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Dear Sir

Response to Chapter 5 of FSA Consultation Paper 09/20 – Proposed amendments to the Insurance Prudential sourcebooks

Please find attached our comments in response to Chapter 5 of FSA Consultation Paper (CP) 08/12 – Proposed amendments to the Insurance Prudential sourcebooks. We are broadly supportive of the limited changes proposed in this Chapter and have no specific points to raise in respect of those changes.

We note paragraph 5.1 of the CP indicates that consideration has been given to whether further changes to rules and guidance should be made in response to recent requests for individual guidance and rule modifications and that it has been concluded that there should be a continuation of the existing approach without further modifications to rules and guidance. We are concerned that, in some areas, this approach may lead to inconsistencies of regulatory interpretation. Whilst rule modifications are matter of public record, individual guidance is not. Where there are areas where the current rules are unclear, to the extent that some insurers have sought and received individual guidance as to their interpretation, it is possible that other insurers may reach a differing interpretation without the knowledge of that individual guidance. We therefore believe that in areas where there is a lack of clarity regarding the general interpretation of the rules and guidance these should be amended to ensure that the FSA's policy intention is unambiguous. We highlight in Appendix 1 certain areas where we believe clarification of the rules and guidance would be beneficial.

In addition, there are certain apparent drafting errors in the current rules which should be corrected. We highlight those areas we have identified in Appendix 2.

Finally there are certain areas where the consolidated Handbook text on FSA's website does not reflect the underlying legal instruments and should therefore be amended. We highlight those areas we have identified in Appendix 3.

We would be happy to discuss our comments further. Please contact Mike Vickery (0117 923 4222) should you wish to discuss or clarify any matter in the attached response.

Yours faithfully

PricewaterhouseCoopers LLP

Appendix 1 – Areas where the insurance prudential rules would benefit from clarification

Clarification of INSPRU 6.1.41R and INSPRU 6.1.42G

One insurer has stated when commenting on their Insurance Groups Directive surplus "Following individual guidance from the FSA we now recognise surpluses in the non-profit funds of our UK life and pensions business which is available for transfer to shareholders ..."¹

However INSPRU 6.1.42G appears unambiguous in stating that "the assets of a long-term insurance fund are restricted assets within the meaning of INSPRU 6.1.41 R".

Clarification should therefore be given as to whether, and in what circumstances, surplus assets of non-profit funds would not be considered to be restricted assets.

In addition INSPRU 6.1.42G indicates that capital resources held in one fund that are meeting the capital resources requirements of another fund cannot contribute to group capital resources. At a solo level, there is no requirement for capital resources requirements to be met by capital resources held in the fund in which the capital resources requirement arises, and, as a result, such capital resources would not be excluded from contributing to group capital resources by virtue of INSPRU 6.1.41R. It therefore appears that INSPRU 6.1.42G (which is guidance) is purporting to impose a restriction on group capital resources over and above that actually contained in the rules (and one which is more onerous than that which applies at a solo level). Clarification of the policy intention in this area should be given and the rules and guidance amended so that the guidance interprets the rules rather than seeking to impose restrictions over and above those contained in the rules.

Clarification of INSPRU 6.1.70R et seq

When calculating group capital resources for the purposes of an adjusted solo solvency calculation, it is unclear how the rules at INSPRU 6.1.70R et seq apply the market risk and counterparty limits to assets of an insurance subsidiary that are in excess of the market risk and counterparty limits for or the purposes of that subsidiary's own solo-solvency calculation.

Clarification of the policy intention and how the rules achieve this policy intention would be welcome.

Clarification of rules surrounding presentation of foreign currency exchange differences in the Insurance Annual Returns.

In a number of forms in Appendix 9.2 amounts attributable to the current year (e.g. Form 22 column 4, Form 24 row 69) are required to be calculated as the aggregate of amounts payable/receivable in the current year (which would be converted at an actual or average rate under GAAP) and the difference between the amount carried forward at the end of the current year and the amount brought forward at the beginning of the current year (which would both be converted at a closing rate under the FSA rules). If this treatment is adopted then the resulting amount attributable to the year will be calculated on a basis that is not consistent with GAAP (and is arguable not meaningful) and will give rise to reconciling differences between the Return and the GAAP accounts.

Forms 11 and 12 use a number of figures taken from the previous three financial years, including those used to calculate the reinsurance ratio at Form 11 line 49. It is not clear whether any element of these figures relating to foreign currencies either should or may be retranslated at the relevant rate for the current year.

¹ See page 29 of Aviva plc Annual Report and Accounts 2008
(http://www.aviva.com/library/reports/2008ar/files/Business_07_CapitalManagement.pdf)

Clarification would be welcome as to the acceptable treatment or treatments in such circumstances.

GENPRU / INSPRU / IPRU(INS) – use of term *deposits*

The Handbook definition of *deposits* excludes amounts paid by an authorised person who has permission to effect or carry out contracts of insurance. In a number of cases it appears that the word *deposits* should not be italicised as it is not intended to exclude amounts paid by insurers. The relevant rules include GENPRU 2 Annex 7R (in the phrase "*deposits with credit institutions...*"), INSPRU 2.1.11G, INSPRU 2.1.21G, INSPRU 2.1.22R(5B) (two occurrences), INSPRU 2.2.16R, Instruction 3 to Form 13 of IPRU(INS) (two occurrences).

Clarification of GENPRU 1.3.35G

Our understanding is that the FSA's intention is that valuation adjustments or reserves (calculated under INSPRU 1.3.29R et seq) should be reflected in asset values and capital resources reporting in the insurance annual return. As a result the clause "should not be reflected in the valuations under GENPRU 1.3 but" contained in GENPRU 1.3.35G appears contrary to FSA's policy intention in respect of insurers. If our understanding of FSA's policy intention is correct, these words should either be deleted or the guidance should clarify that this wording does not apply to insurers.

Clarification of INSPRU 1.5.11G

INSPRU 1.5.11G (which deals with the application of section 1.5 of INSPRU) should be clarified. The guidance at INSPRU 1.5.11G indicates that all or some of the requirements of INSPRU 1.5 apply only to composites or to long-term insurers conducting both linked and nonlinked business. INSPRU 1.5.11G is itself not consistent with the drafting of the rules within INSPRU 1.5 (many of which, such as the restriction of transfers out of the long term fund, appear applicable to all long-term insurers) or with certain other guidance (such as INSPRU 1.5.16G which states one of the purposes of the internal contagion rules is the separation of long-term insurance assets from shareholder funds which is relevant to all long-term insurers). The final two sentences of INSPRU 1.5.11G should either be deleted or be amended to be consistent with the actual application of the rules in that section.

Clarification of INSPRU 2.1.22R(3)(b)(ii)

Guidance should be added indicating how this rule should be applied in circumstances where the total exposures which are greater than 5% arising from applying a 10% limit exceed 40%. Suggested wording is set out below:

"In INSPRU 2.1.22R(3)(b)(ii), if the exposures which are greater than 5% do exceed 40% then the limit of 5% is not increased to 10% for all exposures. The overall limit can be obtained by selecting exposures for which the limit remains at 5% so that the total of the exposures which are greater than 5% arising from increasing the limit to 10% for the remaining exposures does not exceed 40%."

IPRU(INS) Forms 13, 14 and 15 - Offset of debtors / creditors within different funds or subfunds.

An issue that sometimes arises in respect of the balance sheet forms (Forms 13, 14 and 15) is where an insurer as a whole has an asset (such as an admissible debtor) reflected in the accounts, but at the (sub)fund level this is the net result of a larger debtor in one (sub)fund and a creditor due to the same person in the other sub-fund. Guidance would be welcomed on the completion of Forms showing assets and liabilities at a sub fund level where either;

- an aggregate asset or liability of the company to a third party is comprised of a mixture of assets and liabilities at the fund or sub fund level; or
- the accounting records of the Company show amounts owing between funds or sub-funds.

IPRU(INS) Forms 49 and 56 – reporting of mean terms

The instructions to these forms should clarify that mean terms should be reported to two decimal places.

Reporting by members of financial conglomerates under SUP 16.12.32R and SUP 16.12.33R
Under SUP 16.12.32R a firm that is a member of a financial conglomerate must submit financial reports to the FSA in accordance with the table in SUP 16.12.33R if its Part IV permission contains a relevant requirement where a relevant requirement is one that applies SUP 16.12.33R to the firm.

Guidance as to the circumstances in which a Part IV permission would be considered to apply SUP 16.12.33R to a Firm would be welcomed. The decision tree at IPRU(INS) 9.42C (which currently makes no reference to a relevant requirement) should be revisited to ensure there are no inconsistencies with the scope requirements at SUP 16.12.32R.

Appendix 2 - Apparent drafting errors within the current prudential rules for insurers

The following apparent drafting errors in the prudential rules for insurers should be corrected:

Rule ref	Issue
IPRU(INS)	
9.15(2)(b), 11.1, App 9.2(3)	<p>Legal instrument 2008/22 changed the definition of the insurance accounts rules to mean Schedule 9A to CA 1985 where applicable and otherwise Schedule 3 to SI 2008/410. In IPRU(INS) there are certain references to paragraphs of the insurance accounts rules which are now not correct in circumstances where "insurance accounts rules" refers to Schedule 3 to SI 2008/410. Listed below are instances where amendment is required:</p> <ul style="list-style-type: none"> • Rule 9.15(2)(b) - contains a reference to paragraph 52 - the equivalent paragraph in the Schedule 3 is paragraph 58 • Rule 11.1 - the definition of discounting - contains a reference to paragraph 48 - the equivalent paragraph in Schedule 3 is paragraph 54 • Rule 11.1 - definition of insurance liabilities - contains a reference to paragraph 9 - the equivalent paragraph in Schedule 3 is paragraph 10 • Appendix 9.2(3)(a) - contains a reference to paragraph 52 - the equivalent paragraph in Schedule 3 is paragraph 58 • Appendix 9.2(3)(b) - contains a reference to paragraph 52(4) - the equivalent paragraph in Schedule 3 is paragraph 58(4)
9.54(1)(h)	"INSPRU 4.2.5R" should be "INSPRU 3.2.5R"
Form 13 and Form M3	On Form 13 the reference to "line 93" in instruction 9 should be to "line 94" and the reference to "line 94" in instruction 10 should be to "line 95" (equivalent comments apply to instructions 6 and 7 to Form M3).
Form 15	The reference to "line 99 of Form 13" in instruction 4 should be "line 100 of Form 13"
Form 38	In instruction 1 "INSPRU 1.45.34R" should read "INSPRU 1.4.34R"
INSPRU	
6.1.69G	In the heading of the right hand column of Example 2 in INSPRU 6.1.69G the words "of which 4 relates to the long-term insurance business" should read "of which 5 relates to the long-term insurance business".

Appendix 3 - Areas where the online handbook text does not reflect the underlying legal instrument

Rule reference	Error
IPRU(INS)	
Rule 9.42(4)	The final paragraph of this rule is duplicated at the end of rule 9.42(3) (LI 2005/60)
Form 16	In Line 51 "forseeable" should be "foreseeable" (LI 2007/64)
Form 17	The underlining should be removed from the final line of Instruction 3 (LI 2008/66).
Form 40	The words " <u>or to</u> " should not be underlined in instruction 12 (LI 2006/63)
Form 48	The underlining should be removed from the Instruction 16 (LI 2008/66).
Form 60	Line 11 column 4, line 31 columns 2, 3 and 4 and line 41 column 4 should be shaded (LI 2006/39) Headers appear over columns 3-6 that have not been introduced by legal instrument.
INSPRU	
1.4.7G	"Threshold in INSPRU 1.4.4G" should read "Threshold in INSPRU 1.4.44R" (LI 2006/42)
6.1.45R(1)	In (a), (b) and (c) "=" should read "≥" In (d), (e) and (f) "¿" should read "≤" (error in pdf version only) (LI 2006/42)