate financial resources. GENPRU 2 deals specifically with the adequacy of the *capital resources* element of a *firm's* financial resources.

7.1.5 G The adequacy of a *firm's capital resources* needs to be assessed both by the *firm* and the *FSA*. In *GENPRU* 2.1, the *FSA* sets minimum *capital resources requirements* for *firms*.

7.1.6 G The *FSA* also assesses whether the minimum *capital resources requirements* are appropriate by reviewing:

(1) a *firm's* own assessment of its capital needs; and

(2) the processes and systems by which that assessment is made.

7.1.7 G In assessing whether the minimum *capital resources requirements* are appropriate, the *FSA* is principally concerned with capital resources as calculated in accordance with *GENPRU* 2.2.17R. However, in carrying out its own assessment of its capital needs, a *firm* may take into account other capital available to it (see *GENPRU* 1.2.30R and *GENPRU* 1.2.36R), although it should be able to explain and justify its reliance on these other forms of capital.

7.1.8 G There are two main aims in this section:

(1) to enable *firms* to understand the issues which the *FSA* would expect to see assessed and the systems and processes which the *FSA* would expect to see in operation for *ICAs* by *firms* to be regarded as thorough, objective and prudent; and

(2) to enable *firms* to understand the *FSA's* approach to assessing whether the minimum *capital resources requirements* of *GENPRU* 2.1 are appropriate and what action may be taken if the *FSA* concludes that those requirements are not appropriate to a *firm's* circumstances.

General approach

7.1.9 G The *rules* in *GENPRU* 1.2 require a *firm* to identify and assess risks to its being able to meet its liabilities as they fall due, to assess how it intends to deal with those risks and to quantify the financial resources it considers necessary to mitigate those risks. To meet these requirements, a *firm* should consider:

(1) the extent to which capital is an appropriate mitigant for the risks identified; and

(2) assess the amount and quality of capital required.

7.1.10 G *GENPRU* 1.2.42R requires a *firm* to carry out stress tests and scenario analyses for each of the major sources of risk identified in accordance with *GENPRU* 1.2.30R. A *firm* may also approach the assessment of the adequacy of its capital resources in another way. The method should be proportionate to the size and nature of its business.

7.1.11 G In accordance with *GENPRU* 1.2.60R, these assessments must be documented so that they can be easily reviewed by the *FSA* as part of the *FSA's* assessment of the adequacy of the *firm's capital resources*.

7.1.12 G The *FSA* may ask for the results of these assessments to be provided to it together with a description of the processes by which the assessments have been made, the range of results from each stress test or scenario analysis performed and the main assumptions made. The *FSA* may also carry out a more detailed examination of the details of the *firm's* processes and calculations.

7.1.13 G Based upon this information and other information available to it, the *FSA* will consider whether the *capital resources requirement* applicable to the *firm* is appropriate. Where relevant, the *firm's ECR* will be a key input to the *FSA's* assessment of the adequacy of the *firm's capital resources*. For *firms* carrying on *general insurance business,* the *ECR* is calculated in accordance with *INSPRU* 1.1.72CR. For *realistic basis life firms*, the *ECR* forms part of the *CRR* and is calculated in accordance with *GENPRU* 2.1.38R.

7.1.14 G *Firms* that are required to calculate an *ECR* may wish to note that the *ECR* as calculated is based upon the assumptions that a *firm's* business is well diversified, well managed with assets matching its liabilities and good controls, and stable with no large, unusual, or high risk transactions. *Firms* may find it helpful to assess the extent to which their actual business differs from these assumptions and therefore what adjustments it might be reasonable to make to the *CRR* or *ECR* to arrive at an adequate level of *capital resources*.

Methodology of capital resources assessment

7.1.15 R Where a *firm* is carrying out an assessment of the adequacy of its overall financial resources in accordance with *GENPRU* 1.2, the assessment of the adequacy of the *firm's* capital resources must:

(1) reflect the *firm's* assets, liabilities, intra-group arrangements and future plans;

(2) be consistent with the *firm's* management practice, systems and controls;

(3) consider all material risks that may have an impact on the *firm's* ability to meet its liabilities to *policyholders*; and

(4) use a valuation basis that is consistent throughout the assessment.

Representative of the firm's characteristics

7.1.16 G The *ICA* should reflect both the *firm's* desire to fulfil its business objectives and its responsibility to meet liabilities to *policyholders*. This means that the *ICA* should demonstrate that the *firm* holds sufficient capital to be able to make planned investments and take on new business (within an appropriate planning horizon). It should also ensure that if the *firm* had to close to new business (if it has not already done so), it would be able to meet its existing commitments. The costs of writing new business, the expenses incurred in servicing all liabilities, including liabilities to non-*policyholders*, and the nature of intra-group arrangements and *reinsurance* arrangements should be considered as part of the assessment as well as the costs that would be incurred in the event of closure to new business.

7.1.17 G Where a *firm* has not already closed to new business, the *ICA* should be made on the basis that the *firm* closes to new business after an appropriate period. This period should allow for the time it would take for the *firm* to identify the need for closure and to implement the necessary action.

7.1.18 G Where including new business would increase the capital resources by more than any increase in the capital required, or reduce the capital required by more than any reduction in available capital, new business should be excluded. To the extent that including new business increases the required capital, a *firm* should consider whether it is appropriate to include the additional amount within the *ICA*.

7.1.19 G Any contract that the *firm* is legally obliged to renew should be considered part of the *firm's* existing liabilities and not treated as new business. Such contractual obligations include multi-year *general insurance contracts* and the exercise of options by long-term *policyholders*.

7.1.20 G For a *firm* to discharge its financial obligations to *policyholders*, it will incur certain expenses, including payments to the *firm's* own staff, contributions to any pension scheme and fees to outsourcing suppliers or service companies. All of these expenses, and risks associated with these payments, should be considered when carrying out the *ICA*. When considering the appropriate level of expenses in a projection, the *firm* should consider the acceptability of the service provided to *policyholders* and the resources required by the senior management to manage the *firm*.

7.1.21 G Where a *firm's* liabilities include payments which are subordinated to liabilities to *policyholders*, these payments do not need to be included within the *ICA*. However, the *ICA* should include all payments that must be made to avoid putting *policyholders'* interests at risk, including any payment on which a default might trigger the winding up of the *firm*. For example, if the principal of a loan could be recalled on default of a coupon payment, coupon payments over the lifetime of *policyholder* liabilities should be included in the *ICA*. As a further example, declared dividends should be treated as a liability. However, planned dividends that have not been declared need not be included in the *ICA*.

Intra-group capital considerations

7.1.22 G It is common for *firms* whose corporate *group* consists of a number of separate legal entities to have intra-group transactions in place. Capital and risk may originate within the *firm* and be passed to another company or may originate in another company and be passed to the *firm*. The *ICA* should consider the underlying effect of intra-group arrangements.

7.1.23 G Risks may exist within the individual legal entity from these intra-group transactions. Intra-group transactions should not be treated differently from external transactions just because they are intra-group. However, some intra-group transactions may carry less credit risk than the equivalent external transactions if the *firm* has access to more information regarding the financial position of an internal *reinsurer*. In assessing intra-group risks, consideration should be given, but should not be limited, to:

(1) future defaults on intra-group *reinsurance* arrangements: *Firms* should consider, for example, a test akin to the credit risk assessment undertaken on external *reinsurance* assets held or future anticipated recoveries; in other cases it may be more appropriate to perform a more explicit assessment of the *group* counterparty's own capital position, to inform the *firm's* exposure to default;

(2) non-recoverability on intra-group loans: Even though these transactions occur within the same *group*, there is a risk that an entity may default on such intra-group payments; and

(3) non-payment of future internal dividends or transfers: Many entities or funds within a *group* rely on these payments as a means to maintaining their solvency position. There is a risk that the entity paying the dividend or making the transfer may not be able to do so, and *ICAs* performed for separate regulated legal entities or funds within a *group* should consider these risks as appropriate.

7.1.24 G A *firm's* capital should normally be restricted to resources within the *firm*. Where the *firm* is relying on resources outside the direct control of the *firm*, these should only be included to the extent that the *firm* has a right to call on those resources and the provider has the ability to provide those resources without recourse to the assets of the *firm* itself, in the circumstances considered as part of the *ICA*.

Consistency with a firm's practice, systems and controls

7.1.25 G The *ICA* should reflect the *firm's* ability to react to events as they occur. When relying on prospective management actions, *firms* should understand the implications of taking such actions, including the financial effect, and taking into consideration any preconditions that might affect the value of management actions as risk mitigants.

7.1.26 G The *ICA* should assume that a *firm* will continue to manage its business having regard to the *FSA's* Principles for Businesses. In particular, a *firm* should take into account how the *FSA's* Principles for Businesses may constrain its prospective management actions, for example, *Principle* 6 (Treating Customers Fairly).

7.1.27 G *Firms* should also consider whether their systems and controls provide sufficient information to permit senior management to identify the crystallisation of risks in a timely manner so as to provide them with the opportunity to respond and allow the *firm* to obtain the full value of the modelled management action. *Firms* should also analyse the wider implications of the management actions, particularly where they represent significant divergence from the business plan and use this information to consider the appropriateness of taking this action.

7.1.28 G Where the *ICA* assumes that the *firm* may move capital from one part of its business to another across legal or geographical boundaries, the *firm* should explain the mechanisms that it would apply and satisfy itself that it could achieve the necessary capital movements in times of distress (see *GENPRU* 1.2.51R). The *firm* should also consider any associated costs or restrictions in the amount of capital that would be able to be relocated.

Considering all material risks

7.1.29 G The *ICA* should give the required level of confidence that the *firm's* liabilities to *policyholders* will be paid. The *ICA* should consider all material risks which may arise before the *policyholder* liabilities are paid (including those risks set out in *GENPRU* 1.2.30R).

7.1.30 G *Firms* should not ignore risks simply because they relate to events that occur with an expected likelihood beyond the confidence level. However, the capital required in the face of these tail events may be reduced for the purpose of carrying out the *ICA*. For example, while an A-rated bond may be assumed not to default within the required confidence level, allowance should be made for the devaluation of that bond through a more likely downgrade or change in credit spreads or other method which reflects that this investment includes a default risk to the *firm*.

7.1.31 G Notwithstanding *INSPRU* 7.1.30G, risks which have an immaterial effect on the *firm's* financial position or only occur with an extreme probability may be excluded from the *ICA*.

7.1.32 G The number of *claims*, the amount paid and the timing of a *firm's* liabilities may be uncertain. The *ICA* should consider risks which result in a change in the cost of those liabilities.

7.1.33 G The assets that a *firm* holds will include assets to back both the liabilities and any capital requirement. These assets carry risk, both in their own right and to the extent that they do not match the liabilities that they are backing. The risk associated with these assets should be considered over the full term for which the *firm* expects to carry the liabilities.

7.1.34 G Where the *firm* is relying on systems and controls in order to mitigate risks, the *firm* should consider the risk of those systems and controls failing at the confidence level at which the *ICA* is being carried out.

7.1.35 G If a *firm* summarises cash flows over part of the lifetime of the portfolio using a balance sheet but is exposed to risks which emerge after the balance sheet date, then these longer-dated risks may be captured by adjusting the assumptions used in the closing balance sheet.

Valuation basis

7.1.36 G The valuation of the assets and of the liabilities should reflect their economic substance. A realistic valuation basis should be used for assets and liabilities taking into account the actual amounts and timings of cash flows under any projections used in the assessment.

7.1.37 G In carrying out the *ICA*, wherever possible the value of assets should be marked to market. Where marking to market is not possible, the *ICA* should use a method suitable for assessing the underlying economic benefit of holding each asset.

7.1.38 G The methods and assumptions used in valuing the liabilities should contain no explicit margins for risk, nor should the approach be optimistic. The valuation of liabilities should be consistent with the valuation of assets. To the extent the market price includes an implicit allowance for risk, this should be included within the valuation.

7.1.39 G The methodology used to place a value on an asset or a liability following a risk event should be consistent with the methodology used prior to the risk event.

7.1.40 G Approximate valuation methods may be used by the *firm* for minor lines of business or to capture less material types of risk. However, the *firm* should avoid methods which under-estimate the risk in aggregate.

7.1.41 G The *firm* should carry out a broad reconciliation of key parts of any balance sheet used in the *ICA* with the corresponding entry from audited results.

ICA submitted to FSA: confidence level

7.1.42 R Where the *FSA* requests a *firm* to submit to it a written record of the *firm's* assessments of the adequacy of its capital resources carried out in accordance with *INSPRU* 7.1.15R, those assessments must include an assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities, whether or not this is the confidence level otherwise used in the *firm's* own assessments.

7.1.43 G In considering the value of liabilities for the purpose of *INSPRU* 7.1.42R, *firms* should have regard to the guidance in *INSPRU* 7.1.21G, *INSPRU* 7.1.26G and *GENPRU* 1.2.27G to *GENPRU* 1.2.29G.

7.1.44 G The *FSA* requires *firms* to submit a capital assessment calibrated to a common confidence level, as set out in *INSPRU* 7.1.42R, to enable the *FSA* to assess whether the minimum *capital resources requirements* in *GENPRU* 2.1 are appropriate. This then allows the *FSA* to give a consistent level of *individual capital guidance* across the industry.

7.1.45 G If a *firm* selects a longer time horizon than one year it may choose to use a lower confidence level than 99.5%. In such a case, the *firm* should be prepared to justify its choice and explain why this confidence interval is appropriate and how it is comparable to a 99.5% confidence level over a one year timeframe. An assessment based on a longer timeframe should also demonstrate that there are sufficient assets to cover liabilities at all future dates. This may be illustrated by future annual balance sheets.

Measurement

7.1.46 G In determining the strength of the *ICA*, a *firm* should consider all risks in aggregate making appropriate allowance for diversification such that the assessment meets the required confidence level overall. The *firm* should be able to describe and explain each of the main diversification benefits allowed for.

7.1.47 G For risks that can be observed to crystallise over a short period of the order of a year, the confidence level may be measured with reference to the probability distribution for the impact of the risks over one year. For example, catastrophic events such as hurricanes can be measured in this way by estimating the ultimate capital cost.

7.1.48 G For risks that are not observable over a short period (such as long-tailed liability business or annuitant mortality), the confidence level may be measured with reference to the probability distribution for the emergence of that risk over the lifetime of the liabilities.

Documenting ICAs submitted to the FSA

7.1.49 R The written record of a *firm's individual capital assessments* carried out in accordance with *INSPRU* 7.1.15R submitted by the *firm* to the *FSA* must:

(1) in relation to the assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities, document the reasoning and judgements underlying that assessment and, in particular, justify:

(a) the assumptions used;

(b) the appropriateness of the methodology used; and

(c) the results of the assessment; and

(2) identify the major differences between that assessment and any other assessments carried out by the *firm* using a different confidence level.

7.1.50 G A *firm's* management should determine their own risk appetite or confidence level and a risk measure that they believe is suitable for the management of the business. The *FSA* expects that the *firm's* capital resources assessment under *GENPRU* 1.2 which it uses in the management of its business may well be at a different confidence level than the 99.5% one required by *INSPRU* 7.1.42R for a number of reasons, for example, because its view of capital adequacy is different, or to satisfy the demands of rating agencies, or to meet the proposition to *policyholders* as to the strength of the *firm*. A *firm* will maintain its own written assessment of the adequacy of its financial resources, as required by *GENPRU* 1.2, through the written record requirement of *GENPRU* 1.2.60R.

7.1.51 G *INSPRU* 7.1.49R(2) recognises that a *firm* may carry out a number of different assessments of the adequacy of its capital resources, using different confidence levels, in reaching its overall assessment of the adequacy of its financial resources under *GENPRU* 1.2. The purpose of asking the *firm* to identify the major differences between those assessments and the assessment documented under *INSPRU* 7.1.49R(1) is to enable the *FSA* better to understand the *firm's* approach to capital adequacy and risk management in running its business. Understanding the written record made under *GENPRU* 1.2.60R is therefore key to the *FSA's* understanding of the *firm's* risk and capital management processes.

7.1.52 G The written record of any other assessment by the *firm* required by *GENPRU* 1.2.60R is not itself part of the submission to the *FSA*, but the

FSA is interested in the connection between that other assessment, as documented in the written record required by *GENPRU* 1.2.60R, and the assessment documented under *INSPRU* 7.1.49R(1) in terms of the *firm's* compliance with *GENPRU* 1.2, and the use of capital measures within the *firm*.

7.1.53 G For the purpose of the written record submitted to the *FSA*, the submitted comparison should include:

(1) A description of any direct difference in the strength of the *firm's* own assessment compared to the assessment submitted to the *FSA*. This is likely to be expressed as a different confidence level to the assessment undertaken to a 99.5% confidence level or the targeting of a defined margin about the 99.5% assessment.

(2) A description of any major differences in the definition of the assets or liabilities, the management actions used, the risks considered or the valuation methodology and assumptions included within the assessment.

7.1.54 G Some *firms* may not undertake an assessment at a separate confidence level because they consider that a 99.5% confidence level is appropriate to manage their business and meets the requirements of *GENPRU* 1.2. In the case of these *firms*, no analysis of the major differences is required to be submitted.

Justifying assumptions used

7.1.55 G *Firms* should provide evidence to support the choice of assumptions used within the *ICA*.

7.1.56 G Where the choice of assumptions is supported by data, the *firm* should consider the relevance of that data to the *firm's* current and future circumstances and the robustness of any estimates derived.

7.1.57 G Where the choice of assumptions is supported by expert judgement, the *firm* should consider the nature and value of the expertise being used to support this judgement and any biases that may exist. Where possible, the *firm* should use data to test and support these expert judgements.

Approach taken for significant assumptions

7.1.58 G *Firms* should be able to demonstrate how they have identified the most financially significant assumptions and calculate the sensitivity of the *ICA* to changes in these assumptions. The choice of assumption may be decided using the results of sensitivity testing.

7.1.59 G *Firms* may seek to justify their assumptions by considering the process used to determine those assumptions from relevant data. Alternatively, where historical data is either limited or not considered to be indicative of likely future experience, *firms* may justify their assumptions by reference to the suitability of the calibration for the purpose of the *ICA*. However, relatively more attention should be given to the justification where the choice of assumption has a more significant effect on the *ICA*.

7.1.60 G Where there is a concentration of business from a single source (for example, a single sales channel or cedant), consideration should be given to the greater impact of a risk crystallising, compared to that for a well-diversified portfolio.

Justification of prospective management actions

7.1.61 G Where projection of the value of assets and liabilities reflects the *firm's* prospective management actions, the *firm* should justify the choice of prospective management actions and the assumptions used.

7.1.62 G Where the prospective management action is identical to those used in another regulatory assessment of solvency (e.g. calculation of the *WPICC* for *realistic basis life firms*), no further justification is required.

7.1.63 G Where the prospective management action is not similar to those used in another regulatory assessment of solvency, or uses different assumptions, the *firm* should show the financial impact of the management action.

Regular review of assumptions

7.1.64 G *Firms* should regularly review key parameters, both to ensure their continued applicability and to reduce uncertainty over the current level of capital required. *Firms* using assumptions that are very different from past experience should present robust arguments in support of the differences.

Methodology

7.1.65 G The methodology used within the *ICA* should allow the *firm* to quantify the financial effect of material risks at the required confidence level. The methodology used should also reflect the nature of the *firm's* business and be consistent with the way in which the *firm* identifies and manages risk.

7.1.66 G *Firms* should be able to explain their rationale for choosing their approach to risk and assessment of capital required. There are no simple classifications of approach to risk and capital assessment, so the rationale should be considered in the context of a number of defining characteristics in the structure of the capital model.

7.1.67 G Generally, larger *firms* would be expected to take a more sophisticated approach to capital modelling than smaller ones.

Stress tests and scenario analyses

7.1.68 G A *firm* may choose to carry out the assessment of the adequacy of capital resources through the use of stress testing and scenario analysis (noting that *GENPRU* 1.2.42R requires stress tests and scenario analyses to be undertaken to determine the overall adequacy of a *firm's* financial resources). Where used, such testing should reflect the potential range of outcomes for the risks being quantified, consistent with the prescribed confidence level for the *ICA*.

7.1.69 G The overall assessment of capital required may require the aggregation of results from the stress and scenario testing. The *firm* should explain its choice of aggregation approach and its understanding of the implications of combining the individual risks. The *firm* should be satisfied that the resultant capital provides the required degree of confidence, given the variability of the underlying risks and the uncertainty associated with modelling those risks. A useful component of this process is the characterisation and explanation of a range of possible circumstances that could give rise to a loss of this magnitude.

Documenting the results

7.1.70 G The conclusion of the *ICA* should consider whether the *firm* has adequate capital to meet its assessment of the required capital. Furthermore, the *firm* should consider any implications for its approach to risk management arising from the work carried out. The *ICA* should be supported by an explanation of the material sources of risk and financial impact of the management actions that the *firm* may take to manage those risks. Where possible, the reasonableness of the results should be supported by considering other evidence of the capital needed.

7.1.71 G The objective of capital modelling is to consider all possible outcomes, however unlikely any one outcome might be, and set capital as protection against all but the most extreme losses. It is therefore important to focus not only on the assumptions and methodology used to quantify individual risks, but also on the approach to aggregating the capital required for each risk.

7.1.72 G However the risks have been aggregated to give the *firm's* capital requirement, checks should be made as to the reasonableness of the outcome. It should be possible to characterise scenarios, or combinations of loss events, that would result in a loss of similar magnitude to that indicated by the *ICA*. *Firms* should consider a range of scenarios that could give rise to such a loss.

7.1.73 G The results of the *ICA* should be supplemented by analysis of the sources of the risks to which the *firm* is exposed, discussion of the events which are most likely to threaten the financial stability of the *firm* and the potential mitigating actions which are available to senior management.

Additional guidance for Lloyd's

7.1.74 G Responsibility for:

(1) managing the risks associated with the *insurance business*; and

(2) holding the *capital resources* that support those risks;

is divided between *managing agents* and the *Society*. To clarify the respective responsibilities of *managing agents* and the *Society* for ensuring the adequacy of financial resources, the *FSA* distinguishes between the *managing agents*' responsibility to carry out capital adequacy assessments of the *capital resources* held at *syndicate* level for each *syndicate* that they manage, and the *Society's* responsibility to carry out an assessment for each *member*.

7.1.75 R In carrying out *ICAs* in respect of the *insurance business* carried on through each *syndicate* (the *syndicate ICA*), *managing agents* must consider the risks, controls and the financial resources relevant to each *syndicate*.

7.1.76 R When carrying out the *syndicate ICA*, *managing agents* must not take into account risks to which a *member* may be exposed or controls from which a *member* may benefit:

(1) because that *member* carries on *insurance business* through another *syndicate* or more than one *syndicate year* (whether or not managed by the same *managing agent*); or

(2) because that *member's* financial resources include *funds at Lloyd's* or *central assets*.

7.1.77 R The *Society* must have regard to *syndicate ICAs* in arriving at its own capital assessment for each *member*.

7.1.78 G In assessing the adequacy of the *capital resources* supporting the *insurance business* of each *member*, the *Society* should consider the risks, controls and financial resources relevant to the totality of the *member's insurance business*, including:

(1) the adequacy of *syndicate ICAs*;

(2) the *member's* share of *syndicate ICAs*;

(3) adjustments in respect of risks and controls relating to *funds at Lloyd's*, *central assets* and the interaction of risks underwritten by the *member* through different *syndicates* and in respect of different *syndicate years*; and

(4) the ongoing validity of any relevant assumptions it makes.

7.1.79 G In taking account of a *syndicate ICA* under *INSPRU* 7.1.77R:

(1) if the *Society* considers a *syndicate ICA* to be adequate, it should use the *managing agent's* risk and capital assessments in carrying out its *ICA* in relation to any *member* of that *syndicate*, or it should be able to justify why it will not; and

(2) if the *Society* considers a *syndicate ICA* to be less than adequate, the *Society* should increase the *syndicate ICA* so that it is adequate for the purpose of carrying out its *ICA* in relation to the *members* of that *syndicate*.

7.1.80 G The assessment of capital adequacy for a *member* will rarely equal the proportionate share of a *syndicate ICA* (or sum of those shares, where the *member* participates on more than one *syndicate*) as attributed to that *member*, because, in determining the capital assessments for each *member*, the *Society* may make adjustments to take account of:

(1) risks and controls associated with *funds at Lloyd's* and *central assets*, which can increase the assessment for that *member*;

(2) diversification effects, including as a result of *members'* participations on more than one *syndicate year*, which can reduce the assessment for that *member*; and

(3) its own assessment of *syndicate* risks, which can be higher than the *managing agent's* and so increase the assessment for that *member*.

7.1.81 G *Capital resources* to meet each *syndicate ICA* could be:

(1) held within a *syndicate* and managed by the *managing agent*; or

(2) held and managed by the *Society*; or

(3) not needed in full, because of effects such as diversification that the *Society* takes into account.

7.1.82 G The *balancing amount* is a function of the relationship between the *syndicate ICA* and the amount of assets held within the *syndicate*. As illustrations:

(1) if the *syndicate* holds no *capital resources* (but its liabilities are fully covered by relevant assets), the *balancing amount* equals the *syndicate ICA* (as there are no *capital resources* at *syndicate* level, all the *capital resources* must be held as *funds at Lloyd's* or *central assets*);

(2) if *capital resources* held at *syndicate* level are negative (i.e. if relevant assets do not fully cover liabilities for the *syndicate*), the *balancing amount* should be higher than the *syndicate ICA* by an amount corresponding to the negative *capital resources* held by *managing agents* on behalf of the *syndicate*; and

(3) conversely, if a *syndicate* holds positive *capital resources* for the *syndicate*, the *balancing amount* should be lower than the *syndicate ICA* by a corresponding amount.

7.1.83 R *Managing agents* must periodically notify the *Society* of the *syndicate ICA* and the *balancing amount* in respect of each *syndicate*.

7.1.84 R For the purpose of assessing the adequacy of *capital resources* held as *funds at Lloyd's* and *central assets*, the *Society* must have regard to *balancing amounts* notified to it by *managing agents*.

7.1.85 R After notification of a *balancing amount* by a *managing agent*, the *Society* must:

(1) confirm to the *managing agent* that *capital resources* held as *funds at Lloyd's* and *central assets* are adequate to support the *balancing amount*; or

(2) notify the *managing agent* that it cannot give that confirmation.

7.1.86 G *Managing agents* should submit *syndicate ICAs* and notify *balancing amounts* to the *Society* as part of the annual capital-setting process at Lloyd's. The submission of the *syndicate ICA* and the notification of the *balancing amount* should be made in good time for the *Society* to review them and place appropriate reliance on them when it determines the capital assessments for each *member*.

7.1.87 G When communicating the *syndicate ICA* and *balancing amount* for each *syndicate* to the *Society*, *managing agents* should agree with the *Society* an allocation of the *syndicate ICA* between *syndicate years*. The purpose of the allocation is to ensure that there is an appropriate matching of assets to risk and liabilities and an equitable treatment between the *members* reflecting the provision of capital in each *syndicate year*.

7.1.88 G For the purposes of complying with their obligations under *INSPRU*, *managing agents* may assume that any *balancing amount* confirmed by the *Society* under *INSPRU* 7.1.85R is supported by *capital resources* held as *funds at Lloyd's* and *central assets*.

7.1.89 R If a *managing agent* has, at any time, a significant doubt about the adequacy of a *syndicate ICA* or *balancing amount* with respect to *syndicate* risks and controls, it must notify the *Society* immediately.

7.1.90 R If the *Society* has, at any time, a significant doubt about the adequacy of any *member's capital resources* held by it in support of any *balancing amount*, it must notify the relevant *managing agent* immediately.

FSA assessment process – all firms

7.1.91 G In assessing the adequacy of a *firm's capital resources*, the *FSA* draws on more than just a review of the submitted *ICA*. Use is made of wider supervisory knowledge of a *firm* and of wider market developments and practices. When forming a view of any *individual capital guidance* to be given to a *firm*, the review of the *firm's ICA* along with the ARROW risk assessment and any other issues arising from day-to-day supervision will be considered.

7.1.92 G The *FSA* will take a risk-based and proportionate approach to the review of a *firm's ICA*, focusing on the *firm's* approach to dealing with the key risks it faces. Any *individual capital guidance* given will reflect the judgements reached through the ARROW review process as well as the review of the *firm's ICA*.

7.1.93 G A *firm* should not expect the *FSA* to accept as adequate any particular model that the *firm* develops or that the results from the model are automatically reflected in any *individual capital guidance* given to the *firm* for the purpose of determining adequate *capital resources*. However, the *FSA* will take into account the results of any sound and prudent model when giving *individual capital guidance* or considering applications for a *waiver* under section 148 of the *Act* of the *capital resources requirement* in *GENPRU* 2.1.

7.1.94 G Where the *FSA* considers that a *firm* will not comply with *GENPRU* 1.1.26R (adequate financial resources, including *capital resources*) by holding the *capital resources* required by *GENPRU* 2.1, the *FSA* may give the *firm* *individual capital guidance* advising it of the amount and quality of *capital resources* which the *FSA* considers it needs to hold in order to meet that *rule*.

7.1.95 G In giving *individual capital guidance*, the *FSA* seeks a balance between delivering consistent outcomes across the *individual capital guidance* it gives to all *firms* and recognising that such *guidance* should reflect the individual features of the *firm*. Comparison with the assumptions used by other *firms* will be used to trigger further enquiry. Debate will be sought where good arguments are made for a particular result that differs markedly from those of a *firm's* peers. The *FSA* also takes account of the quality of the wider risk management around the development of the numbers used in the *ICA*. The aim is to deliver *individual capital guidance* that comes closest to ensuring that there is no significant risk that a *firm* is unable to pay its liabilities as they fall due.

7.1.96 G Following an internal validation process, the *FSA* will write to the Board of the *firm* being assessed providing both quantitative and qualitative feedback on the results of the *FSA's* assessment. This letter will notify the *firm* of the *individual capital guidance* considered appropriate. The letter will include reasons for any capital add-ons identified, where applicable.

7.1.97 G If a *firm* considers that the *individual capital guidance* is inappropriate to its circumstances, then the *firm* should inform the *FSA* that it does not intend to follow that *guidance*. Informing the *FSA* of such an intention would be expected if a *firm* is to comply with *Principle* 11 (Relations with regulators).

7.1.98 G The *FSA* expects most disagreements about the adequacy of capital will be resolved through further analysis and discussion. The *FSA* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances. If the *FSA* and the *firm* still do not agree on an adequate level of capital, then the *FSA* may consider using its powers under section 45 of the *Act* to, on its own initiative, vary a *firm's Part IV permission* so as to require it to hold capital in accordance with the *FSA's* view of the capital necessary to comply with *GENPRU* 1.2.26R. *SUP* 7 provides further information about the *FSA's* powers under section 45.

7.1.99 G Where a *firm* considers that the *capital resources requirements* of *GENPRU* 2.1 require the holding of more capital than is needed for the *firm* to comply with *GENPRU* 1.2.26R then the *firm* may apply to the *FSA* for a *waiver* of the requirements in *GENPRU* 2.1 under section 148 of the *Act*. In addition to the statutory tests under section 148, in deciding whether to grant a *waiver* and, if granted, its terms, the *FSA* will consider the thoroughness, objectivity and prudence of a *firm's ICA* and the extent to which the *guidance* in this section has been followed. The *FSA* will not grant a *waiver* that would cause a breach of the minimum capital requirements under the *Insurance Directives* or *Reinsurance Directive*.

Annex D

Other amendments to Annex B (Text of INSPRU) to the Prudential Sourcebook for Insurers Instrument 2006 (FSA 2006/42)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where a block of new text is inserted, this is indicated and the new text is not underlined.

…

1.1.11 G These requirements are dealt with in the part of this section headed "Capital requirements for insurers" (see *INSPRU* 1.1.43G to *INSPRU* 1.1.91R). That part of this section also contains *rules* about the calculation ~~of the~~ ~~*insurance-related capital requirement*, which forms part~~ of the *enhanced capital requirement* for *firms* carrying on *general insurance business*, including the calculation of the *insurance-related capital requirement*. The calculation of the *asset-related capital requirement*, which also forms part of the calculation of the *ECR* for *firms* carrying on *general insurance business*, is set out in *INSPRU* 2.2.

…

1.1.43 G (1) …

(2) For non-life *firms* the *MCR* represents the *minimum capital requirement* (or margin of solvency) prescribed by the *Insurance Directives*. *GENPRU* 2.1.24R provides that, for a *firm* carrying on *general insurance business*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *general insurance business* applicable to that *firm* and the *general insurance capital requirement*. *GENPRU* 2.1.24AR provides that, for a *firm* carrying on *long-term insurance business* which is a *realistic basis life firm*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *long-term insurance business* applicable to that *firm* and the *long-term insurance capital requirement*. *GENPRU* 2.1.25R provides that, for a *firm* carrying on *long-term insurance business* which is a *regulatory basis only life firm*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *long-term insurance business* applicable to that *firm* and the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*. As specified in *GENPRU* 2.1.14R, a *firm* carrying on both *general insurance business* and *long-term insurance business* must apply *GENPRU* 2.1.13R (referred to in paragraph (1) above) separately to

its *general insurance business* and its *long-term insurance business*.

(3) …

…

1.1.66 R …

(c) to account for *premiums* and *claims* which arose from *contracts of insurance* that have been transferred to the *firm* from another body as if they were receivable by or payable ~~to~~by the *firm*.

…

1.1.69 G Conversely, *INSPRU* 1.1.66R(2)(c) requires a *firm*, for the purpose of calculating its *GICR*, to account for *contracts of insurance* transferred to it by another body as if it had been responsible for those contracts from inception and not merely from the date of transfer. All amounts of *premiums* and *claims* that arose from those contracts are included even where they arose prior to the date of transfer and were, in fact, receivable by or payable ~~to~~by the other body.

…

Insert after INSPRU 1.1.72R the following new text, INSPRU 1.1.72AG to INSPRU 1.1.72DG, which is not underlined:

Enhanced capital requirement for general insurance business

1.1.72A G This section sets out the requirement for *firms* carrying on *general insurance business*, other than *non-directive insurers*, to calculate their *ECR*. The *ECR* for *firms* carrying on *general insurance business* is an indicative measure of the *capital resources* that a *firm* may need to hold based on risk sensitive calculations applied to its business profile. For *firms* carrying on *general insurance business*, the *FSA* will use the *ECR* as a benchmark for its consideration of the appropriateness of the *firm's* own capital assessment. For *firms* where an *ECR* is not calculated, the *MCR* will provide a benchmark for the *firm's* own capital assessment.

1.1.72B R A *firm* carrying on *general insurance business*, other than a *non-directive insurer*, must calculate the amount of its *ECR*.

1.1.72C R A *firm* to which *INSPRU* 1.1.72BR applies must calculate its *ECR* in respect of its *general insurance business* as the sum of:

(1) the *asset-related capital requirement*; and

(2) the *insurance-related capital requirement*; less

(3) the *firm's equalisation provisions*.

1.1.72D G Details of the calculation of the *asset-related capital requirement* are set out in *INSPRU* 2.2.10R to *INSPRU* 2.2.16R. Details of the calculation of the *insurance-related capital requirement* are set out in *INSPRU* 1.1.76R to *INSPRU* 1.1.79R.

Insurance-related capital requirement ~~(general insurance business only)~~

1.1.73 ~~G~~ ~~*INSPRU* 7.1.11R requires *firms* carrying on *general insurance business*, other than a *non-directive insurer*, to calculate their *ECR* as the sum of the *asset-related capital requirement* and the *insurance-related capital requirement* less the *firm's equalisation provisions*. The *ECR* for *firms* carrying on *general insurance business* is an indicative measure of the *capital resources* that a *firm* may need to hold based on risk sensitive calculations applied to its business profile. For *firms* carrying on *general insurance business*, the *FSA* will use the *ECR* as a benchmark for *individual capital guidance* for a *firm* carrying on *general insurance business*. Details of the calculation of the *asset-related capital requirement* are set out in *INSPRU* 2.2. Details of the calculation of the *insurance-related capital requirement* are set out in *INSPRU* 1.1.76R to *INSPRU* 1.1.79R.~~ [intentionally blank]

…

1.1.80 G *GENPRU* 2.1.13R requires an *insurer* to maintain *capital resources* equal to or in excess of its *capital resources requirement*. *GENPRU* 2.1.18R defines the *capital resources requirement* for a *firm* to which that *rule* applies (a *realistic basis life firm*) as the higher of the *MCR* and the *ECR*. For other *firms* carrying on *long-term insurance business* (*regulatory basis only life firms*), the *capital resources requirement* is equal to the *MCR*. Except where the *base capital resources requirement* is the higher requirement, the *MCR* in respect of *long-term insurance business* is the sum of the *long-term insurance capital requirement* (*LTICR*) and the *resilience capital requirement* or, in the case of a *realistic basis life firm*, the *LTICR* (see *GENPRU* 2.1.24AR, *GENPRU* 2.1.25R and *GENPRU* 2.1.26R). *GENPRU* 2.1.36R defines the *LTICR* as the sum of the *insurance death risk*, *health risk and life protection reinsurance*, *expense risk*, and *market risk capital components* (see *INSPRU* 1.1.81R to *INSPRU* 1.1.91R). *Rules* and *guidance* about the *resilience capital requirement* are set out in *INSPRU* 3.1.9G to *INSPRU* 3.1.26R.

…

1.2.19 G Further detailed *rules* and *guidance* on margins for adverse deviation are included in *INSPRU* 1.2.32G to *INSPRU* 1.2.89G. In particular, the cross-references for the different assumptions used in calculating the *mathematical* *reserves* are as follows:

…

(4) persistency (*INSPRU* ~~1.2.73G to~~ 1.2.76R and *INSPRU* 1.2.77G); and

…

…

1.2.22 R (1) …

(2) Approximations or generalisations may be made:

(a) in the case of non-attributable expenses, in relation to a group of contracts with the same or similar expense risk characteristics, provided that the *mathematical reserves* in respect of such expenses established by the *firm* in relation to that group of contracts have a minimum value of at least zero; and

(b) in any other case, where they are likely to provide the same, or a higher, result than a determination made in accordance with (1).

(3) …

(4) For the purpose of (2), non-attributable expenses are expenses which are not directly attributable to a particular *long-term insurance contract*.

1.2.23 G *INSPRU* 1.2.22R to *INSPRU* 1.2.89G set out *rules* and *guidance* for the separate prospective valuation of each contract. These may be applied instead to groups of contracts where the conditions set out in *INSPRU* 1.2.22R(2)(a) or (b) are satisfied. Guidance on non-attributable expenses and the application of *INSPRU* 1.2.22R(2)(a) is provided in *INSPRU* 1.2.54AG.

~~Contracts not to be treated as assets~~Negative mathematical reserves

1.2.24 R ~~(1)~~ ~~A *firm* must not treat a *long-term insurance contract* as an asset.~~

~~(2)~~ ~~(1) does not apply to a *pure reinsurer* in respect of a *contract of insurance* which does not have a guaranteed *surrender value* and falls within:~~

~~(a)~~ ~~its *life protection reinsurance business*; or~~

~~(b)~~ ~~its *permanent health reinsurance business*.~~

~~(3)~~ ~~Notwithstanding (2), the total *mathematical reserves* established by a *pure reinsurer* must have a minimum value of at least zero.~~

<u>A *firm* may calculate a negative value for the *mathematical reserves* in respect of a *long-term insurance contract* provided that:</u>

<u>(1)</u> <u>this is based on assumptions which meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R;</u>

<u>(2)</u> <u>the contract does not have a *surrender value* which at the *actuarial valuation date* is guaranteed; and</u>

<u>(3)</u> <u>the total *mathematical reserves* established by the *firm* have a minimum value of at least:</u>

<u>(i) where the *firm's long-term insurance contracts* include *linked long-term* contracts, the sum of the *surrender values* of all its *linked long-term* contracts at the *actuarial valuation date*; and</u>

<u>(ii) in any other case, zero.</u>

1.2.25 G ~~A separate prospective valuation for each contract may identify contracts for which the value of future cash inflows exceeds that of outflows, that is, the contracts have an asset value, rather than liability value. However, the *Consolidated Life Directive* requires that no contract should be valued at less than its guaranteed *surrender value*. As a result, no contract with a guaranteed *surrender value* to which the *Consolidated Life Directive* applies should be treated as an asset. Although the *Reinsurance Directive* does not require this treatment of contracts with guaranteed *surrender values* to be applied to *pure reinsurers*, the *FSA's* policy is that there should be equal treatment in this respect. *Pure reinsurers* may therefore treat as an asset a contract written as part of carrying on *life protection reinsurance business* or *permanent health reinsurance business* provided that this is based on assumptions which meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R and it is not written on terms that provide for a guaranteed *surrender value*. This does not, however, allow a *pure reinsurer* to establish total *mathematical reserves* which are negative.~~

<u>A separate prospective valuation for each contract may identify contracts for which the value of future cash inflows under and in respect of the contract</u>

exceeds that of outflows. In these circumstances, the *firm* may calculate the *mathematical reserves* for that contract as having a negative value and that value is available to off-set *mathematical reserves* for other contracts which have a positive value when establishing the overall *mathematical reserves*. However, the *Consolidated Life Directive* requires that no contract should be valued at less than its guaranteed *surrender value* (see *INSPRU* 1.2.62AG). As a result, no contract with a guaranteed *surrender value* to which the *Consolidated Life Directive* applies should be valued as if it were an asset. Although the *Reinsurance Directive* does not require this treatment of contracts with guaranteed *surrender values* to be applied to *pure reinsurers*, the *FSA's* policy is that there should be equal treatment in this respect. *INSPRU* 1.2.62R makes further provision relating to the *mathematical reserves* to be established in respect of such contracts. When considering the impact that the amount payable on surrender may have on the valuation of a contract, a *firm* should have regard to *INSPRU* 1.2.71R.

Avoidance of future valuation strain

1.2.26	R	(1)	…
		(2)	…
		(3)	Subject to (4), (1) may be applied to a group of similar contracts instead of to the individual contracts within that group.
		(4)	(1) must be applied to a group of contracts in relation to which *mathematical reserves* in respect of non-attributable expenses are established for that group of contracts in accordance with *INSPRU* 1.2.22R(2)(a), instead of to the individual contracts within that group.

…

1.2.30	G	All cash flows are to be valued using prudent assumptions in accordance with generally accepted actuarial practice. Cash flows may be omitted from the valuation calculations provided the reserves obtained as a result of leaving those cash flows out of the calculation are not less than would have resulted had all cash flows been included (see *INSPRU* 1.2.22R(2)(b)). …

…

1.2.39	G	The valuation method for future *premiums* in *INSPRU* 1.2.38R retains the difference, if any, between the gross *premium* and the *net premium* as an implicit margin available to finance future bonuses, expenses and other costs. It thus helps to protect against the risk that adequate resources may not be available in the future to meet those costs. Where expenses are not directly attributable to a particular contract, a *firm* may establish

mathematical reserves in respect of such expenses in relation to a group of contracts with the same or similar expense risk characteristics in accordance with *INSPRU* 1.2.22R(2)(a).

…

1.2.54 G …

1.2.54A G (1) A *firm* should attribute to an individual contract at least those expenses which are directly attributable to that contract including expenses which vary with the volume of business for that type of contract. Commission payments, charges to a fund on a 'per policy' basis and investment management fees are generally directly attributable. For expenses of the fund which are calculated directly based on actual expenses (and not calculated in accordance with a management services agreement), the attributable expenses will also include those costs which vary with the volume of business for that product, for example, salaries and accommodation costs of staff in a processing centre, printing and postage of communications to *policyholders* and associated computer services.

(2) Non-attributable expenses may include overheads which are relatively insensitive to the volume of business for the type of contract in question and an apportionment of group overheads. Examples of expenses that *firms* may consider non-attributable include salaries of head office staff involved in monitoring products and drafting standard communications to *policyholders* and allocated overheads for centralised functions such as human resources, finance and IT. Where non-attributable expenses arise in relation to a homogeneous risk group of contracts sharing the same or similar expense risk characteristics, a *firm* may determine the reserve for those expenses at the level of that risk group, provided that the reserve so established has a minimum value of at least zero (see *INSPRU* 1.2.22R(2)(a)). In identifying its homogeneous risk groups, a *firm* should consider all risks that impact on the level of expenses borne by contracts including persistency risk and expense inflation risk. For example, business that is subject to bulk lapse risk, such as any large group contract that would give rise to a reduction in surplus on lapse, should be considered as forming a homogeneous risk group of its own. A *firm* must document and justify its approach to identifying homogeneous risk groups in accordance with the record-keeping requirements of *INSPRU* 1.2.20R. This approach to reserving for expenses ensures that prudent reserves are established in respect of both directly attributable and non-attributable expenses arising in relation to the *firm's long-term insurance business*.

1.2.54B G In valuing cash flows in respect of *commissions*, a *firm* may wish to take into account any contractual arrangements for the "clawback" or repayment of *commissions* already paid in the event of voluntary discontinuance of a *contract of insurance*. In deciding how to treat such arrangements in determining the *mathematical reserves* for a *contract of insurance*, the *firm* must use assumptions which meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R. For example, the *firm* should establish prudent margins for adverse deviation in respect of the credit risk of the intermediary by whom the *commission* would be repayable.

…

1.2.56 G The provision for future expenses, whether implicit or explicit, should include a prudent margin for adverse deviation in the level and timing of expenses (see *INSPRU* 1.2.13R to *INSPRU* 1.2.19G). The margin should cover the risk of underestimating expenses whether due to, for example, initial under-calculation or subsequent increases in the amount of expenses. In setting the amount of the margin, the *firm* should take into account the extent to which:

(1) an appropriately validated method based on reliable data is used to allocate expenses ~~by product type, by distribution channel and~~ as between attributable and non-attributable expenses or between acquisition and non-acquisition expenses and by product type, by distribution channel or by homogeneous risk group, as appropriate;

…

...

1.2.62 R ...

1.2.62A G A contract has a guaranteed *surrender value* where the *policy* wording states that a *surrender value* is payable and either provides for a minimum amount payable on surrender or sets out a method for calculating such an amount. For example, where a unit-linked contract provides for a *surrender value* equal to the value of the units allocated to the contract, the *firm* must establish *mathematical reserves* for that contract greater than or equal to the value of the units allocated at the valuation date.

...

1.2.64 G The *firm* should provide for the benefit which the *firm* anticipates the *policyholder* is most likely to choose. ~~Except for the "option" of voluntary discontinuance in the case of *regulatory basis only life firms* (see *INSPRU* 1.2.74R), p~~Past experience may be used as a guide, but only if this is likely to give a reasonable estimate of future experience. For example, past experience of the take-up of a cash payment option instead of an annuity would not be a reliable guide, if, in the past, market rates exceeded those guaranteed in the annuity but no longer do so. Similarly, past experience on the take-up of options may not be relevant in the light of the assumptions made in respect of future interest rates and mortality rates in the valuation of the benefits.

…

1.2.73 ~~G~~ ~~*INSPRU* 1.2.76R and *INSPRU* 1.2.77G apply to the valuation of the *with-profits insurance liabilities* of *realistic basis life firms*. *INSPRU* 1.2.76AR and *INSPRU* 1.2.77G apply to the valuation of liabilities arising from the *life protection reinsurance business* and *permanent health reinsurance business* of *pure reinsurers*. *INSPRU* 1.2.74R and *INSPRU* 1.2.75G apply to the valuation of all other liabilities.~~ [intentionally blank]

1.2.74 ~~R~~ ~~Except as permitted by *INSPRU* 1.2.76R and *INSPRU* 1.2.76AR, a *firm* must not make any allowance in the calculation of the *mathematical reserves* for the voluntary discontinuance of any *contract of insurance* if the amount of the *mathematical reserves* so determined would, as a result, be reduced.~~ [intentionally blank]

1.2.75 ~~G~~ ~~The rate of voluntary discontinuance (that is, lapse, surrender or paying up) is often difficult to predict and may be volatile especially in the short term during stressful economic conditions. Depending upon the circumstances and contract terms, voluntary discontinuance may increase or decrease the *firm's* liability. In effect, *INSPRU* 1.2.74R requires a *firm* to assume that there will be no voluntary discontinuance if assuming voluntary discontinuance would reduce the liability. This protects against the risk that arises from volatility in the rate of voluntary discontinuance. In addition, there is the risk of assets not being realisable when needed due to the rates of discontinuance exceeding expected levels~~. [intentionally blank]

1.2.76 R A ~~*realistic basis life*~~ *firm* may make assumptions about voluntary discontinuance rates in the calculation of the *mathematical reserves* ~~for its *with-profits insurance business*~~ provided that those assumptions meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R.

~~1.2.76A~~ ~~R~~ ~~A *pure reinsurer* may make assumptions about voluntary discontinuance rates in the calculation of the *mathematical reserves* in respect of *contracts of insurance* falling within:~~

~~(1) its *life protection reinsurance business*; or~~

~~(2) its *permanent health reinsurance business*;~~

~~provided that those assumptions meet the general requirements for prudent~~

~~assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R.~~

…

1.3.7 R (1) The *with-profits insurance capital component* for a *firm* is the aggregate of any amounts that:

(a) result from the calculations specified in (2) and (3); and

(b) are greater than zero.

(2) Subject to (3), in relation to each *with-profits fund* within the *firm*, the *firm* must deduct B from A, where:

(a) A is the amount of the *regulatory excess capital* for that fund (see *INSPRU* 1.3.23R); and

(b) B is the ~~amount~~ sum of:

(i) the *realistic excess capital* for that fund (see *INSPRU* 1.3.32R);

(ii) the value, in the most adverse scenario required by *INSPRU* 1.3.43R(3), of future internal transfers from the fund to shareholders or another of the *firm's* funds in respect of the future distribution of surplus between *policyholders* and shareholders; and

(iii) an amount not exceeding the value, in the most adverse scenario required by *INSPRU* 1.3.43R(3), of any other future internal transfers from the fund to a *non-profit fund* in respect of expense-related charges to the extent that the future receipt of the amount transferred is not already taken into account in the calculation of the *firm's capital resources* or in establishing its *technical provisions*.

(3) Where a capital instrument that can be included in the *firm's capital resources* in accordance with *GENPRU* 2.2 has been attributed wholly or partly to a *with-profits fund* and that instrument meets the requirements of *GENPRU* 2.2.271R, the *firm* must add to the amount calculated under (2) for that fund the result, subject to a minimum of zero, of deducting D from C where:

(a) C is the outstanding face amount of the instrument to the extent attributed to the fund; and

(b) D is the realistic value of the instrument to the extent attributed to the fund in the single event that determines the *risk capital margin* under *INSPRU* 1.3.43R.

1.3.7A G Future internal transfers from a *with-profits fund* are included in the *realistic value of liabilities* (see *INSPRU* 1.3.105R, *INSPRU* 1.3.119R, *INSPRU* 1.3.128R and *INSPRU* 1.3.165R). *INSPRU* 1.1.27R ensures that sufficient assets are maintained in a *with-profits fund* to meet those future internal transfers. In calculating the *WPICC*, the economic value to the *firm* of those future transfers in the most adverse scenario required in calculating the *risk capital margin* (see *INSPRU* 1.3.43R) should be recognised. In the case of internal transfers to a *non-profit fund* in respect of expense-related charges, those transfers may only be recognised to the extent that those cash flows have not already been taken into account in calculating the *firm's capital resources* or *technical provisions*. In effect, the future asset of the shareholders or another of the *firm's* funds is available to offset the corresponding liability of the *with-profits fund* and should, therefore, subject to the limitation in *INSPRU* 1.3.7R(2)(b)(iii), be treated as capital arising from that fund which is available to reduce the amount of the *WPICC*.

…

1.3.23 R A *firm* must calculate the *regulatory excess capital* for each of its *with-profits funds* by deducting B from A, where:

(1) …

(2) B is the sum of:

(a) the *regulatory value of liabilities* of the fund (*INSPRU* 1.3.29R); and

(b) the *long-term insurance capital requirement* in respect of the fund's *with-profits insurance contracts*.~~; and~~

~~(c) the *resilience capital requirement* in respect of the fund's *with-profits insurance contracts*.~~

...

1.3.24 R (1) …

(2) Where *non-profit insurance contracts* are written in a *with-profits fund*, the amount representing those contracts is the sum of:

(a) the *mathematical reserves* in respect of the *non-profit insurance contracts* written in the fund; and

(b) ~~the following amounts, to the extent that each of them is covered by the fund's *long-term admissible assets*:~~

~~(i)~~ an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the *firm's long-term insurance capital requirement*, to the extent that it is covered by the fund's *long-term admissible assets*.~~; and~~

~~(ii) an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the firm's *resilience capital requirement*.~~

…

1.3.27 ~~G~~ ~~In calculating the amount of a *firm's resilience capital requirement* allocated to the *non-profit insurance contracts* in the *with-profits fund*, the *firm* should calculate the amount of resilience capital that would be required if that business were in a stand-alone company owning the assets allocated. The *resilience capital requirement* for the *with-profits insurance business* should also be calculated as if it were a stand-alone company. An allocation of the *firm's* total *resilience capital requirement* should then be made in a manner that would produce a result materially consistent with an allocation in proportion to the amounts calculated for each part of the business as stand-alone entities.~~ [intentionally blank]

…

1.3.33 R (1) …

(2) …

(3) For the purposes of (2):

(a) …

(b) …

and D is equal to the sum of:

(v) the *long-term insurance capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;

(vi) where B is a *regulatory basis only life firm*, the amount of the *resilience capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;

(vii) any part of the *with-profits insurance capital component* of B, or of B's *long-term insurance capital requirement* or, where B is a *regulatory basis only life firm*, *resilience capital requirement* in respect of B's *with-profits insurance contracts*, that is not covered from the assets of the *with-*

profits fund from which it arises after deducting from those assets the amount calculated under (iv); and

(viii) any assets of B that back its regulatory capital requirements and that are valued in (iii) in the calculation of the present value of future profits of *non-profit insurance business* written by B.

(4) …

…

1.3.38 G In calculating the present value of future profits (or losses) for *non-profit insurance business* required by *INSPRU* 1.3.33R(1)(c), to the extent that the *long-term insurance capital requirement* is ~~and the *resilience capital requirement* are~~ covered by the *with-profits fund's long-term admissible assets*, a *firm* may take into consideration any release of ~~these items~~ this item as the relevant *policies* go off the books.

…

1.3.39B G In determining current market yields for the purpose of *INSPRU* 1.3.37R(4), a *firm* is required to have regard to IFRS 4 as if it were being applied to determine the value under that standard for the first time, that is, without reference to existing practices. Paragraph 27 of the standard is likely to be of particular relevance. In general, a~~A~~ *firm* should ~~not~~ only include an allowance for future investment margins if its assumptions are limited to no more than a risk-free rate and the discount rate is set consistently~~until they are earned. In particular, a *firm* should not include an allowance for capital growth in determining current market yields for equities and real estate investments~~. However, this does not preclude a *firm* from using a replicating portfolio of assets to determine the discount rate for the liability with suitable adjustments for differences in their characteristics (for the example of annuity business, see *INSPRU* 1.3.39G). In setting assumptions for future investment returns, a *firm* should also consider sections BC134 to BC144 of the Basis for Conclusions in IFRS 4.

…

1.3.65 G In relation to the *market risk* scenarios in *INSPRU* 1.3.68R and *INSPRU* 1.3.73R, the effect of *INSPRU* 1.3.52R and *INSPRU* 1.3.58R is that a *firm* may reflect management actions and must make a realistic assessment of *policyholder* actions in projecting the assets and liabilities in its calculation of the *risk capital margin* for a *with-profits fund* within the *firm*. ~~This contrasts with the position for calculating the *resilience capital requirement* for the *firm* (*INSPRU* 3.1.9 G to *INSPRU* 3.1.26R).~~

…

1.3.108 ~~G~~ ~~*INSPRU* 1.3.105R(7) requires *firms* to provide fully for shareholder transfers. Such transfers do not therefore count as capital in the *with-profits fund*. However, a *firm* may apply under section 148 of the *Act* for a *waiver* from this requirement. In exercising its discretion under section 148 of the *Act*, the *FSA* will have regard (among other factors) to whether a *firm* has put in place undertakings satisfactory to the *FSA*, including that future transfers will not be paid out of the *firm* by way of dividend.~~ [intentionally blank]

…

1.4.9 G However, *firms* are permitted to include *equalisation provisions* within their financial resources when demonstrating compliance with non-Directive capital requirements. Hence *equalisation provisions* are deducted from the available *capital resources* of a *firm* for the purpose of meeting its *minimum capital requirement* for *general insurance business*; but, in the calculation of a *firm's enhanced capital requirement* for *general insurance business* under *INSPRU* ~~7.1.11R~~1.1.72CR, its *equalisation provisions* (if any) are added back to its *capital resources*.

…

1.5.44 R For the purposes of *INSPRU* 1.5.42R, a *non-EEA direct insurer* (except a *UK-deposit insurer*) must calculate a *UK MCR*:

(1) for *long-term insurance business*, in accordance with *GENPRU* 2.1.36R~~INSPRU 1.1.81R to *INSPRU* 1.1.91R~~ but only in relation to business carried on by the *firm* in the *United Kingdom*;

(2) for *general insurance business*, in accordance with *GENPRU* 2.1.34R~~INSPRU 1.1.45R to *INSPRU* 1.1.72R~~ but only in relation to business carried on by the *firm* in the *United Kingdom*.

…

1.5.46 R For the purposes of *INSPRU* 1.5.42R, a *UK-deposit insurer* must calculate an *EEA MCR*:

(1) for *long-term insurance business*, in accordance with *GENPRU* 2.1.36R~~*INSPRU* 1.1.81R to *INSPRU* 1.1.91R~~ but only in relation to business carried on by the *firm* in all *EEA States*, taken together;

(2) for *general insurance business*, in accordance with *GENPRU* 2.1.34R~~*INSPRU* 1.1.45R to *INSPRU* 1.1.72R~~ but only in relation to

business carried on by the *firm* in all *EEA States*, taken together.

…

2.1.22 R …

(3) …

(c) …

(i) …

(ii) 1% for that part of the exposure arising from *shares* and other variable yield participations, bonds, *debt securities* and other *money market instruments* and capital market instruments from the same *counterparty* that are not dealt in on a *regulated market*, or ~~any~~ a beneficial interest in a *collective investment scheme* ~~which is not a *UCITS* scheme, a *non-UCITS retail* scheme or a *recognised scheme*~~to which *INSPRU* 2.1.39R applies; the limit for that part of the exposure arising from *debt securities* (other than hybrid securities) issued by the same *regulated institution* is increased to 5%;

(iii) …

…

(e) 10% for the aggregate of all *counterparty* exposures and asset exposures that fall within (c)(ii) above or (j) below, whether or not they arise from *persons* who are closely related, but excluding amounts that are in excess of the limit in (c)(ii) above or, in the case of an asset exposure, (j) below;

…

(h) 10% for the asset exposure (including an exposure arising from a reversionary interest) arising from any one piece of land or building, or a number of pieces of land or buildings close enough to each other to be considered effectively as one investment~~.~~;

(i) 5% for the asset exposure arising from a beneficial interest in any single *non-UCITS retail scheme* or *recognised scheme* which does not fall within the *UCITS Directive*; and

(j) 1% for the asset exposure arising from a beneficial interest in any single *collective investment scheme* which does not fall within the *UCITS Directive* and is not a *non-UCITS retail scheme* or a *recognised scheme*.

(4) In (3) a *firm's* business amount means the sum of:

(a) …

(b) …

(c) …

(ii) in the case of a *firm* carrying on *long-term insurance business*, the amount of its *long-term insurance capital requirement* and, where it is a *regulatory basis only life firm*, the amount of its *resilience capital requirement*.

…

…

2.1.39 R For the purposes of *INSPRU* 2.1.20R and *INSPRU* 2.1.22R, ~~a *UCITS scheme*, a *non-UCITS retail scheme*, a *recognised scheme* or any other *collective investment scheme* that invests only in *admissible assets* (including any *derivatives* or quasi-derivatives held by the scheme) is to be treated as closely related to the *issuer* of the *units* in that scheme~~ *units* in a *collective investment scheme* that does not fall within the *UCITS Directive* must be treated as a *counterparty* exposure to the *issuer* of the *units* in that scheme if the *issuer* and those *units* are to be regarded as constituting a single risk because they are so interconnected that, if the *issuer* were to experience financial problems, this would be likely to affect the value of the *units*.

2.1.39A G Where the value of *units* in a *collective investment scheme* other than one falling within the *UCITS Directive* would be likely to be adversely affected by financial problems experienced by the *issuer* of those *units*, for the purposes of *INSPRU* 2.1.20R and *INSPRU* 2.1.22R, the *units* must be treated as a *counterparty* exposure to the *issuer*, with the result that the exposure is subject to the limit in *INSPRU* 2.1.22R(3)(c)(ii). In all other cases, the *units* would fall to be treated as an asset exposure, with the result that they are subject to the relevant limit under *INSPRU* 2.1.22R(3)(i) or (j).

Meaning of closely related

2.1.40 R For the purposes of *INSPRU* 2.1, a group of *persons* is closely related if it consists solely of two or more ~~natural or legal persons~~*persons* who, unless it is shown otherwise, constitute a single risk because as between any two of them one or other of the following relationships apply:

(1) one of them, directly or indirectly, has control, as defined in *INSPRU* 2.1.41R, over the other or they are both controlled by the same third party; or

(2) there is no relationship of control as defined in *INSPRU* 2.1.41R but they are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other would be likely to encounter repayment difficulties.

…

3.1.7 G *INSPRU* 3.1 addresses the impact of *market risk* on *insurance business* in the ways set out below:

(1) Any *firm* that carries on *long-term insurance business* which is a *regulatory basis only life firm* must comply with the *resilience capital requirement*. This requires the *firm* to hold capital to cover *market risk*. The *resilience capital requirement* is dealt with in *INSPRU* 3.1.9G to *INSPRU* 3.1.26R.

…

…

Resilience capital requirement (only applicable to the long-term insurance business of regulatory basis only life firms~~only~~)

3.1.9 G The *resilience capital requirement* forms part of the calculation of the *capital resources requirement* for *regulatory basis only life firms. GENPRU* 2.1.23R specifies that the *CRR* for a *regulatory basis only life firm* is equal to the *MCR* in *GENPRU* 2.1.25R. The *resilience capital requirement* forms part of the *MCR* for a *regulatory basis only life firm* (see *GENPRU* 2.1.25R(2)(b).~~ all *firms* carrying on *long-term insurance business*. *GENPRU* 2.1.18R to *GENPRU* 2.1.23R set out the different elements of this calculation. These include the *Minimum Capital Requirement* and the *Enhanced Capital Requirement*. The *resilience capital requirement* forms part of both of these requirements (see *GENPRU* 2.1.25R(2) and *GENPRU* 2.1.38R(2)).~~

3.1.10 R (1) A *regulatory basis only life firm* ~~that carries on *long-term insurance business*~~ must calculate a *resilience capital requirement* in accordance with (2) to (5).

…

…

3.1.14 ~~G~~ ~~The *resilience capital requirement* requires *firms* to assume different adverse *market risk* scenarios for equities, real estate and fixed interest securities (see *INSPRU* 3.1.16R and *INSPRU* 3.1.23R) to those required by *INSPRU* 1.3.68R (UK and certain other assets) and *INSPRU* 1.3.73R (non-UK assets) in relation to the calculation of the *risk capital margin* for a *with-profits fund* by a *realistic basis life firm* calculating its *with-profits insurance capital component*.~~ [intentionally blank]

...

3.1.28 R (1) The rates of interest required by *INSPRU* 1.2.33R to be used by a *firm* for the calculation of the present value of a *long-term insurance liability* must not exceed 97.5% of the risk-adjusted yield (see *INSPRU* 3.1.30R to *INSPRU* 3.1.48G) that is expected to be achieved on:

(~~1~~a) the assets allocated to cover that liability;

(~~2~~b) the reinvestment of sums expected to be received from those assets (see *INSPRU* 3.1.45R to *INSPRU* 3.1.48G); and

(~~3~~c) the investment of future *premium* receipts (see *INSPRU* 3.1.45R to *INSPRU* 3.1.48G).

(2) (1) does not apply to a *long-term insurance contract* in respect of which the *firm* has calculated a negative value for the *mathematical reserves* in accordance with *INSPRU* 1.2.24R.

…

3.1.29A G *INSPRU* 3.1.28R ~~applies~~ only applies to a *long-term insurance contract~~s~~* in respect of which a *firm* has calculated *mathematical reserves* with a positive value.~~that are treated as liabilities. Where a *firm* treats a *long-term insurance contract* as an asset~~A *firm* may, however, also have *long-term insurance contracts* where the value of future cash inflows under and in respect of the contract exceeds that of outflows, allowing the *firm* to calculate a negative value for the *mathematical reserves* for that contract (see *INSPRU* 1.2.24R).~~,~~ ~~in~~ In calculating the present value of future net cash flows under and in respect of the~~that~~ contract, the *firm*~~it~~ must include margins for adverse variation in accordance with *INSPRU* 1.2.13R. These margins should include margins for *market risk* and, where relevant, credit risk. For those margins to be sufficiently prudent as required by *INSPRU* 1.2.13R, the rate of interest used may need to be higher than that which would apply under

INSPRU 3.1.28R.

…

8.1.7 G … *INSPRU* 7.1 contains *rules* and guidance on the assessment of capital adequacy for *firms* and *INSPRU* ~~7.1.57R~~7.1.74G to *INSPRU* ~~7.1.70R~~7.1.90R provide for the application of *INSPRU* 7.1 to the *Society* and *managing agents*.

...

INSPRU TP

Transitional provisions

…

6 Admissible assets

Application

6.1 R *INSPRU* TP 6 applies to an *insurer* which is not a *pure reinsurer*.

Duration of transitional

6.2 R *INSPRU* TP 6 applies until 30 December 2007.

GENPRU 2 Annex 7R

6.3 R (1) In determining whether its assets are *admissible assets*, instead of applying *GENPRU* 2 Ann 7R, a *firm* may elect to treat as an *admissible asset* an asset that would have been an *admissible asset* for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.

(2) (1) does not apply when determining whether a *derivative* or *quasi-derivative* is an *approved derivative* or *approved quasi-derivative*.

(3) If a *firm* applies (1) to any of its assets, it must do so for all of its assets except *derivatives* and *quasi-derivatives*.

Annex E

Amendments to Annex A (Chapter TP of GENPRU and GENPRU Schedules) to the General Prudential Sourcebook (Transitional Provisions and Schedules) Instrument 2006 (FSA 2006/51)

In this Annex, underlining indicates new text.

TP Transitional provisions

…

15 Admissible assets

Application

15.1 R *GENPRU* TP 15 applies to an *insurer* which is not a *pure reinsurer*.

Duration of transitional

15.2 R *GENPRU* TP 15 applies until 30 December 2007.

GENPRU 2 Annex 7R

15.3 R (1) In determining whether its assets are *admissible assets*, instead of applying *GENPRU* 2 Ann 7R, a *firm* may elect to treat as an *admissible asset* an asset that would have been an *admissible asset* for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.

(2) (1) does not apply when determining whether a *derivative* or *quasi-derivative* is an *approved derivative* or *approved quasi-derivative*.

(3) If a *firm* applies (1) to any of its assets, it must do so for all of its assets except *derivatives* and *quasi-derivatives*.

Annex F

Amendments to Annex A (Amendments to the Glossary) to the CRD (Consequential Amendments) Instrument 2006 (FSA 2006/53)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where different amendments are to be substituted for those currently set out in Annex A, this is indicated below.

…

Part 1B (New definitions taking effect on 1 January 2007)

supervisory review and evaluation process	the *FSA's* assessment of the adequacy of certain *firms'* capital, as more fully described in *BIPRU* 2.2.9G and *INSPRU* ~~7.1.8G~~7.1.12G.

…

Part 2A (Revised definitions taking effect on 31 December 2006)

…

Substitute for the amendments to the definition of admissible asset the following:

admissible asset	(1) (~~in *LLD*~~ for the purpose of the *rules* in *GENPRU* and *INSPRU* as they apply to *members* of the *Society* of Lloyd's, the *Society* and *managing agents*) an asset that, subject to paragraphs (2) and (3) of *GENPRU* 2 Ann 7R, falls into one or more categories in paragraph (1) of *GENPRU* 2 Ann 7~~1~~R as modified by ~~*LLD* 19.3.19R~~ *GENPRU* 2.3.34R. (2) otherwise: (a) (in relation to an *insurer* which is not a *pure reinsurer*) an asset that, subject to paragraphs (2) and (3) of *GENPRU* 2 Ann 7R, falls into one or more categories in paragraph (1) of *GENPRU* 2 Ann 7~~1~~R; or (b) …

…

enhanced capital requirement	(1) (in relation to a *firm* carrying on *general insurance business*) the amount calculated in accordance with ~~*PRU* 2.3.11R~~*~~INSPRU~~* ~~7.1.11R~~*INSPRU* 1.1.72CR.
	(2) …

…