

**INTEGRATED PRUDENTIAL SOURCEBOOK (INSURERS AND OTHER
AMENDMENTS) (NO 2) INSTRUMENT 2005**

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 on 31 December 2005.

Amendments to the Glossary of definitions

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

Amendments to the Integrated Prudential sourcebook

- E. The Integrated Prudential sourcebook is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Integrated Prudential Sourcebook (Insurers and Other Amendments) (No 2) Instrument 2005.

By order of the Board
17 November 2005

Annex A

Amendments to the Glossary of definitions

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

approved credit institution ~~an institution~~ a credit institution recognised or permitted under the law of an *EEA State* to carry on any of the activities set out in Annex 1 to the *Banking Consolidation Directive*.

...

asset management company (for the purpose of *ELM* and *PRU* ~~8 (Group risk)~~ and in accordance with Article 2(5) of the *Financial Groups Directive* (Definitions))...

...

collateral (1) ...

(2) ...

(3) (in *PRU*):

(a) ~~an asset that is subject to~~ (in relation to any transaction) a mortgage, charge, pledge or other security interest or, as the context may require, an asset that is subject to a mortgage, charge, pledge or other security interest; and

(b) (in relation to a *stock lending*, *repo* or *derivative* transaction only):

(i) a transfer of assets (other than by way of sale) subject to a right of the transferor to have transferred back to it the same, or equivalent, assets or, as the context may require, the assets so transferred by the original transferor; or

(ii) a letter of credit;

where the assets are transferred, or the letter of credit is issued, to secure the performance of the obligations of one of the parties to that transaction.

...

- counterparty (1) ...
- (2) ...
- (d) any group of companies excluding:
- (i) (for the purposes of PRU 3.2) any companies within the group which are subsidiary undertakings of the insurer and which fall within PRU 1.3.31R; and
 - (ii) (for all other purposes) any companies within the group which are subsidiary undertakings of the insurer; or
- ...

...

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

...

- guarantee fund (1) (a) ...
- (b) where the *firm* is required to calculate a *UK MCR* or an *EEA MCR* under *PRU 7.6*, for the purposes of that section ~~the reference in (1)(a)~~ the reference to the general insurance capital requirement is replaced by UK MCR or EEA MCR, as appropriate, and the reference to the base capital resources requirement is replaced by the amount which is one half of the base capital resources requirement applicable to the firm set out in PRU 2.1.26R.
- (2) (a) ...
- (b) where the *firm* is required to calculate a *UK MCR* or an *EEA MCR* under *PRU 7.6*, for the purposes of that section

~~the reference in (2)(a) the reference to the *long-term insurance capital requirement* is replaced by *UK MCR* or *EEA MCR*, as appropriate, and the reference to the *base capital resources requirement* is replaced by the amount which is one half of the *base capital resources requirement* applicable to the *firm* set out in *PRU 2.1.26R*.~~

...

long-term insurance liabilities ~~insurance~~ liabilities arising from *long-term insurance business*.

...

- regulated market* (1) (a) ...
- (b) ...
- (2) (in *PRU*) ~~a market which is characterised by:~~
- (a) ~~regular operation~~ a market as defined in (1); and
- (b) ~~the fact that regulations issued or approved by the appropriate authority of the state where the market is situated~~ a market situated outside the *EEA States* which is characterised by the fact that:
- (i) ~~define the conditions for the operation of and access to the market~~ it meets comparable requirements to those set out in (1)(a)(ii), (iii) and (iv); and
- (ii) ~~define the conditions to be satisfied by a *financial instrument* in order for it to be dealt in on the market;~~ and the *financial instruments* dealt in are of a quality comparable to those in a regulated market in the *United Kingdom*.
- (iii) ~~require compliance with reporting and transparency requirements comparable to those laid down in articles 20 and 21 of the *Investment Services Directive*; and~~
- (e) ~~in the case of a market situated outside the *EEA States*, the fact that the *financial instruments* dealt in are of a quality comparable to those in a regulated market in the *United Kingdom*.~~

Annex B

Amendments to the Integrated Prudential sourcebook

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

1.2.34 G Certain risks such as systems and controls weaknesses may not be adequately addressed by, for example, holding additional capital and a more appropriate response would be to rectify the weakness. In such circumstances, the amount of financial resources required to address these risks, ~~which may not be adequately addressed by holding additional capital, will~~ might be zero. However, a *firm* should consider whether holding additional capital might be an appropriate response until the identified weaknesses are rectified. The *firm* must, in accordance with *PRU* 1.2.37R, document the approaches taken to manage these risks.

...

1.3.36 R For the purposes of *PRU* 1.3.35R(1), the regulatory surplus value of an *undertaking* referred to in *PRU* 1.3.31R(1) or *PRU* 1.3.31R(3) is, subject to *PRU* 1.3.37R, the sum of:

- (1) ~~the tier one capital resources~~ total capital after deductions of the *undertaking*; ~~plus~~ less
- (2) ~~the tier two capital resources of the~~ *undertaking*; less
- (3) the individual capital resources requirement of the *undertaking*.

1.3.37 R (1) Subject to *PRU* 1.3.38R, for the purposes of *PRU* 1.3.36R, only the relevant proportion of the:

- (a) ~~tier one capital resources~~ total capital after deductions of the *undertaking*; and
- (b) ~~tier two capital resources of the~~ *undertaking*;
- (e) individual capital resources requirement of the *undertaking*;

is to be taken into account.

- (2) ...

1.3.38 R If the individual capital resources requirement of an *undertaking* in *PRU* 1.3.31R(1) that is a *subsidiary undertaking* exceeds ~~the sum of its tier one capital resources and tier two capital resources~~ total capital after deductions,

the full amount of the items referred to in *PRU* 1.3.37R(1) are to be taken into account for the purposes of *PRU* 1.3.36R.

1.3.39 R For the purposes of *PRU* 1.3.35R to *PRU* 1.3.38R:

- (1) in relation to an *undertaking* referred to in *PRU* 1.3.31R(1):
 - (a) ...
 - (b) ~~the following expressions are to be construed in accordance with *PRU* 8.3.37R~~ total capital after deductions means:
 - (i) ~~tier one capital resources~~ when used in relation to a regulated related undertaking that is subject to *PRU* 2.2.14R, the total capital after deductions (as calculated at stage M of the calculation in *PRU* 2.2.14R) of the undertaking; and
 - (ii) ~~tier two capital resources~~ when used in relation to a regulated related undertaking that is not subject to *PRU* 2.2.14R, the total capital after deductions calculated as if that undertaking were required to calculate its total capital after deductions in accordance with stage M of the calculation in *PRU* 2.2.14R, but with such adjustments being made to secure that the undertaking's calculation of its total capital after deductions complies with the relevant sectoral rules applicable to it; and
 - (c) ineligible surplus capital has the meaning given by *PRU* 8.3.67R;
- (2) in relation to an *undertaking* referred to in *PRU* 1.3.31R(3), ~~the following expressions are to be construed as if that undertaking were an insurance holding company:~~
 - (a) the individual capital resources requirement is zero; and
 - (b) ~~tier one capital resources; and~~ the total capital after deductions means the total capital after deductions of the undertaking calculated as if the undertaking were an insurance holding company required to calculate its total capital resources in accordance with *PRU* 2.2.14R but with such adjustments being made to secure that the undertaking's calculation of its total capital after deductions complies with the sectoral rules for the insurance sector.

(c) ~~tier two capital resources. [deleted]~~

...

2.1.25 R The amount of a *firm's base capital resources requirement* is set out in Table 2.1.26R. If a *firm* falls within more than one of the descriptions of type of *firm* set out in Table 2.1.26R, its *base capital resources requirement* is the highest amount set out against the different types of *firm* within whose description it falls.

2.1.26 R Table: Base capital resources requirement

Firm type			Amount: Currency equivalent of
<i>General insurance business</i>			
	Liability insurer (classes 10-15)	Directive mutual	€2.25 million
		Non-directive insurer	€300,000
		Overseas firm	€1.5 million
		Other	€3 million
	Other insurer	Directive mutual	€1.5 million
		Non-directive insurer (classes 1 to 8, 16 or 18)	€225,000
		Non-directive insurer (classes 9 or 17)	€150,000
		Overseas firm	€1 million
		Other	€2 million

<i>Long-term insurance business</i>			
	<i>Mutual</i>	Directive	€2.25 million
		<i>Non-directive</i>	€600,000
	<i>Overseas firm</i>		€1.5 million
	Any other insurer		€3 million

...

2.1.27 R (1) Subject to ~~(2)~~ and (1A) to (3), the amount of the *base capital resources requirement* specified in the last column of the table in PRU 2.1.26R for a firm which is not a *non-directive insurer* will increase each year, starting on the review date of 20 September 2005 (and annually after that), by the percentage change in the European index of consumer prices (comprising all EU member states, as published by Eurostat) from 20 March 2002, to the relevant review date, rounded up to a multiple of €100,000.

(1A) In the case of a mutual, the amount of the increased base capital resources requirement will be three-quarters of the amount that would apply if it were not a mutual.

(2) ...

(3) The increase will take effect 30 days after the EU Commission has informed the European Parliament and Council of its review and the increased amount ~~relevant percentage change~~.

...

2.2.7 G *Tier two capital* includes forms of capital that do not meet the requirements for permanency and absence of fixed servicing costs that apply to *tier one capital*. *Tier two capital* includes, for example:

(1) capital which is perpetual (that is, has no fixed term) but cumulative (that is, servicing costs cannot be waived at the issuer's option, although they may be deferred – for example cumulative *preference shares*); only perpetual capital instruments may be included in *upper tier two capital*; and

(2) capital which is not perpetual (that is, it has a fixed term) ~~and~~ or which may ~~also~~ have fixed servicing costs that cannot generally be either waived or deferred, for example, most subordinated debt. Such capital should normally be of a medium to long-term maturity (that

is, an original maturity of at least five years). Dated capital instruments are included in *lower tier two capital*.

...

2.2.14 R Table: Capital resources (see *PRU 2.2.12R*)

	Related text	Included in the calculation of capital resources
		A ✓ denotes that the item is included in the calculation of a <i>firm's capital resources</i> ; a ✗ denotes that the item is not included in the calculation of a <i>firm's capital resources</i> .
(A) Core tier one capital		
...		
Fund for future appropriations	None <u><i>PRU</i></u> <u>2.2.81AR</u>	✓
...		
(G) Upper tier two capital		
Perpetual cumulative preference shares	<i>PRU</i> 2.2.101R to <u><i>PRU</i></u> <u>2.2.121R</u>	✓
Perpetual subordinated debt	<i>PRU</i> 2.2.101R to <u><i>PRU</i></u> <u>2.2.121R</u>	✓
Perpetual subordinated securities	<i>PRU</i> 2.2.101R to <u><i>PRU</i></u> <u>2.2.121R</u>	✓

(H) Lower tier two capital		
Fixed term <i>preference shares</i>	<i>PRU</i> 2.2.108R to <i>PRU</i> <u>2.2.124R</u>	✓
Fixed term subordinated debt	<i>PRU</i> 2.2.108R to <i>PRU</i> <u>2.2.124R</u>	✓
Fixed term subordinated securities	<i>PRU</i> 2.2.108R to <i>PRU</i> <u>2.2.124R</u>	✓

...

2.2.17 R ...

with the sum of the items listed at stages A, B, G and H in PRU 2.2.14R less the sum of the items listed at stage E in *PRU 2.2.14R*.

2.2.18 R ...

with the sum of the items listed at stages A, B, G and H in PRU 2.2.14R less the sum of the items listed at stage E in *PRU 2.2.14R*.

2.2.18A R In *PRU 2.2.17R* and *PRU 2.2.18R*:

- (1) items listed at stage B in *PRU 2.2.14R* may be included notwithstanding *PRU 2.2.20R(1)*;
- (2) *innovative tier one capital* that meets the conditions (other than *PRU 2.2.108R(11)*) for it to be included as *upper tier two capital* at stage G in *PRU 2.2.14R* may be treated as an item listed at stage G; and
- (3) a *firm* must exclude from the calculation the higher of the following:
 - (a) the amount (if any) by which the sum of the items listed at stages G and H in *PRU 2.2.14R* exceeds the total (net of deductions) of the remaining constituents of adjusted stage M; and

- (b) the amount (if any) by which the sum of the items listed at stage H in PRU 2.2.14R exceeds one-third of the total (net of deductions) of the remaining constituents of adjusted stage M:

where adjusted stage M means the amount calculated at stage M of the calculation in PRU 2.2.14R less the amount of any innovative tier one capital that is not treated as upper tier two capital for the purpose of PRU 2.2.17R or PRU 2.2.18R, as the case may be.

...

2.2.22 G R ~~The amount of any capital item excluded from a firm's tier one capital resources under PRU 2.2.20R may form part of its tier two capital resources subject to the limits in PRU 2.2.23R.~~

- (1) A firm may, subject to the limits in PRU 2.2.23R, include in its tier two capital resources any capital item excluded from its tier one capital resources under PRU 2.2.20R which meets the conditions for it to be included as tier two capital at stage G or H in PRU 2.2.14R.
- (2) For the purpose of (1), the requirement to obtain a legal opinion in PRU 2.2.108R(11) does not apply.

...

2.2.24 R At least 75% of a firm's MCR must be accounted for by the sum of:

- (1) the amount calculated at stage A plus, notwithstanding PRU 2.2.20R(1), the amount calculated at stage B less the amount calculated at stage E of the calculation in PRU 2.2.14R; and
- (2) the amount calculated at stage G of the calculation in PRU 2.2.14R.

2.2.24A R In PRU 2.2.24R the amount of any innovative tier one capital that meets the conditions for it to be included as upper tier two capital at stage G in PRU 2.2.14R may be included in the amount calculated at stage G.

...

2.2.29 R Subject to PRU 2.2.30R, an item of capital in a firm complies with PRU 2.2.27R(3) if:

...

- (7) the firm has the right to choose whether or not is under no obligation

to pay a *coupon* on it in cash at any time; and

- (8) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy *PRU 2.2.29R(1)* to (7) and, where it applies, *PRU 2.2.93R*.

...

2.2.36 R *Permanent share capital* means an item of capital which (in addition to satisfying *PRU 2.2.29R*) meets the following conditions:

...

- (2) any *coupon* on it is not cumulative, and the *firm* ~~has both the right to choose whether or not~~ is under no obligation to pay a *coupon* and has the right to choose the amount of ~~that~~ any *coupon* that it pays; and

...

...

2.2.38 R In relation to a perpetual non-cumulative *preference share* which is redeemable, a *firm* may not include it in its *tier one capital resources* unless its contractual terms are such that:

- (1) ...
- (2) the *firm* cannot exercise that redemption right:
- (a) ~~on or~~ before the fifth anniversary of its date of issue;

...

...

2.2.47 G ...

- (2) Under *PRU 2.2.29R(7)*, the *firm* ~~has the right not~~ is not obliged to pay a *coupon* in cash at any time.

...

2.2.48 G *PRU 2.2.36R(2)* says that a capital instrument on which a cumulative *coupon* is payable must not be included in a *firm's permanent share capital*. The payment of a *coupon* must be purely discretionary. There must be no obligation to pay a *coupon* and the *firm* must be able to choose the amount

of any coupon paid.

...

2.2.50 R A perpetual non-cumulative *preference share* may be included at stage B of the calculation in *PRU 2.2.14R* if:

...

(2) any *coupon* on it is not cumulative, and the *firm* ~~has the right to choose whether or not~~ is under no obligation to pay a *coupon* in ~~all~~ any circumstances;

...

...

2.2.58 R A *firm* wishing to issue an *innovative tier one instrument* must obtain ~~an~~ a properly reasoned legal opinion from Queen's Counsel or, ~~or~~ where the opinion relates to the law of a jurisdiction outside the *United Kingdom*, from a lawyer in that jurisdiction of equivalent status, confirming that the criteria in *PRU 2.2.29R(5)* and *PRU 2.2.31R* are met.

...

2.2.63 R If a *potential tier one instrument* is or may become subject to a *step-up*, a *firm* must not include it in its *tier one capital resources* if the amount of the *step-up* as calculated as at the date of issue of the instrument exceeds or may exceed:

...

...

2.2.76 R Negative amounts, including any interim net losses, must be deducted from profit and loss account and other reserves ~~*tier one capital resources*~~.

...

Fund for future appropriations

2.2.81A R The fund for future appropriations means the fund of the same name required by the *insurance accounts rules*, comprising all funds the allocation of which either to *policyholders* or to shareholders has not been determined by the end of the *financial year*, or the balance sheet items under *international accounting standards* which in aggregate represent as nearly as possible that fund.

...

2.2.86 R For the purposes of *PRU 2.2.14R*, a *firm* must deduct from total *capital resources* the value of any asset which is not an *admissible asset* as listed in *PRU 2 Ann 1R*, unless the asset is held to cover *property-linked liabilities* or *index-linked liabilities* under *PRU 4.2.57R* or *PRU 4.2.58R*.

...

2.2.98 G *Tier two capital resources* is split into upper and lower tiers. ~~The principal~~ A major distinction between *upper* and *lower tier two capital* is that only perpetual instruments may be included in *upper tier two capital* whereas dated instruments, such as fixed term *preference shares* and dated subordinated debt, are included in *lower tier two capital*.

...

2.2.101 R A capital instrument must meet the following conditions before it can be included in a *firm's upper tier two capital resources*:

...

(3) the contractual terms of the instrument must provide for the *firm* to have the option to defer any interest payment in cash on the debt; ~~and~~

(4) the contractual terms of the instrument must provide for the loss-absorption capacity of the debt and unpaid interest, whilst enabling the *firm* to continue its business; and

(5) the contractual terms of the instrument must not provide for the instrument to be redeemable or the debt to be repayable on notice from the holder.

2.2.101 R Where a capital instrument meets *PRU 2.2.101R*, and notice of the
A redemption or repayment of that instrument has been given by the *firm* in accordance with *PRU 2.2.116AR*, the *firm* must no longer include that instrument in its *tier two capital resources*.

...

2.2.105 R A *firm* wishing to issue an *upper tier two instrument* other than a perpetual ~~cumulative~~ *preference share* must obtain ~~an~~ a properly reasoned legal opinion from Queen's Counsel or, ~~or~~ where the opinion relates to the law of a jurisdiction outside the *United Kingdom*, from a lawyer in that jurisdiction of equivalent status, confirming that the criteria in *PRU 2.2.101R(4)* are met.

...

~~Lower tier two capital~~

- 2.2.107 G ~~Capital instruments that meet the general conditions described in PRU 2.2.108R may be included in lower tier two capital resources. [deleted]~~

General conditions for eligibility as tier two capital

- 2.2.108 R A capital instrument must not form part of the *tier two capital resources* of a *firm* unless it meets the following conditions:

...

- (5) in addition to the requirement about repayment in (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by PRU 2.2.116AR or PRU 2.2.123AR;

...

- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, PRU 2.2.93R; and

...

- 2.2.116 R A tier two instrument may be redeemable at the option of the firm, but any
A contractual term of the instrument providing for the firm to have the right to
exercise such an option on a specified date must not provide for that right to
be exercisable earlier than the fifth anniversary of the date of issue of the
instrument.

...

- 2.2.119 R Where a *tier two instrument* is subject to one or more *step-ups*, the first date that a *step-up* can take effect must be treated, for the purposes of this section, as the instrument's final maturity date if its actual maturity date occurs after that, unless the effect of the *step-up* or *step-ups* as calculated as at the date of issue of the instrument is to increase the *coupon* rate at which payments are to be made by no more than:

...

...

- 2.2.121 R Where a *step-up* arises through a change from paying a *coupon* on a debt instrument to paying a dividend on a *share* issued in settlement of the *coupon*, ~~then~~ any net cost to the *firm* arising from the different tax treatment

of the dividend compared to the tax treatment of interest may be ~~excluded~~ignored for the purpose of assessing the effect of the *step-up*.

...

Other conditions for eligibility as lower tier two capital

2.2.122 A G Capital instruments that meet the general conditions described in PRU 2.2.108R, including perpetual capital instruments that do not meet one or more of the conditions in PRU 2.2.101R(3), (4) and (5), may be included in lower tier two capital resources.

2.2.123 R A capital instrument may be included in *lower tier two capital resources* only if it has an original maturity of at least five years or, ~~where~~ it has no fixed maturity date, ~~notice of repayment of not less than five years has been given.~~

2.2.123 A R A lower tier two instrument may include a contractual term providing for the instrument to be redeemable on notice from the holder, but the period of notice of redemption or repayment required to be given by the holder must not be less than five years.

2.2.124 R ~~In its final five years to maturity, f~~For the purposes of calculating the amount of a *lower tier two instrument* which may be included in a *firm's capital resources*;

(1) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and

(2) in the case of an instrument with or without a fixed maturity date but where five or more years' notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;

the principal amount must be amortised on a straight line basis.

2.2.125 G ~~PRU 2.2.124R applies both to a tier two instrument with a fixed maturity and to a tier two instrument with no fixed maturity but where the firm has given five years' notice of repayment. [deleted]~~

...

Annex 1R

Admissible assets in insurance

...

(2) Debts and claims

(a) ...

(b) ~~deposits~~ deposits with and debts owed by ceding *undertakings*;

...

Annex 2G

Guidance on applications for waivers relating to implicit items

Implicit items under the Act

1. *PRU 2.2.14R* does not permit *implicit items* to be included in the calculation of a *firm's capital resources*, except subject to a *waiver* under section 148 of the *Act*. Article 27(4) of the *Consolidated Life Directive* states that *implicit items* can be included in the calculation of a *firm's capital resources*, within limits, provided that the supervisory authority agrees. Certain *implicit items*, however, are not eligible for inclusion beyond 31 December 2009 (see paragraph 5). The *FSA* may be prepared to grant a *waiver* from *PRU 2.2.14R* to allow *implicit items*, in line with the purpose of the *Consolidated Life Directive*, and provided the conditions as set out in article 27(4) of the *Consolidated Life Directive* are met. Such a *waiver* would allow an *implicit item* to count towards the *firm's capital resources* available to count against its *capital resources requirement (CRR)* set out for *realistic basis life firms* in *PRU 2.1.15R* and for *regulatory basis only life firms* in *PRU 2.1.20R*. ~~Where a *firm* applies for an *implicit item waiver* the *firm* may also apply for a *waiver* from *PRU 2.2.16R*, which requires at least 50% of a *firm's MCR* to be covered by *core tier one capital* and *perpetual non-cumulative preference shares*. An *implicit item* may potentially count as *tier one capital* (but not *core tier one capital*) or *tier two capital*. Where a *waiver* is granted allowing an *implicit item* as *tier one capital*, the value of the *implicit item* so allowed must be included at stage B of the calculation in *PRU 2.2.14R*. If the application of the value of the *implicit item* is restricted by *PRU 2.2.20R(1)*, which requires that at least 50% of a *firm's tier one capital resources* must be accounted for by *core tier one capital*, the remainder may be included at stage G of the calculation in *PRU 2.2.14R*, subject to *PRU 2.2.23R*. An *implicit item* treated as *tier two capital* will also be included at stage G of the calculation, again subject to *PRU 2.2.23R*. Article 29(1) of the *Consolidated Life Directive* requires that *implicit items* be excluded from the capital eligible to cover the *guarantee fund*. Under *PRU 2.2.17R* a *firm* must meet the *guarantee fund* from the sum of the items listed at~~

stages A, B, G and H of the calculation in PRU 2.2.14R less the sum of the items listed at stage E of the calculation in PRU 2.2.14R. PRU 2.2.17R addresses the requirement in article 29(1) of the *Consolidated Life Directive* that *implicit items* should be excluded from capital eligible to cover the *guarantee fund*. ~~Where an *implicit items waiver* is granted, an *implicit item* may potentially count as either *tier one* or *tier two capital*, but not *core tier one capital*. PRU 2.2.20R requires that at least 50 % of a firm's *tier one capital resources* must be accounted for by *core tier one capital*.~~The FSA will only grant an *implicit items waiver* if the *waiver* includes a modification to PRU 2.2.17R to ensure that the *implicit item* does not count towards meeting the *guarantee fund*.

...

15. An application for a *waiver* (which includes an application for an extension to or other variation of a *waiver*) should be prepared using the standard application form for a *waiver* (see *SUP 8 Ann 2D*). In addition, the application should be accompanied by full supporting information to enable the FSA to arrive at a decision on the merits of the case. In particular, the application should state clearly the nature and the amounts of the *implicit items* that a firm wishes to count against its *capital resources requirement* and ~~the treatment it proposes to adopt in counting the *implicit items* towards the firm's *capital resources*.~~whether it proposes to treat the *implicit item* as *tier one capital* or *tier two capital*. In order to assess an application, the FSA needs information as to the make-up of the firm's *capital resources*, the quality of the capital items which have been categorised into each tier of capital and a breakdown of capital both within and outside the firm's *long-term insurance fund* or *funds* and between the firm's *with-profits funds* and *non-profit funds*. An explanation as to the appropriateness of the proposed treatment of the *implicit item* under the calculation in PRU 2.2.14R should also be provided. Furthermore, the application should demonstrate including a demonstration that, in allowing for *implicit items*, there has been no double counting of future margins and that the basis for valuing such margins is prudent.

...

28. The estimated annual profit should be taken as the average annual surplus arising in the *long-term insurance fund* over the last five *financial years* up to the date of the most recent available valuation which has been submitted to the FSA prior to, or together with, the application. For this purpose, deficiencies arising should be treated as negative surpluses. Where a firm's *financial year* has altered, the surplus arising in a period falling partly outside the relevant five year period should be assumed to accrue uniformly over the period in question for the purpose of estimating the profits arising within the five year period. When there has been a transfer of a block of business into the firm (or out of the firm) during the period, ~~the impact of the transfer will need to be taken into account to reflect the remaining portfolio surplus arising from the transferred block should be included (or excluded) for the full five year period.~~ Where a portion of a block of business is transferred, the surplus included (or excluded) should be a reasonable estimate of the surplus arising from the portion transferred.

...

3.2.22 R ...

(3) ...

(b) ...

(i) 5% for that part of the exposure not arising from short term *deposits* made with an *approved credit institution*; this limit is increased to 10% if the total of ~~such exposures which exceed 5%~~ is less than exposures which are greater than 5% arising from applying a 10% limit does not exceed 40%;

(ii) ...

(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*...

...

(4) ...

(c) such amount as the *firm* may select not exceeding, in the case of a *firm* which is not a *participating insurance undertaking*, the amount of the *firm's* total capital after deductions as calculated at stage M of the calculation in *PRU 2.2.14R* or, in the case of a *firm* which is a *participating insurance undertaking*, the amount calculated in accordance with (5A) or, in either case, if higher...

(5) ...

(5A) For the purpose of (4)(c), a *firm* which is a *participating insurance undertaking* must calculate the amount of the *firm's* group capital resources less the difference between:

(a) the firm's group capital resources requirement; and

(b) the firm's capital resources requirement.

(5B) In (3)(b)(i) short term deposit means a deposit which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less.

(6) ...

Large exposure calculation for reinsurance exposures

3.2.23 R A firm must notify the FSA in accordance with SUP 15.7 as soon as it first becomes aware that:

(1) a reinsurance exposure to a reinsurer or group of closely related reinsurers is reasonably likely to exceed 100% of its capital resources, ~~excluding capital resources held to cover property-linked liabilities~~; or

(2) ...

...

3.2.33 R In PRU 3.2.20R and PRU 3.2.22R, references to a counterparty exposure or an asset exposure do not include such an exposure arising from:

(1) ~~a debt which is fully secured on assets whose value at least equals the amount of the debt; [deleted]~~

...

(9) a holding in a collective investment scheme falling within the UCITS Directive scheme.

...

3.2.35 R If:

(1) a firm has a counterparty exposure, an asset exposure or a reinsurance exposure in respect of which it has rights over collateral (except where that collateral is a letter of credit – see PRU 3.2.36R and PRU 3.2.37R); and

(2) ...

...

...

4.2.4 G This section sets out *rules and guidance* relating to *market risk*. Under *PRU 7.2.20R and PRU 7.2.21R*, a *firm* is required to hold *admissible assets* of a value sufficient to cover its *technical provisions* and its other *long-term insurance or general insurance liabilities*. In addition...

...

4.2.7 G *PRU 4.2* addresses the impact of *market risk* on *insurance business* in the ways set out below:

...

(2) For a *firm* that carries on *long-term insurance business*, the assets that it must hold must be of a value sufficient to cover the *firm's ~~mathematical reserve requirements~~ technical provisions and other long-term insurance liabilities*. *PRU 7.3* contains *rules and guidance* as to the methods and assumptions to be used in calculating these *mathematical reserves*. One of these assumptions is the assumed rate of interest to be used in calculating the present value of future payments by or to a *firm*. *PRU 4.2.28R to PRU 4.2.48G* set out the methodology to be used in relation to *long-term insurance liabilities*.

...

4.2.8 R For the purposes of *PRU 4.2*:

(1) ...

(2) a significant territory is any country or territory in which more than 2.5% of a *firm's long-term insurance assets* (by *market value*), excluding assets held to cover *index-linked liabilities* or *property-linked liabilities* (see *PRU 4.2.57R* and *PRU 4.2.58R*), are invested; ~~and~~

(3) the long term gilt yield means the annualised equivalent of the fifteen year gilt yield for the *United Kingdom* Government fixed-interest *securities* index jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and

(4) the member states of the European Union which have adopted the Euro as the official currency may be treated as a single territory.

...

- 4.2.10 R (1) ...
- (2) ~~From amongst its long-term insurance assets,~~ The firm must identify relevant assets (see *PRU 4.2.10AR*) which, after applying the scenarios in (3), have a value that is equal to the firm's long-term insurance liabilities under those scenarios.
- (3) For the purpose of (2), the scenarios are:
- (a) for those relevant assets invested in the *United Kingdom*, the *market risk* scenario set out in *PRU 4.2.16R*;
- (b) subject to (c) and to *PRU 4.2.26R*, for those relevant assets invested outside of the *United Kingdom*, the *market risk* scenario set out in *PRU 4.2.23R*; and
- (c) where the relevant assets in (b) are...
- (4) The *resilience capital requirement* is the result of deducting B from A, where:
- (a) A is the value of the relevant assets which will produce the result described in (2); and
- (b) ...
- (5) ...

4.2.10A R In *PRU 4.2.10R* relevant assets means a range of assets which must be selected by the firm from the assets specified in (1) and (2) in the order specified:

- (1) its long-term insurance assets; and
- (2) only where the firm has selected all the assets within (1), its shareholder assets, other than assets of an amount and kind required:
- (a) to cover its liabilities arising outside its long-term insurance funds; or
- (b) to meet any regulatory capital requirements in respect of business written outside its long-term insurance funds.

...

4.2.13 G ...

4.2.13A G In the market risk scenarios set out in PRU 4.2.16R to PRU 4.2.26R, a firm is required to assess the changed value of its assets and liabilities in the economic conditions of the scenarios set out in PRU 4.2.16R and PRU 4.2.23R. A firm is required to assess the changed value of each relevant asset (as defined in PRU 4.2.10AR), notwithstanding any uncertainty about the appropriate valuation basis for that asset. In valuing an asset in the specified scenarios, a firm should have regard to the economic substance of the asset, rather than its legal form, and assess its value accordingly. Consider, for example, a convertible bond that is close to its conversion date and where the conversion option has value. The value of the convertible bond in the specified scenarios is likely to be sensitive primarily to equity market scenarios and to a lesser extent to interest rate scenarios. The firm should value the asset according to its expected market value in the economic conditions underlying the specified scenarios.

4.2.13B G In determining where particular assets are invested for the purpose of determining which market risk scenario should be applied to those assets, or whether a country or territory in which a firm has invested part of its long-term insurance assets is a significant territory, a firm should generally treat:

- (1) a security dealt in on a regulated market as invested in any country or territory in which a regulated market on which the security is dealt is situated;
- (2) a security which is not dealt in on a regulated market as invested in the country or territory in which the issuer has its head office;
- (3) an asset consisting of a claim against a debtor as invested in any country or territory where it can be enforced by legal action;
- (4) real estate as invested in the country or territory in which the land, buildings or other immovable property is situated;
- (5) a tangible asset as invested in the country or territory where it is situated; and
- (6) a derivative or quasi-derivative as invested in the country or territory in which the assets to which the firm is exposed by reason of having entered into the derivative or quasi-derivative are situated.

Where, however, the nature of a firm's investment is such that the economic risks to which it is principally exposed are risks relating to assets invested in, or the currency of, a different country or territory to that in which are invested the assets directly invested in by the firm, then the firm should consider whether it would be more reasonable to treat the assets as invested

in that other country or territory. For example, if a firm has invested in the securities of a collective investment scheme which are dealt in on a regulated market in country A, but the scheme principally invests in real estate situated in country B, the firm should consider whether its principal exposure is in fact to the country in which the underlying assets are situated (that is, country B). Another example might be where a firm has invested in a bond or other fixed interest security that is denominated in the currency of a country or territory other than that in which the security would be treated as invested under (1) or (2) above. The firm may wish to consider whether that bond or fixed interest security should be treated as invested in the country or territory of the currency of denomination.

...

- 4.2.27 G The rates of interest to be used for the calculation of the present values of *general insurance liabilities* are specified in the *insurance accounts rules*, except where benefits resulting from a claim must be paid in the form of an annuity, in which case the rules require calculation by recognised actuarial methods. In the case of claims not payable in the form of an annuity, the ~~These~~ *insurance accounts rules* state that the rate of interest to be used must not exceed the lowest of:

...

Interest rates: long-term insurance liabilities

- 4.2.28 R The rates of interest required by PRU 7.3.33R 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 PRU 4.2.30R to PRU 4.2.48G) that is expected to be achieved on...

...

- 4.2.53 R (1) Subject to PRU 4.2.54R, a firm must hold *admissible assets* in each currency of an amount equal to at least 80% of the amount of its liabilities in that currency arising under or in connection with contracts of insurance (but excluding, for a firm that carries on general insurance business, any equalisation provision) in that ~~currency~~, except where the amount of those assets does not exceed 7% of the assets in other currencies.
- (2) In (1) references to an asset in a currency are to an asset which is expressed in or capable of being realised (without exchange risk) in that currency, and an asset is capable of being so realised if it is reasonably capable of being realised in that currency without risk that changes in exchange rates would reduce the cover for liabilities in that currency.

...

- 4.2.60 G If a *firm* has incurred a *policy* liability which cannot be exactly matched by appropriate assets (for example the Limited Price Index (LPI) ~~and Earnings Index~~), the *firm* should seek to match assets that at least cover the liabilities. For example, an LPI limited to 5% per annum may be matched by ~~a 5% fixed interest bond or an RPI bond or a fixed interest investment matching cash flows increasing at 5% per annum compound.~~

...

~~Over the counter~~ Off-market transactions

- 4.3.34 R ...

...

Stock lending

- 4.3.36 R (1) For the purposes of *PRU 2* Ann 1R (Admissible assets in insurance), a *stock lending* transaction is approved if:

(a) ...

(b) ~~the counterparty is an authorised person or, an approved counterparty,~~ a person registered as a broker-dealer with the Securities and Exchange Commission of the United States of America or a bank, or a branch of a bank, supervised, and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities of the United States of America:

(i) the Office of the Comptroller of the Currency;

(ii) the Federal Deposit Insurance Corporation;

(iii) the Board of Governors of the Federal Reserve System;
and

(iv) the Office of Thrift Supervision; and

(c) ...

(2) ...

...

Collateral

- 4.3.38 R For the purposes of *PRU 4.3.36R(31)(c)*, *collateral* is adequate only if it:
- (1) is transferred to the *firm* or its agent or, in the case of a letter of credit, meets the conditions described in *PRU 4.3.38AR*;
 - (2) is, at the time of the transfer or, in the case of a letter of credit, at the time of issue, at least equal in value to the value of the *securities* transferred, or consideration provided, by the *firm*; and
 - (3) ...
- 4.3.38A R The conditions referred to in *PRU 4.3.38R(1)* are that the letter of credit is:
- (1) direct, explicit, unconditional and irrevocable; and
 - (2) issued by an *undertaking* which is:
 - (a) not a *related undertaking* of the *counterparty*; and
 - (b) either an *approved credit institution* or a bank, or a branch of a bank, whether chartered by the federal government of the United States of America or a US state, that is supervised and examined by at least one of the following US federal banking supervisory authorities:
 - (i) the Office of the Comptroller of the Currency;
 - (ii) the Federal Deposit Insurance Corporation;
 - (iii) the Board of Governors of the Federal Reserve System;
and
 - (iv) the Office of Thrift Supervision.
- 4.3.39 G For the purposes of assessing adequate quality in *PRU 4.3.38R(3)*, reference should be made to the criteria for credit risk loss mitigation set out in *PRU 3.2.16R*. The valuation rules in *PRU 1.3* apply for the purpose of determining the value of both *collateral* received, and the *securities* transferred, by the *firm*. In addition, where *collateral* takes the form of assets transferred, under the rules in *PRU* any such asset that is not an *admissible asset* (see *PRU 2 Ann 1R*) does not have a value (see *PRU 2 Ann*

1R).

4.3.40 R For the purposes of *PRU 4.3.36R(3)(c)*, *collateral* is sufficiently immediate only if:

(1) it is transferred or, in the case of a letter of credit, issued before, or at the same time as, the transfer of the *securities* by the *firm*; or

(2) it will be transferred or, in the case of a letter of credit, issued, at latest, by the close of business on the day of the transfer.

4.3.41 R *Collateral* continues to be adequate only if its value is at all times at least equal to the value of the *securities* transferred by the *firm*. This will be satisfied in respect of *collateral* ~~the validity of which~~ where the validity of the *collateral* or the *firm's* interest in the *collateral* is about to expire or has expired ~~where~~ if sufficient *collateral* will again be transferred or issued at the latest by the close of business on the day of expiry.

4.3.42 G References in *PRU 4.3.40R(2)* and *PRU 4.3.41R* to the close of business on the day of the transfer or the day of expiry are to close of business on that day in all time regions.

...

7.2.3 R For a *non-EEA direct insurer* with a *branch* in the *United Kingdom*, the part of this section headed “Capital requirements for insurers” (*PRU 7.2.43G* to *PRU 7.2.91R*) applies to its world-wide activities, whilst the parts of this section headed “Establishing technical provisions” (*PRU 7.2.12R* to *PRU 7.2.19G*), “Assets of a value sufficient to cover technical provisions and other liabilities” (*PRU 7.2.20R* to *PRU 7.2.29G*)...

7.2.4 R For an *EEA-deposit insurer* or a *Swiss general insurer*, the parts of this section headed “Establishing technical provisions” (*PRU 7.2.12R* to *PRU 7.2.19G*), “Assets of a value sufficient to cover technical provisions and other liabilities” (*PRU 7.2.20R* to *PRU 7.2.29G*)...

7.2.5 R For an ~~an~~ *UK-deposit insurer*, the part of this section headed “Capital requirements for insurers” (*PRU 7.2.43G* to *PRU 7.2.91R*) applies to its world-wide activities, whilst the parts of this section headed “Establishing technical provisions” (*PRU 7.2.12R* to *PRU 7.2.19G*), “Assets of a value sufficient to cover technical provisions and other liabilities” (*PRU 7.2.20R* to *PRU 7.2.29G*)...

...

7.2.16 R For *long-term insurance business*, a *firm* must establish adequate technical provisions in respect of its *long-term insurance contracts* as follows:

- (1) ~~for its long-term insurance contracts, mathematical reserves~~ in accordance with the *rules and guidance* in *PRU 7.3* relating to ~~mathematical reserves~~ such reserves, and with due regard to generally accepted actuarial practice; and
- (2) ~~for long-term insurance liabilities which~~ liabilities in respect of such contracts that have fallen due, in accordance with *PRU 1.3.5R*.

...

Assets of a value sufficient to cover technical provisions and other liabilities

7.2.20 R A firm which is not a composite firm must hold *admissible assets* of a value at least equal to the amount of:

- (1) the *technical provisions* that it is required to establish under *PRU 7.2.12R* and or *PRU 7.2.16R* ~~(excluding technical provisions for property linked and index linked benefits and the assets held to cover them under *PRU 4.2.57R* and *PRU 4.2.58R*);~~ and
- (2) its other general insurance liabilities or long-term insurance liabilities;

but excluding property-linked liabilities and index-linked liabilities and the assets held to cover them under *PRU 4.2.57R* and *PRU 4.2.58R*.

7.2.21 R A *composite firm* must ensure that:

- (1) ~~its separately identified long-term insurance assets have~~ it holds admissible assets separately identified in accordance with *PRU 7.6.18R* of a value at least equal to the amount of:
 - (a) ~~its technical provisions for long-term insurance liabilities~~ the technical provisions that it is required to establish under *PRU 7.2.16R*; and
 - (b) ~~any other liabilities connected with long-term insurance business~~ its other long-term insurance liabilities;

but excluding property-linked liabilities and index-linked liabilities and the assets held to cover them under *PRU 4.2.57R* and *PRU 4.2.58R*; and

- (2) ~~that it has~~ it holds other admissible assets (other than those excluded under (1)) of a value at least equal to the amount of:

(a) ~~its technical provisions for general insurance liabilities~~ the technical provisions that it is required to establish under PRU 7.2.12R; and

(b) its other general insurance liabilities.

...

7.2.23 G When valuing assets for the purposes of PRU 7.2.20R and PRU 7.2.21R, a firm should bear in mind:

(1) that the technical provisions and other long-term insurance liabilities or general insurance liabilities should be covered by admissible assets (see PRU 2 Ann 1R); and

...

7.2.25 R For the purpose of determining the value of assets available to meet technical provisions and other long-term insurance liabilities in accordance with PRU 7.2.20R, PRU 7.2.21R, PRU 7.2.27R and PRU 7.2.28R, no value is to be attributed to ~~debts and claims other than in respect of:~~

(1) ~~amounts that have already fallen due~~ debts owed by reinsurers; or

(2) claims; or

(~~3~~) tax recoveries and; or

(4) claims against compensation funds;

to the extent ~~not~~ already offset in the calculation of mathematical reserves ~~technical provisions.~~

7.2.26 G Certain debts and ~~claims~~ claims are excluded from PRU 7.2.20R, PRU 7.2.21R, PRU 7.2.27R and PRU 7.2.28R to avoid double-counting. The rules and guidance in PRU 7.3 (Mathematical reserves) set out how a firm may offset debts and claims against liabilities in calculating the mathematical reserves required for long-term insurance business. ~~Tax recoveries and claims against compensation funds in PRU 7.2.25R(2) are set out in the list of admissible assets (see PRU 2 Ann 1R).~~

...

7.2.27 R A firm carrying on long-term insurance business must ensure that it has admissible assets in each of its with-profits funds of a value sufficient to cover:

- (1) the *technical provisions* in respect of all the business written in that *with-profits fund*; and
- (2) its other long-term insurance liabilities in respect of that *with-profits fund*.

...

7.2.29 G PRU 7.2.27R and PRU 7.2.28R support the funding of *policyholder* benefits by requiring *firms* to maintain *admissible assets* in *with-profits funds* to cover the *technical provisions* and other long-term insurance liabilities relating to all the business in that fund and, in the case of a *realistic basis life firm*, realistic assets to cover the realistic liabilities of the *with-profits insurance contracts* written in the fund.

...

7.2.34 R (1) Subject to (4), the assets held by a *firm* to cover its *technical provisions* and other long-term insurance liabilities or general insurance liabilities (see PRU 7.2.20R and PRU 7.2.21R) must:

...

7.2.35 G A *firm* should take account of the amount, currency and timing of its expected cash outflows in determining whether the assets it holds to cover its *technical provisions* and other long-term insurance liabilities or general insurance liabilities meet the requirements of PRU 7.2.34R(2).

7.2.36 G For the purpose of PRU 7.2.34R(2), the relevant cash inflows are those which the *firm* reasonably expects to receive from the *admissible assets* which it holds to cover its *technical provisions* and other long-term insurance liabilities or general insurance liabilities. A *firm* may receive cash inflows as a result of...

...

7.2.40 G PRU 7.2.20R lays down a general requirement for a *firm* that carries on *long-term insurance business* to hold *admissible assets* that are of a value sufficient to cover its ~~mathematical reserves (calculated in accordance with the rules in PRU 7.3)~~ *technical provisions* and other long-term insurance liabilities. The PRU 7.2.34R(2) requirement to match liabilities with assets that allow cash outflows to be met with suitable inflows as the outflows become due may mean that a *firm* has to hold assets of a value greater than would otherwise be required by the general rule in PRU 7.2.20R.

Premiums for new business

7.2.41 R A *firm* must not enter into a *long-term insurance contract* unless it is satisfied on reasonable actuarial assumptions that:

...

are sufficient to enable it, when taken together with the *firm's* other resources, to:

- (a) ...
- (b) hold *admissible assets* of a value at least equal to the amount of the *technical provisions and other long-term insurance liabilities* as required by *PRU 7.2.20R* to *PRU 7.2.28R*; and
- (c) ...

...

7.2.56 R For the purpose of *PRU 7.2.45R*, the *gross adjusted premiums amount* is the higher of the *gross written premiums* and *gross earned premiums* (as ~~determined~~ adjusted in accordance with *PRU 7.2.66R*) for the *financial year in question*...

...

7.2.66 R For the purposes of *PRU 7.2.54R*, *PRU 7.2.56R*, *PRU 7.2.60R* and *PRU 7.2.62R*, amounts of *premiums* and *claims* must be:

- (1) determined in accordance with ~~*PRU 1.3 (Valuation)*~~ the *insurance accounts rules* or the *Friendly Societies (Accounts and Related Provisions) Regulations 1994*, as appropriate; and
- (2) ...

...

7.2.71 R Where there has been a significant change in the business portfolio of the *firm* since the end of the *financial year in question*, for example, a line of business has been transferred to another *firm*, or the *firm* no longer carries on a particular *class of insurance business*, the *gross adjusted premiums amount* and the *gross adjusted claims amount* must both be recalculated to take into account the impact of this change. The recalculation must take into account the requirements of ~~*PRU 1.3 (Valuation)*~~ the *insurance accounts rules* or the *Friendly Societies (Accounts and Related Provisions)*

Regulations 1994, as appropriate.

...

Insurance death risk capital component

7.2.81 R The *insurance death risk capital component* is the aggregate of the amounts which represent the fractions specified by *PRU 7.2.82R* of the capital at risk, defined in *PRU 7.2.83R*, for each category of contracts of insurance (as specified in *PRU 7.2.81AR*), in respect of those contracts where the capital at risk is not a negative figure, multiplied by the higher of:

- (1) 50%; and
- (2) the ratio as at the end of the ~~preceding~~ *financial year in question* of:
 - (a) the aggregate capital at risk in respect of that category of contracts net of reinsurance cessions; to
 - (b) the aggregate capital at risk in respect of that category of contracts gross of reinsurance cessions.

7.2.81A R For the purpose of *PRU 7.2.81R*, the categories of *contracts of insurance* are as follows:

- (1) contracts which fall in *long-term insurance business classes I, II or IX*; and
- (2) contracts which fall in *long-term insurance business classes III, VII or VIII*.

...

Insurance expense risk capital component

7.2.88 R ...

- (1) in respect of *long-term insurance business classes III, VII and VIII*, an amount equivalent to 25% of the net *administrative expenses* in the ~~preceding~~ *financial year in question* relevant to the business of each of those *classes*, in so far as the *firm* bears no investment risk and the allocation to cover *management expenses* in the *contract of insurance* does not have a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;

- (2) ...
- (3) in the case of any other *long-term insurance business*, 1% of the “adjusted *mathematical reserves*” (as defined in *PRU 7.2.89AR90R* and *PRU 7.2.91R*).

Insurance market risk capital component

- 7.2.89 R The *insurance market risk capital component* is 3% of the “adjusted *mathematical reserves*” (as defined in *PRU 7.2.89AR90R* and *PRU 7.2.91R*) for all ~~*contracts of insurance*~~ insurance liabilities except those of a kind which:
- (1) ~~fall arise from contracts of insurance falling~~ in long-term insurance business classes III, VII or VIII and in respect of which to the extent that the firm does not bear any investment risk; or
 - (2) ~~fall arise from contracts of insurance falling~~ in long-term insurance business class V.

Adjusted mathematical reserves

- 7.2.89A R (1) For the purpose of *PRU 7.2.88R* and *PRU 7.2.89R*, the "adjusted *mathematical reserves*" is the aggregate of the amounts which result from the performance of the calculation in *PRU 7.2.90R* for each category of insurance liability specified in (2).
- (2) The categories of insurance liability referred to in (1) are:
- (a) for the purpose of *PRU 7.2.88R*, those categories described in *PRU 7.2.91R*(1), (2), (3), (4) and (5); and
 - (b) for the purpose of *PRU 7.2.89R*, those categories described in *PRU 7.2.91R*(1), (2), (4) and (5).

- 7.2.90 R ~~For the purpose of *PRU 7.2.88R* and *PRU 7.2.89AR*(1), the “adjusted *mathematical reserves*” is the multiplication of the amount of the *mathematical reserves* (gross of *reinsurance cessions*); multiplied in respect of a category of insurance liability by the higher of:~~
- (1) 85% or, in the case of a *pure reinsurer*, 50%; and
 - (2) the ratio as at the end of the ~~preceding~~ financial year in question of:
 - (a) the *mathematical reserves* in respect of that category of

insurance liability net of *reinsurance* cessions; to

- (b) the *mathematical reserves* in respect of that category of insurance liability gross of *reinsurance* cessions.

7.2.91 R ~~The “adjusted *mathematical reserves*” do not include~~ For the purpose of *PRU 7.2.89AR* and *PRU 7.2.90R*, the categories of insurance liability are as follows:

- (1) ~~for the purposes of *PRU 7.2.88R(3)* and *PRU 7.2.89R*, amounts arising from *tontines (long-term insurance business class V)*~~ liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes I, II or IX*;
- (2) ~~for the purposes of *PRU 7.2.88R(3)*, amounts arising from *insurance business in classes III, VII or VIII*, to the extent that such business meets the conditions in *PRU 7.2.88R(1)*~~ liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes III, VII or VIII* to the extent that the *firm* bears an investment risk;
- (3) ~~for the purposes of *PRU 7.2.89R*, amounts arising from *insurance business in classes III, VII or VIII*, to the extent that such business meets the conditions in *PRU 7.2.89R(1)*~~ liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes III, VII or VIII* to the extent that the *firm* bears no investment risk and where the allocation to cover *management expenses* in the *contract of insurance* has a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;
- (4) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class IV*; and
- (5) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class VI*.

7.2.92 G Where a *firm* has written a unit-linked contract, the *firm's* liability under the contract may consist of a unit liability, where the *firm* bears no investment risk, and other liabilities for which the *firm* bears an investment risk, and for which a separate reserve is held. *PRU 7.2.91R(2)* and (3) require a *firm* to analyse its liabilities under unit-linked contracts between those for which it bears an investment risk and those for which it does not. *PRU 7.2.88R* and *PRU 7.2.89R* taken together result in a capital requirement for any liabilities for which the *firm* bears an investment risk of 4% of “adjusted *mathematical reserves*” (1% for expense risk and 3% for market risk).

...

7.3.9 R Except in *PRU 7.3.71R(1)*, *PRU 7.3* does not apply to *final bonuses*. In addition, for *realistic basis life firms* only, *PRU 7.3* does not apply to other discretionary benefits, including future annual bonuses.

...

7.3.19 G Further detailed *rules* and *guidance* on margins for adverse deviation are included in *PRU 7.3.32G* to *PRU 7.3.9189G*. In particular...

(5) *reinsurance* (*PRU 7.3.78G77AR* to *PRU 7.3.9189G*).

...

7.3.23 G *PRU 7.3.22R* to *PRU 7.3.9189G* 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 *PRU 7.3.22R(2)* are satisfied.

...

7.3.28 R ...

(4) amounts to be received or paid in respect of the *long-term insurance contracts* under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements (see *PRU 7.3.78G77AR* to *PRU 7.3.9189G*).

...

7.3.31 G *PRU 7.3.29R(4)* requires *regulatory basis only life firms* to make allowance for any future *annual bonus* that a *firm* would expect to grant, assuming future experience is in line with the assumptions used in the calculation of the *mathematical reserves*. *Final bonuses* do not have to be taken into consideration in these calculations except in relation to *accumulating with-profits policies* (see *PRU 7.3.9R*). The calculations required for *accumulating with-profits policies* are set out in *PRU 7.3.71R(1)*. For *realistic basis life firms*, except for *accumulating with-profits policies*, the *mathematical reserves* may be calculated as ~~the amount required to cover guaranteed benefits without taking into account discretionary benefits, including both *annual bonuses* and *final bonuses*.~~ as for For such *firms* full allowance for discretionary benefits is made in the calculation of the *realistic value of liabilities* (see *PRU 7.4.105R(5)*). ~~The calculations required for *accumulating with-profits policies* are set out in *PRU 7.3.71R(1)*.~~

...

7.3.32 G More detailed *rules* and *guidance* about the valuation of cash flows are set out in *PRU 7.3.33R* to *PRU 7.3.9189G*.

...

7.3.70 R (4) (1) may be applied to a group of similar contracts instead of to the individual contracts within that group except where the cash amount or series of cash payments is the amount or amounts likely to be paid on a voluntary discontinuance.

...

7.3.72 G *PRU 7.3.71R(1)* applies only to *accumulating with-profits policies*; *PRU 7.3.71R(2)* applies to any other type of *policy*, including *non-profit insurance* contracts. In *PRU 7.3.71R(1)(a)* ~~*firms*~~ a *firm* must take into consideration, for example, a market value adjustment where such an adjustment has been described in representations made to *policyholders* by the *firm*. However, any discretionary adjustment, such as a market value adjustment, ~~cannot~~must not be included in the amount calculated in *PRU 7.3.71R(1)(b)*.

...

Reinsurance

7.3.77A R In *PRU 7.3.78G* to *PRU 7.3.89G* references to:

(1) *reinsurance* and contracts of *reinsurance* include analogous non-*reinsurance* financing agreements, including contingent loans, securitisations and any other arrangements giving rise to charges on future surplus arising;

(2) *reinsured risks*, in relation to a contract of *reinsurance* entered into by a *firm*, means that part of:

(a) the risks insured by the *firm* under *long-term insurance contracts* entered into by it; and

(b) the other risks arising directly from the *firm's long-term insurance business*;

that have been transferred to the *reinsurer* under that contract of *reinsurance*; and

(3) *reinsurance* cash outflows include any reduction in *policy liabilities* recognised as covered under a contract of *reinsurance* or any reduction of any debt to the *firm* under or in respect of a contract of

reinsurance.

...

7.3.79 R ...

- (3) *reinsurance* cash inflows that are contingent on factors or conditions other than the ~~*insurance* risks that are reinsured~~ risks must not be valued.

...

7.3.83 G Only *reinsurance* cash inflows that are triggered unambiguously by the ~~*insurance* risks of the firm that are reinsured~~ risks may be valued. *Reinsurance* cash inflows that depend on other contingencies where the outcome does not form part of the valuation basis should not be given credit.

...

7.3.85 R For the purposes of *PRU 7.3.79R(2)*, the “link” must be such that a contingent liability to pay or repay the amount to the *reinsurer* could not arise except when, and to the extent that, the margins in the valuation of the existing *contracts of insurance* emerge as surplus, or the *reinsurer* exercises its rights under a termination clause in the contract of *reinsurance* as a result of:

- (1) ~~fraud~~ fraudulent conduct by the *firm* under or in relation to the contract of *reinsurance*; or
- (2) ~~misrepresentation~~ a representation as to the existence, at or before the time the contract of *reinsurance* is entered into, of a state of affairs which is within the knowledge or control of the *firm* and which is material to the *reinsurer's* decision to enter into the contract being discovered to be false; or
- (3) the non-payment of *reinsurance premiums* by the *firm*; or
- (4) a failure by the *firm* to obtain the agreement of the *reinsurer* to a transfer by the *firm* of the whole or a specified part of its business by the *firm* without the agreement of the *reinsurer*, except where that agreement has been unreasonably withheld.

...

7.3.88 G *PRU 7.3.85R* allows a *firm* not to value *reinsurance* cash outflows provided the contingencies in which the *reinsurance* would require repayment other than out of future surpluses are limited to termination clauses concerning fraud, material misrepresentation, non-payment of *reinsurance premiums* by

the *firm* or a failure by the *firm* to obtain the agreement of the *reinsurer* to a transfer of business by the *firm* without the agreement of the *reinsurer*, except if unreasonably withheld.

...

7.3.90 R ~~In PRU 7.3.78G to PRU 7.3.89G references to *reinsurance* and contracts of *reinsurance* include analogous non-*reinsurance* financing agreements. [deleted]~~

7.3.91 G ~~In PRU 7.3.78G to PRU 7.3.89G references to *reinsurance* cash outflow include any provision for the reduction in *policy* liabilities recognised as covered under a contract of *reinsurance* or for the reduction of any debt to the *firm* previously created under a contract of *reinsurance*. In PRU 7.3.90R analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements giving rise to charges on future surplus arising. [deleted]~~

...

7.4.25 R For the purpose of determining the value of a fund's *long-term admissible assets* in accordance with PRU 7.4.24R(1)(a), no value is to be attributed to ~~debts and claims other than in respect of:~~

(1) ~~amounts that have already fallen due~~ debts owed by *reinsurers*; and or

(2) *claims*; or

(~~2~~3) tax recoveries; or

(4) claims against *compensation funds*;

to the extent ~~not~~ already offset in the calculation of *mathematical reserves* technical provisions.

...

7.4.33 R ...

(3) ...

(a) ...

(b) ...

(iii) any additional amount arising from ~~the excess of the~~

present value of future profits (or losses) on any *non-profit insurance contracts* written by B (calculated on a basis consistent with *PRU 7.4.37R*), excluding any amount arising from business that is written in a *with-profits fund*, ~~over any present value of future profits (or losses) used in calculating B's regulatory capital requirements and arising from business outside its *with-profits funds*~~; and

...

(vii) any part of the *with-profits insurance capital component* of B, or of B's *long-term insurance capital requirement* or *resilience capital requirement* in respect of B's *with-profits insurance contracts*, to the extent that this 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

...

7.4.37 R A *firm* must calculate the present value of future profits (or losses) on *non-profit insurance contracts* written in the *with-profits fund* using methodology and assumptions which:

...

(4) are derived from current market yields, having regard to International Financial Reporting Standard 4: Insurance Contracts, as if it were being applied to determine the value under that standard for the first time;

...

...

7.4.39 G ...

7.4.39A G In view of *PRU 7.4.39G*, it is likely that the discount rate to be applied to the market-consistent valuation of those annuities that fall within the scope of *PRU 7.4.37R(3)* would not be significantly different from that which applies to other annuities (to which a discount rate based on the return on the matching assets less an allowance for risk which is reasonable but not excessively prudent, in accordance with *PRU 7.4.37R(2)*, might be applied).

7.4.39B G In determining current market yields for the purpose of *PRU 7.4.37R(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. A *firm* should not include an allowance for future investment margins 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.

...

7.4.51 G ...

7.4.51A G In the scenario tests set out in PRU 7.4.62R to PRU 7.4.103G, a *firm* is required to assess the changed value of its assets and liabilities in the economic conditions of the most adverse scenario. A *firm* is required to assess the changed value of each relevant asset (as defined in PRU 7.4.45R), notwithstanding any uncertainty about the appropriate valuation basis for that asset. In valuing an asset in the most adverse scenario, a *firm* should have regard to the economic substance of the asset, rather than its legal form, and assess its value accordingly. Consider, for example, a convertible bond that is close to its conversion date and where the conversion option has value. The value of the convertible bond in the most adverse scenario is likely to be sensitive primarily to equity market scenarios and to a lesser extent to interest rate scenarios. The *firm* should value the asset according to its expected market value in the economic conditions underlying the most adverse scenario.

...

7.4.63 R ...

7.4.63A G Guidance on how a *firm* should determine where particular assets are invested is provided in PRU 4.2.13BG.

...

7.4.66 G ~~In PRU 7.4.62R to PRU 7.4.76G, where there is reference to exposure to assets invested in a territory this should be interpreted as follows:~~

- ~~(1) for equities, a stock that is listed on a stock market in that territory or, if unlisted, the stock of a *company* that is incorporated in that territory;~~
- ~~(2) for bonds, one that is denominated in the currency of that territory, or issued by an institution incorporated in that territory;~~
- ~~(3) for real estate, a property that is located in that territory; and~~
- ~~(4) for derivatives, quasi-derivatives and other instruments, one where the assets to which the instrument is exposed are assets invested in~~

that territory.

In *PRU 7.4.62R to PRU 7.4.76G*, a *preference share* should be subjected to the same stress tests as an equity share. [deleted]

...

7.6.2 R ...

(4) *PRU 7.6.41R to PRU 7.6.57R* (UK branches of certain non-EEA insurers) do not apply to:

...

(b) *non-EEA insurers which are pure reinsurers whose insurance business in the United Kingdom is restricted to reinsurance; or*

...

7.6.18 R A firm carrying on long-term insurance business must identify the assets relating to its long-term insurance business which it is required to hold by virtue of *PRU 7.2.20R* and or *PRU 7.2.21R*.

7.6.19 G *PRU 7.2.16R* requires a firm to establish adequate technical provisions for its long-term insurance contracts. *PRU 7.2.20R* requires a firm to hold *admissible assets* of a value at least equal to the amount of the *technical provisions and its other long-term insurance liabilities*. *PRU 7.2.21R* ensures that a composite firm identifies separate *long-term insurance assets admissible assets* with a value at least equal to the *technical provisions for long-term insurance business and its other long-term insurance liabilities* as well as holding other assets *admissible assets* of a value at least equal to the amount of its *technical provisions for general insurance business and its other general insurance liabilities*. The overall impact of these provisions in *PRU 7.2*, and of *PRU 7.6.18R*, is that any firm writing long-term insurance business must identify separately its *long-term insurance assets* and ensure that their value is *admissible assets* of a value at least equal to the amount of its long-term insurance business technical provisions and its other long-term insurance liabilities.

...

7.6.29 G *PRU 7.2.27R* and *PRU 7.2.28R* provide further constraints on the transfer of assets out of a with-profits fund. *PRU 7.2.27R* requires a firm to have *admissible assets* in each of its with-profits funds to cover the *technical provisions and other long-term insurance liabilities* relating to all the business in that fund. *PRU 7.2.28R* requires a realistic basis life firm to ensure that the realistic value of assets for each of its with-profits funds is at

least equal to the *realistic value of liabilities* of that fund.

...

7.6.32 G ...assets of the *firm*. A firm may also lend securities held in a long-term insurance fund under a stock lending transaction or transfer assets as collateral for a stock lending transaction where the firm is the borrower, where such lending or transfer is for the benefit of the long-term insurance business.

...

7.6.48 R A non-EEA direct insurer (except a UK-deposit insurer) must hold:

(1) admissible assets, which are required to cover its *technical provisions* in accordance with PRU 7.2.20R(1) or PRU 7.2.21R(1)(a) and (2)(a); and

(2) other admissible assets not required to cover property-linked liabilities or index-linked liabilities in accordance with PRU 4.2.57R or PRU 4.2.58R which ~~to~~ represent its *UK MCR* as calculated in accordance with PRU 7.6.44R;

as follows:

- (~~1~~a) (where the assets cover the *technical provisions* and the *guarantee fund*) in the *United Kingdom*;
- (~~2~~b) (where the assets represent the amount of the *UK MCR* in excess of the *guarantee fund*) in any *EEA State*.

7.6.49 R A UK-deposit insurer must hold:

(1) admissible assets, which are required to cover its *technical provisions* in accordance with PRU 7.2.20R(1) or PRU 7.2.21R(1)(a) and (2)(a); and

(2) other admissible assets not required to cover property-linked liabilities or index-linked liabilities in accordance with PRU 4.2.57R or PRU 4.2.58R which ~~to~~ represent its *EEA MCR* as calculated in accordance with PRU 7.6.46R;

as follows:

- (~~1~~a) (where the assets cover the *technical provisions* and the *guarantee fund*) within the *EEA states* where the *firm* carries on *insurance*

business;

(2b) (where the assets represent the amount of the *EEA MCR* in excess of the *guarantee fund*) in any *EEA State*.

...

7.6.54 R A *non-EEA direct insurer* must keep assets of a value at least equal to one half quarter of the *base capital resources requirement* on deposit in the *United Kingdom* with a *BCD credit institution*.

7.6.55 G The assets deposited as security may count towards the assets required under *PRU 7.6.48R* and *PRU 7.6.49R*. If, after the deposit is made, the value of the deposited assets falls below one half quarter of the *base capital resources requirement*, the *firm* should deposit further *admissible assets* in order to comply with *PRU 7.6.48R* and *PRU 7.6.49R*. Deposited assets may be exchanged for other *admissible assets* and excess assets may be withdrawn, provided that the exchange or deposit does not cause a breach of *PRU 7.6.48R* or *PRU 7.6.49R*.

...

8.3.1 R *PRU 8.3* applies to an *insurer* that is either:

(1) ...

(2) a member of an *insurance group* (which is not a *participating insurance undertaking*) and which is not:

(a) a pure reinsurer; or

(b) a non-EEA insurer; or

(c) a friendly society.

...

8.3.34 R ...

8.3.34A G For the purposes of *PRU 8.3.34R(3)(b)* and (6)(a), where the *solo capital resources requirement* in a *designated State or territory* is ascertained by reference to the trigger for regulatory intervention, the *FSA* considers that the solo capital resources requirement of the insurance undertaking in such a designated State or territory will generally correspond to the highest point at which any regulatory or corrective action is triggered or which is in effect most nearly equivalent to the capital resources requirement which would

apply if the insurance undertaking were an insurer.

...

8.3.45 R (1) ...

(2) For the purposes of *PRU 8.3.9R* and *PRU 8.3.10R*, a firm must ensure that at all times its *tier one capital resources* and *tier two capital resources* are of such an amount that its *group capital resources* comply with the following limit, subject to (4):

$$(P - Q + T) \geq \frac{1}{3}X + (R - S - U - X).$$

(3) ...

(4) For the purposes of (2):

(a) *PRU 8.3.45R(1)(a)* does not apply;

(b) the innovative tier one capital of the firm or its regulated related undertakings that meets the conditions for it to be upper tier two capital may be included as upper tier two capital for the purpose of the calculation in *PRU 8.3.50R*; and

(c) the firm must exclude from the calculation of $(P - Q + T)$ in (2) the higher of:

(i) any amount by which the total group tier two capital exceeds the group capital resources of the firm less any innovative tier one capital excluded by (b); and

(ii) any amount by which the sum of lower tier two capital resources calculated in accordance with *PRU 8.3.57R* exceeds one third of the group capital resources of the firm less any innovative tier one capital excluded by (b).

...

PRU TP 1 Transitional Provisions

PRU TP 1.1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
23	<p><i>PRU</i> 4.3.5R (3) (b)</p> <p><i>PRU</i> 4.3.34R</p> <p><i>PRU</i> 4.3.35R</p>	R	<p>(1) <i>PRU</i> 4.3.5R(3)(b) has effect as if the words "and is capable of valuation" and "to 4.3.35R" were omitted.</p> <p>(2) <i>PRU</i> 4.3.34R has effect as if it read "For the purpose of <i>PRU</i> 4.3.5R(3)(b), a transaction is on approved terms only if the <i>firm</i> reasonably believes that it may be readily closed out".</p> <p>(3) <i>PRU</i> 4.3.35R does not apply.</p>	From 31 December 2004 until 30 December 2005 6	31 December 2004
<u>23A</u>	<u><i>PRU</i> 7.3.85R(2)</u>	<u>R</u>	<u><i>PRU</i> 7.3.85R(2) has effect as if it read "misrepresentation".</u>	<u>From 31 December 2005 until 31 March 2006</u>	<u>31 December 2005</u>
<u>23B</u>	<u><i>PRU</i> 7.3.88G</u>	<u>G</u>	<u><i>PRU</i> 7.3.88G has effect as if the word "material" were omitted.</u>	<u>As <i>PRU</i> TR 23AR</u>	<u>As <i>PRU</i> TR 23AR</u>

...