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STATUTORY INSTRUMENTS

1994 No. 1516

The Insurance Companies Regulations 1994

PART IX

DETERMINATION OF LIABILITIES

Interpretation: Part IX

58. In this Part of these Regulations—

"derivative contract" has the meaning given in regulation 44(1) of these Regulations;

"general business liabilities" means liabilities of an insurance company arising under or in connection with contracts for general business;

"long term liabilities" means liabilities of an insurance company arising under or in connection with contracts for long term business, including liabilities arising from deposit back arrangements;

"the valuation date", in relation to an actuarial investigation, means the date to which the investigation relates.

Application: Part IX

59. This Part of these Regulations applies with respect to the determination of the amount of liabilities of insurance companies for the purposes of—

(a) sections 29(7), 31, 32, 34, 35, 37(3), 38, 39 and 45 of the Act;

(b) an investigation to which section 18 of the Act applies; and

(c) any investigation made in pursuance of a requirement under section 42 of the Act.

Long term and general business

60.—(1) Subject to this Part of these Regulations, the amount of liabilities of an insurance company in respect of long term and general business shall be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance companies.

(2) In determining under paragraph (1) above the amount of liabilities of an insurance company, all contingent and prospective liabilities shall be taken into account but save as provided in regulation 23(3) of these Regulations not liabilities in respect of share capital.

Provision for adverse changes

61.—(1) An insurance company which has or may have (following the exercise of any right by a third party) an obligation under a derivative contract or a contract to which regulation 48(8) applies shall make such provision as shall be sufficient, on prudent assumptions, to allow for the effect of possible adverse changes in—

(a) the current value of the assets or indices of assets to which that contract relates; and

(b) the current value of any assets held by the company,

on the ability of the company to meet its obligations under that contract.

(2) For the purposes of paragraph (1) above, the company shall have regard to—

(a) past volatility in the value of such assets or indices of assets (and in the value of assets or indices of a similar nature); and

(b) the possibility of adverse changes in the volatility of the value of such assets or indices in the future.

General business liabilities

62. The amount of the general business liabilities shall be determined in compliance with the rules laid down in Section D of Schedule 9A to the Companies Act 1985(**1**).

Relevant co-insurance operations: general business

63.—(1) Where a relevant company determines the amount of a liability in order to make provision for outstanding claims arising under a relevant co-insurance operation, then, if the leading insurer has informed the company of the amount of the provision made by the leading insurer for such claims, the amount determined by the company—

(a) shall be at least as great as the amount of the provision made by the leading insurer, or

(b) in a case where it is not the practice in the United Kingdom to make such provision separately, shall be sufficient, when all liabilities are taken into account, to include provision at least as great as that made by the leading insurer for such claims,

due regard being had in either case to the proportion of the risk covered by the company and by the leading insurer respectively.

(2) In paragraph (1) above—

"leading insurer", in relation to a relevant co-insurance operation, means an insurer who—

(a) is recognised as the leading insurer by the other insurers involved in the operation, and

(b) determines the terms and conditions of insurance for the operation;

"relevant co-insurance operation" has the meaning given by Schedule 13;

"relevant company", in relation to a relevant co-insurance operation, means an insurance company which is concerned in the operation but is not the leading insurer.

Long term liabilities

64.—(1) The determination of the amount of long term liabilities (other than liabilities which have fallen due for payment before the valuation date) shall be made on actuarial principles which have due regard to the reasonable expectations of policy holders and shall make proper provision for all liabilities on prudent assumptions that shall include appropriate margins for adverse deviation of the relevant factors.

(2) The determination shall take account of all prospective liabilities as determined by the policy conditions for each existing contract, taking credit for premiums payable after the valuation date.

(3) Without prejudice to the generality of paragraph (1) above, the amount of the long term liabilities shall be determined in compliance with each of regulations 65 to 75 below and shall take into account, inter alia, the following factors:

(**1**) 1985 c. 6; Schedule 9A was substituted by S.I. 1993/3246, reg. 4.

(a) all guaranteed benefits, including guaranteed surrender values;

(b) vested, declared or allotted bonuses to which policy holders are already either collectively or individually contractually entitled;

(c) all options available to the policy holder under the terms of the contract;

(d) expenses, including commissions.

Method of calculation

65.—(1) Subject to paragraphs (2), (3) and (4) below, the amount of the long term liabilities shall be determined separately for each contract by a prospective calculation.

(2) A retrospective calculation may be applied to determine the liabilities where a prospective method cannot be applied to a particular type of contract or benefit, or where it can be demonstrated that the resulting amount of the liabilities would be no lower than would be required by a prudent prospective calculation.

(3) Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than individual calculations of the same amount of the liabilities in respect of each contract.

(4) Where necessary, additional amounts shall be set aside on an aggregated basis for general risks which are not individualised.

(5) The method of calculation of the amount of the liabilities and the assumptions used shall not be subject to discontinuities from year to year arising from arbitrary changes and shall be such as to recognise the distribution of profits in an appropriate way over the duration of each policy.

(6) The liabilities for contracts under which the policy holder is eligible to participate in any established surplus as defined in section 30(4) of the Act shall have regard to the level of the premiums under the contracts, to the assets held in respect of those liabilities, and to the custom and practice of the company in the manner and timing of the distribution of profits or the granting of discretionary additions, as the case may be.

Avoidance of future valuation strain

66. The amount of the liability determined in respect of a group of contracts shall not be less than such amount as, if the assumptions adopted for the valuation were to remain unaltered and were fulfilled in practice, would enable liabilities similarly determined at all times in the future to be covered from resources arising solely from the contracts and the assets covering the amount of the liability determined at the current valuation.

Valuation of future premiums

67.—(1) Where further specified premiums are payable by the policy holder under a contract (not being a linked long term contract) under which benefits (other than benefits arising from a distribution of profits) are determined from the outset in relation to the total premiums payable thereunder, then, subject to paragraph (4) and regulation 68 below—

(a) where the premiums under the contract are at a uniform rate throughout the period for which they are payable, the premiums to be valued shall be not greater than such level premiums as, if payable for the same period as the actual premiums under the contract and calculated according to the rates of interest and rates of mortality or disability which are to be employed in calculating the liability under the contract, would have been sufficient at the outset to provide for the benefits under the contract according to the contingencies upon which they are payable, exclusive of any additions for profits, expenses or other charges;

(b) where the premiums under the contract are not at a uniform rate throughout the period for which they are payable, the premiums to be valued shall be not greater than such premiums as would be determined on the principles set out in sub-paragraph (a) above modified as appropriate to take account of the variations in the premiums payable by the policy holder in each year;

save that a premium to be valued shall in no year be greater than the amount of the premium payable by the policy holder.

(2) Where the terms of the contract have changed since the contract was first made (the terms of the contract being taken to change for the purposes of this paragraph if the change is indicated in an endorsement on the policy but not if a new policy is issued), then, for the purposes of paragraph (1) above it shall be assumed that those changes from the time they occurred were provided for in the contract at the time it was made.

(3) Where under a contract (not being a linked long term contract)—

(a) each premium paid increases the benefits (other than benefits arising from a distribution of profits) provided under the contract, or

(b) the amount of a premium payable in future is not determinable until it comes to be paid,

future premiums and the corresponding liability may be left out of account so long as adequate provision is made against any risk that the increase in the liabilities of the company resulting from the payment of future premiums might exceed the amount of the premiums.

(4) An alternative valuation method to that described in paragraphs (1) to (3) above may be used where it can be demonstrated that the alternative method results in reserves no less, in aggregate, than would result from the use of the method described in those paragraphs.

Acquisition expenses

68.—(1) In order to take account of acquisition expenses, the maximum annual premium to be valued under regulation 67 above may (subject to paragraph (2) below) be increased by an amount not greater than the equivalent, taken over the whole period of premium payments and calculated according to the rates of interest and rates of mortality or disability employed in valuing the contract, of 3.5 per cent. (or the defined percentage, if it is lower than 3.5 per cent.) of the relevant capital sum under the contract.

(2) For the purposes of paragraph (1) above "the defined percentage" is the percentage arrived at by taking (for all contracts of the same type as the contract in question for which an adjustment is made) the average of the percentages of the relevant capital sum under each such contract that represent the acquisition costs incurred which, after allowing for the effects of taxation, might reasonably be expected to be recovered from the premiums payable under the contract.

(3) The increase permitted by paragraph (1) above shall be subject to the limitation that the amount of a future premium valued shall not in any event be greater than the amount of the premium actually payable by the policy holder.

(4) For the purposes of this regulation—

(a) for contracts other than temporary assurances, the relevant capital sum under a contract shall be arrived at in accordance with regulation 25(4) above, and

(b) for temporary assurances, the relevant capital sum shall be the sum assured on the valuation date.

Rates of interest

69.—(1) The rates of interest to be used in calculating the present value of future payments by or to an insurance company shall be no greater than the rates of interest determined from a prudent

assessment of the yields on existing assets attributed to the long term business and, to the extent appropriate, the yields which it is expected will be obtained on sums to be invested in the future.

(2) For the purposes of paragraph (1) above, the assumed yield on an asset attributed to the long term business, before any adjustment to take account of the effect of taxation, shall not exceed the yield on that asset calculated in accordance with paragraphs (3) to (7) below, reduced by 2.5 per cent. of that yield.

(3) For the purpose of calculating the yield on an asset—

(a) the asset shall be valued in accordance with Part VIII of these Regulations, excluding any provision under which assets may be taken at lower book values for the purposes of any investigation to which section 18 of the Act applies or any investigation made in pursuance of a requirement under section 42 of the Act, and

(b) where a particular asset is required to be taken into account only to a specified extent by the operation of regulation 57 above, the future income to be taken into account (whether interest, dividends or repayments of capital) shall be correspondingly reduced.

(4) For fixed interest investments (that is to say, investments which are fixed interest securities as defined in regulation 44(1) above) the yield on an asset, subject to paragraph (7) below, shall be that annual rate of interest which, if used to calculate the present value of future payments of interest before the deduction of tax and the present value of repayments of capital, would result in the sum of those amounts being equal to the value of the asset.

(5) For variable interest investments (that is to say, investments which are not fixed interest securities as defined in regulation 44(1) above) that are equity shares or land, the yield on an asset, subject to paragraph (7) below, shall be the ratio to the value of the asset of the income before deduction of tax which would be received in the period of twelve months following the valuation date on the assumption that the asset will be held throughout that period and that the factors which affect income will remain unchanged, so however that account shall be taken of any changes in those factors known to have occurred by the valuation date and in particular, without prejudice to the generality of the foregoing, of—

(a) any known changes in the rental income from property or in dividends on equity shares,

(b) any forecast changes in dividends which have been publicly announced by the valuation date,

(c) the effect of any alterations in capital structure, and

(d) the value (at the most recent date for which it is known at the valuation date) of any determinant of the amount of any future interest payment, the said value being deemed to remain unaltered for all subsequent dates.

(6) For variable interest investments (that is to say, investments which are not fixed interest securities as defined in regulation 44(1) above) other than equity shares or land, the yield on an asset, subject to paragraph (7) below, shall be that annual rate of interest which, if used to calculate the present value of future payments of interest, before deduction of tax, and the present value of repayments of capital, where applicable, would result in the sum of these amounts being equal to the value of the asset, on the assumption that—

(a) the value of any determinant of the amount of the next interest rate payment and capital repayment made during the following twelve months will be the value of that determinant at the most recent date for which it is known at the valuation date;

(b) the amount of future interest payments and capital repayments will take account, where appropriate, of—

(i) the right of either party to have the investment repaid, and

(ii) an assumed yield on other comparable investments made in the future not exceeding an amount determined in accordance with paragraphs (8) to (10) below; and

(c) indices and all other factors which affect future income payments or capital repayments will remain unchanged after the valuation date.

(7) In calculating the yield on an asset under this regulation—

(a) if the asset does not consist of equity shares or land—

(i) a prudent adjustment shall be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due, and

(ii) in making that adjustment, regard shall be had wherever possible to the yields on risk-free investments of a similar term in the same currency;

(b) for assets which are equity shares or land, adjustments to yields shall be made as appropriate to exclude that part, if any, of the yield from each category of asset that is needed to compensate for the risk that the aggregate income from that category of asset, taking one year with another, might not be maintained: for the purposes of this sub-paragraph, a "category of asset" comprises assets of a similar nature, type and degree of risk.

(8) To the extent that it is necessary to make an assumption about the yields which will be obtained on sums to be invested in future, the yield shall be determined in accordance with paragraphs (9) and (10) below.

(9) Where the liabilities are denominated in sterling, the yield assumed, before any adjustment to take account of the effect of taxation—

(a) on any investment to be made more than three years after the valuation date shall not exceed the lowest of—

(i) the long term gilt yield current on the valuation date; or

(ii) 6 per cent. per annum, increased by one quarter of the excess, if any, of the long term gilt yield current on the valuation date over 6 per cent. per annum; or

(iii) 7.5 per cent. per annum,

where "the long term gilt yield" means the annualised equivalent of the 15 year medium coupon yield for United Kingdom Government fixed-interest securities jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries;

(b) on any investment to be made at any time not more than three years after the valuation date shall not exceed the assumed yield determined under paragraph (2) above adjusted linearly over the said three years to the yield determined in accordance with sub-paragraph (a) above.

(10) Where the liabilities are denominated in currencies other than sterling, the yield shall be determined on assumptions that are as prudent as those made under paragraph (9) above.

(11) In no case shall a rate of interest determined for the purposes of paragraph (1) above exceed the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets arrived at under paragraph (2) above; and when that weighted average is calculated—

(a) the weight given to each investment shall be its value as an asset determined in accordance with Part VIII of these Regulations, excluding any provision under which assets may be taken at lower book values for the purposes of any investigation to which section 18 of the Act applies or any investigation made in pursuance of a requirement under section 42 of the Act, and

(b) except in relation to the rate of interest used in valuing payments of property linked benefits (as defined in regulation 44(1) above), both the yield and the value of any linked assets (as so defined) shall be omitted from the calculation.

(12) For the purpose of determining the rates of interest to be used in valuing a particular category of contracts the assets may, where appropriate, be notionally apportioned between different categories of contracts.

Rates of mortality and disability

70. The amount of the liability in respect of any category of contract shall, where relevant, be determined on the basis of prudent rates of mortality and disability that have regard to the State of the commitment.

Expenses

71.—(1) Provision for expenses, whether implicit or explicit, shall be not less than the amount required, on prudent assumptions, to meet the total net cost, after taking account of the effect of taxation, that would be likely to be incurred in fulfilling existing contracts if the company were to cease to transact new business twelve months after the valuation date.

(2) The provision mentioned in paragraph (1) above shall have regard to, among other things, the company's actual expenses in the last twelve months before the valuation date and to the effects of inflation on future expenses on prudent assumptions as to the future rates of increase in prices and earnings.

Options

72.—(1) Provision shall be made on prudent assumptions to cover any increase in liabilities caused by policy holders exercising options under their contracts.

(2) Where a contract includes an option whereby the policy holder could secure a guaranteed cash payment within twelve months following the valuation date, the provision for that option shall be such as to ensure that the value placed on the contract is not less than the amount required to provide for the payments that would have to be made if the option were exercised.

Contracts not to be treated as assets

73. No contract for long term business shall be treated as an asset.

No credit for profits from voluntary discontinuance

74. Allowance shall not be made in the valuation for the voluntary discontinuance of any contract if the amount of the liability so determined would thereby be reduced.

Nature and term of assets

75. The determination of the amount of long term liabilities shall take into account the nature and term of the assets representing those liabilities and the value placed upon them and shall include prudent provision against the effects of possible future changes in the value of the assets on—

(a) the ability of the company to meet its obligations arising under contracts for long term business as they arise, and

(b) the adequacy of the assets to meet the liabilities as determined in accordance with regulations 65 to 74 above.