

Chapter 1

Capital resources requirements and technical provisions for insurance business

1.1 Application

- 1.1.1** **R** ■ INSPRU 1.1 applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*; or
 - (4) a *Solvency II firm*.
- 1.1.2** **R**
- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
 - (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.
- 1.1.3** **R** For a *non-EEA insurer* with a *branch* in the *United Kingdom* whose *insurance business* in the *United Kingdom* is not restricted to *reinsurance* (other than an *EEA-deposit insurer*, a *Swiss general insurer* or a *UK-deposit insurer*) ■ INSPRU 1.1.27R applies separately in respect of its world-wide activities and its activities carried on from a *branch* in the *United Kingdom*.

1.1.4 **R** For an *EEA-deposit insurer* or a *Swiss general insurer* ■ INSPRU 1.1.27R applies in respect of the activities carried on from a *branch* in the *United Kingdom*.

1.1.5 **R** For a *UK-deposit insurer* ■ INSPRU 1.1.27R applies separately in respect of its world-wide activities and its activities carried on from a *branch* in the *EEA*.

1.1.6 **G** This section may apply in cases where a *firm* has its head office in another *EEA State* but is neither an *incoming EEA firm* nor an *incoming Treaty firm*.

Assets of a value sufficient to cover technical provisions and other liabilities
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1.1.27 **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*.

1.1.28 **R**

1.1.29 **G** [deleted]

1.1.53 **G** [deleted]

1.1.74 **G** [deleted]

1.1.75 **G** [deleted]

1.2 Mathematical reserves

Application

- 1.2.1 **R** ■ INSPRU 1.2 applies to a *long-term insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*; or
 - (4) a *Solvency II firm*.

Purpose

- 1.2.6 **G** A number of the *rules* in this section require a *firm* to take into account its regulatory duty to treat *customers* fairly. In this section, references to such a duty are to the duty of a *firm* regulated by the *FCA* to pay due regard to the interests of its *customers* and to treat them fairly (see the *FCA's Principle 6* in *PRIN*). This duty is owed to both *policyholders* and potential *policyholders*.
- 1.2.6A **G** Some of the rules made by the *FCA* contain references to, or are reliant on, *rules* that are only made by the *PRA*. *Firms* should consider ■ GEN 2.2.13A R (cross-references in the *Handbook*) and ■ GEN 2.2.23 R to ■ GEN 2.2.25 G (cutover: application of provisions made by both the *FCA* and the *PRA*) when applying these *rules*. In the context of mathematical reserves, the *FCA rules* ensure a *firm* takes into account its regulatory duty to treat *customers* fairly.

Methods and assumptions

- 1.2.10 **R** In the actuarial valuation under *PRA Rulebook: Non Solvency II firms: Insurance Company – Mathematical Reserves, 2.1*, a *firm* must use methods and prudent assumptions which:
- (1) are appropriate to the business of the *firm*;
 - (2) are consistent from year to year without arbitrary changes (see ■ INSPRU 1.2.11 G);
 - (3) are consistent with the method of valuing assets (see *PRA Rulebook: Non-Solvency II firms: Insurance Company – Overall Resources and Valuation, 3*);
 - (4) include appropriate margins for adverse deviation of relevant factors;

- (5) recognise the distribution of profits (that is, emerging surplus) in an appropriate way over the duration of each *contract of insurance*;
- (6) take into account its regulatory duty to treat its *customers* fairly (see *FCA's Principle 6*); and
- (7) are in accordance with generally accepted actuarial practice.

1.2.11 **G** ■ INSPRU 1.2.10R (2) prohibits only arbitrary changes in methods and assumptions, that is, changes made without adequate reasons. Any such changes would hinder comparisons over time as to the amount of the *mathematical reserves* and so obscure trends in solvency and the emergence of surplus.

Record keeping

1.2.20 **R** A *firm* must make, and retain for an appropriate period, a record of:

- (1) the methods and assumptions used in establishing its *mathematical reserves*, including the margins for adverse deviation, and the reasons for their use; and
- (2) the nature of, reasons for, and effect of, any change in approach, including the amount by which the change in approach increases or decreases its *mathematical reserves*.

1.2.21 **G** For the purposes of ■ INSPRU 1.2.20 R, records should be maintained for a period of longer than three years for a *firm's long-term insurance business*. In determining an appropriate period, a *firm* should have regard to:

- (1) [deleted]
- (2) the nature and term of the *firm's* long-term insurance business; and
- (3) any additional provisions or statutory requirements applicable to the *firm* or its records.

Cash flows to be valued

1.2.28 **R** In a prospective valuation, a *firm* must:

- (1) include in the cash flows to be valued the following:
 - (a) future *premiums*;
 - (b) expenses, including *commissions*;
 - (c) benefits payable (see ■ INSPRU 1.2.29 R); and
 - (d) subject to (2), amounts to be received or paid in respect of the *long-term insurance contracts* under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements; but
- (2) exclude from those cash flows amounts recoverable from an *ISPV*.

1.2.28A **G** A *firm* may include amounts recoverable from an *ISPV* in the cash flows to be valued in a prospective valuation if it obtains a *waiver* of ■ INSPRU 1.2.28 R under sections 138A and 138B of the *Act*.

1.2.29 **R** For the purpose of ■ INSPRU 1.2.28R (1)(c), benefits payable include:

- (1) all guaranteed benefits including guaranteed *surrender values* and paid-up values;
- (2) vested, declared and allotted bonuses to which the *policyholder* is entitled;
- (3) all options available to the *policyholder* under the terms of the contract; and
- (4) discretionary benefits payable in accordance with the *firm's* regulatory duty to treat its *customers* fairly.

1.2.30 **G** All cash flows are to be valued using prudent assumptions in accordance with generally accepted actuarial practice. Cash flows may be omitted from the valuation calculations provided the reserves obtained as a result of leaving those cash flows out of the calculation are not less than would have resulted had all cash flows been included. Provision for future expenses in respect of *with-profits insurance contracts* (excluding *accumulating with-profits policies*) may be made implicitly, using the *net premium* method of valuation. For the purposes of ■ INSPRU 1.2.28R (1)(b), any charges included in expenses should be determined in accordance with the *firm's* regulatory duty to treat its *customers* fairly.

1.2.31 **G** ■ INSPRU 1.2.29R (4) requires *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*. The calculations required for *accumulating with-profits policies* are set out in ■ INSPRU 1.2.71R (1).

Mortality and Morbidity.....

1.2.59 **R** A *firm* must set the assumptions for mortality and morbidity using prudent rates of mortality and morbidity that are appropriate to the country or territory of residence of the person whose life or health is insured.

1.2.60 **G** The rates of mortality or morbidity should contain prudent margins for adverse deviation. In setting those rates, a *firm* should take account of:

- (1) the systems and controls applied in underwriting *long-term insurance contracts* and whether they provide adequate protection against anti-selection (that is, selection against the *firm*) including:
 - (a) adequately defining and identifying non-standard risks; and
 - (b) where such risks are underwritten, allocating to them an appropriate weighting;
- (2) the nature of the contractual exposure to mortality or morbidity risk including:
 - (a) whether lower mortality increases or decreases the *firm's* liability;
 - (b) the period of cover and whether risk charges can be varied during that period and, if so, how quickly; and
 - (c) whether the options in the contract give rise to a significant risk of anti-selection (for example, opportunities for voluntary discontinuance, guaranteed renewal at the option of the *policyholder* and rights for conversion of benefits);
- (3) the credibility of the *firm's* actual experience as a basis for projecting future experience including:
 - (a) whether there is sufficient data (especially for medical or financial risks and for new types of benefit or new methods of distribution); and
 - (b) whether the data is reliable and has been appropriately validated;
- (4) the availability and reliability of:
 - (a) any published tables of mortality or morbidity for the country or territory of residence of the person whose life or health is insured; and
 - (b) any other information as to the industry-wide insurance experience for that country or territory;
- (5) anticipated or possible future trends in experience including, but only where they increase the liability:
 - (a) anticipated improvements in mortality;
 - (b) changes arising from improved detection of morbidity (including critical illnesses);
 - (c) diseases the impact of which may not yet be reflected fully in current experience; and
 - (d) changes in market segmentation (such as impaired life annuities) which, in the light of developing experience, may require different assumptions for different parts of the policy class.

1.2.61

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An additional provision for diseases covered by ■ INSPRU 1.2.60G (5)(c) may be needed, in particular for unit-linked policies. In determining whether such a provision is needed a *firm* may take into consideration any ability to increase product charges commensurately (provided that such increase does not infringe on its regulatory duty to treat its *customers* fairly), but a provision would still be required for the period until such an increase could be brought into effect.

Options

- 1.2.62 **R** When a *firm* establishes its *mathematical reserves* in respect of a *long-term insurance contract*, the *firm* must include an amount to cover any increase in liabilities which might be the direct result of its *policyholder* exercising an option under, or by virtue of, that *contract of insurance*. Where the *surrender value* of a contract is guaranteed, the amount of the *mathematical reserves* for that contract at any time must be at least as great as the value guaranteed at that time.
- 1.2.62A **G** A contract has a guaranteed *surrender value* where the *policy* wording states that a *surrender value* is payable and either provides for a minimum amount payable on surrender or sets out a method for calculating such an amount. For example, where a unit-linked contract provides for a *surrender value* equal to the value of the units allocated to the contract, the *firm* must establish *mathematical reserves* for that contract greater than or equal to the value of the units allocated at the valuation date.
- 1.2.63 **G** An option exists where a *policyholder* is given a choice between alternative forms of benefit, for example, a choice between receiving a cash benefit upon maturity or an annuity at a guaranteed rate. In some cases, the contract may designate one or other of these alternatives as the principal benefit and any other as an option. This designation, in itself, is not one of substance in the context of reserving since it does not affect the *policyholder's* choices. Other forms of option include:
- (1) the right to convert to a different contract on guaranteed terms;
 - (2) the right to increase cover on guaranteed terms;
 - (3) the right to a specified amount on surrender; and
 - (4) the right to a paid up value.
- 1.2.64 **G** The *firm* should provide for the benefit which the *firm* anticipates the *policyholder* is most likely to choose. Past experience may be used as a guide, but only if this is likely to give a reasonable estimate of future experience. For example, past experience of the take-up of a cash payment option instead of an annuity would not be a reliable guide, if, in the past, market rates exceeded those guaranteed in the annuity but no longer do so. Similarly, past experience on the take-up of options may not be relevant in

the light of the assumptions made in respect of future interest rates and mortality rates in the valuation of the benefits.

- 1.2.65 G Many options are long-term and need careful consideration. Improving longevity, for example, can increase the value of guaranteed annuity options vesting further in the future. *firms* also need to have regard to the fact that *policyholder* behaviour can change in the future as *policyholders* become more aware of the value of their options. The impact on *policyholder* behaviour of possible changes in taxation should also be considered.
- 1.2.66 G Take-up rates for guaranteed annuity options should be assessed on a prudent basis with assumptions that include margins for adverse deviation that take account of current experience and the potential for future change. The *firm* should reserve for option take-up at least at a prudent margin over current experience for options shortly to vest. For longer term options where the option becomes increasingly valuable in the future due to projected mortality improvements, increased take-up rates should be assumed. In view of the growing uncertainty over take-up rates for projections further in the future, for guaranteed annuity option dates 20 years or more ahead at least a 95% take-up rate assumption should be made.
- 1.2.67 G Where there is considerable variation in the cost of the option depending on conditions at the time the option is exercised, and where that variation constitutes a material risk for the *firm*, it will generally be appropriate to use stochastic modelling. In this case prices from the asset model used in the stochastic approach should be benchmarked to relevant market asset prices before determining the value of the option. Where stochastic modelling is not undertaken, market option prices should be used to determine suitable assumptions for the valuation of the option. If no market exists for a particular option, a *firm* should take the value of the nearest equivalent benefit or right for which a market exists and document the way in which it has adjusted that valuation to reflect the original option.
- 1.2.68 G Where the option offers a choice between two non-discretionary financial benefits (such as between a guaranteed cash sum or a guaranteed annuity value, or between a unit value and a maturity guarantee) and where there is a wide range of possible outcomes, the *firm* should normally model such liabilities stochastically. In carrying out such modelling *firms* should take into account the likely choices to be made by *policyholders* in each scenario. *Firms* should make and retain a record of the development and application of the model.
- 1.2.69 G The value of a contract with an option is greater than the value of a similar contract without the option, that is, the option has value whether it is expected to be exercised or not. Although in theory a *firm* can rebalance its investments to match the expected cost of the option to the *firm* (including the time value of the option), this takes time to achieve and the market may move more quickly than the *firm* is able to respond. Also, there are likely to be transaction costs. *Firms* should take these aspects into consideration in setting up *mathematical reserves*.

1.2.70

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- (1) Where a *policyholder* may opt to be paid a cash amount, or a series of cash payments, the *mathematical reserves* for the *contract of insurance* must be sufficient to ensure that the payment or payments could be made solely from:
 - (a) the assets covering those *mathematical reserves*; and
 - (b) the resources arising from those assets and from the contract itself.
- (2) In (1) references to a cash amount or a series of cash payments include the amount or amounts likely to be paid on a voluntary discontinuance.
- (3) For the purposes of (1), the *firm* must assume that:
 - (a) the assumptions adopted for the current valuation remain unaltered and are met; and
 - (b) discretionary benefits and charges will be set so as to fulfil the *firm's* regulatory duty to treat its *customers* fairly.
- (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.

1.2.71

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For the purposes of ■ INSPRU 1.2.70 R, a *firm* must assume that the amount of a cash payment secured by the exercise of an option is:

- (1) in the case of an *accumulating with-profits policy*, the lower of:
 - (a) the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm* and including any expectations of a *final bonus*; and
 - (b) that amount, disregarding all discretionary adjustments;
- (2) in the case of any other *policy*, the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus*.

1.2.72

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■ INSPRU 1.2.71R (1) applies only to *accumulating with-profits policies*;
■ INSPRU 1.2.71R (2) applies to any other type of *policy*, including *non-profit insurance contracts*. In ■ INSPRU 1.2.71R (1)(a) 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, must not be included in the amount calculated in
■ INSPRU 1.2.71R (1)(b).

Reinsurance

1.2.86 **R** Future surplus may only be offset against future *reinsurance* cash outflow in respect of surplus on *non-profit insurance contracts* and the charges or shareholder transfers arising as surplus from *with-profits insurance contracts*. Such charges and transfers may only be allowed for to the extent consistent with the regulatory duty of the *firm* to treat its *customers* fairly.

1.2.90 **R** [deleted]

1.2.91 **G** [deleted]

Application of INSPRU 1.2 to Lloyd's

1.2.92 **R**

1.5 Internal-contagion risk

Application

- 1.5.1** **R** ■ INSPRU 1.5 applies to an *insurer* except any *insurer* in (1) to (3):
- (1) (a) *non-directive friendly societies*; or
(b) *Solvency II firms*;
 - (2) none of the provisions, apart from ■ INSPRU 1.5.33 R (payment of financial penalties), apply to *firms* which qualify for authorisation under Schedule 4 of the Act;
 - (3) ■ INSPRU 1.5.33 R (payment of financial penalties) does not apply to *mutuals*.
- [1.5.2 to 1.5.3 not used]**
- 1.5.4** **R** In its application to a *firm* with its head office in the *United Kingdom*, this section applies to the whole of the *firm's* business carried on world-wide.
- 1.5.5A** **R** In the application of this section to activities carried on by a *non-EEA insurer*:
- (1) ■ INSPRU 1.5.13 R to ■ INSPRU 1.5.13B G apply in relation to the whole of its business carried on world-wide;
 - (2) all other provisions of this section apply only in relation to:
 - (a) in the case of any *UK-deposit insurer*, activities carried on from *branches* in any *EEA State*; and
 - (b) in any other case, activities carried on from a *branch* in the *United Kingdom*.
- 1.5.7** **G** The requirements of this section apply to a *firm* on a solo basis.

Purpose

1.5.8 **G** This section sets out requirements for a *firm* relating to 'internal-contagion risk'. This is the risk that losses or liabilities from one activity might deplete or divert financial resources held to meet liabilities from another activity. It arises where the two activities are carried on within the same *firm*. It may also arise from the combination of activities within the same *group*, but this aspect of internal-contagion risk falls outside the scope of this section.

1.5.9 **G** Internal-contagion risk includes in particular the risk that arises where a *firm* carries on:

- (1) both insurance and non-insurance activities; or
- (2) two or more different types of insurance activity; or
- (3) insurance activities from offices or *branches* located in both the *United Kingdom* and overseas.

1.5.10 **G** This section requires *firms* other than *pure reinsurers* to limit non-insurance activities to those that directly arise from their *insurance business*, e.g. investing assets, employing insurance staff etc. It also requires that an adequate provision be established for non-insurance liabilities. *pure reinsurers* must limit their activities to the business of *reinsurance* and related operations.

1.5.11 **G** This section also sets out requirements for the separation of different types of insurance activity. However, in most circumstances the combination of different types of insurance activity within the same *firm* is a source of strength. Adequate pooling and diversification of insurance risk is fundamental to sound business practice. The requirements, therefore, only apply in two specific cases where without adequate protection the combination might operate to the detriment of *policyholders*. They apply where a *firm* carries on both:

- (1) *general insurance business* and *long-term insurance business*;
- (2) *linked* and *non-linked insurance business*.

1.5.12 **G** Finally, the section sets out requirements to protect *policyholders* of *branches* of non-EEA *firms* where these are supervised by the *appropriate regulator*. These apply only to a non-EEA *firm* that has established a *branch* in the *United Kingdom*.

Restriction of business

Requirements: Non-insurance activities

1.5.13 **R** (1) A *firm* other than a *pure reinsurer* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.

(2) (1) does not prevent a *friendly society* which was on 15 March 1979 carrying on *long-term insurance business* from continuing to carry on savings business.

1.5.13A **R** A *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

1.5.13B **G** In **INSPRU 1.5.13A R** related operations include, for example, activities such as provision of statistical or actuarial advice, risk analysis or research for its clients. It may also include a *holding company* function and activities with respect to financial sector activities within the meaning of Article 2, point 8, of the *Financial Groups Directive*. But it does not allow the carrying on of, for example, unrelated banking and financial activities.

Requirements: long-term insurance business

1.5.16 **G** **INSPRU 1.5.18 R**, **INSPRU 1.5.21 R**, **INSPRU 1.5.30 R** and **INSPRU 1.5.31 R** require a *firm* to identify the assets attributable to the receipts of the *long-term insurance business*, called *long-term insurance assets*, and only to apply those assets for the purpose of that business. This has the effect of prohibiting a *composite firm* from using *long-term insurance assets* to meet *general insurance liabilities*. It also keeps *long-term insurance assets* separate from shareholder funds.

Permissions not to include both types of insurance

1.5.17 **G** (1) Under section 19 of the *Act*, a *firm* may not carry on a *regulated activity* unless it has *permission* to do so (or is exempt in relation to the particular activity). Both *general insurance business* and *long-term insurance business* are *regulated activities* and *permission* will extend to the *effecting* or *carrying out* of one or more particular *classes* of *contracts of insurance*.

(2) A *firm's permission* can be varied so as to add other *classes*. The *permission* of an existing *composite firm* may be varied by adding *classes* of both *general insurance business* and *long-term insurance business*.

(3) It is the policy of the *appropriate regulator* not to grant or vary *permission* if that would allow a newly established *firm*, or an existing *firm* engaging solely in *general insurance business* or solely in *long-term insurance business*, to engage in both *general insurance business* and *long-term insurance business*. This does not apply where a *firm's permission* to carry on *long-term insurance business* is or is to be restricted to *reinsurance*. It also does not apply where a *firm's permission* to carry on *general insurance business* is or is to be restricted to *effecting* or *carrying out* *accident or sickness contracts of insurance* .

(4) Where a *firm's permission* extends to *effecting* or *carrying out* *life and annuity contracts of insurance* this will normally include *permission* to *effect* or *carry out* *accident contracts of insurance* or *sickness contracts of insurance* on a supplementary basis.

Separately identify and maintain long term insurance assets

- 1.5.18** **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 the requirements in the Non Solvency II firms: Insurance Company – Technical Provisions and Non-Solvency II firms: Insurance Company – Mathematical Reserves parts of the *PRA Rulebook*.
- 1.5.19** **G** The overall impact of the requirements in the *PRA Rulebook* to hold *admissible assets* of a value at least equal to the amount of *technical provisions*, when read together with **INSPRU 1.5.18R**, is that any firm writing *long-term insurance business* must identify separately assets of a value at least equal to the amount of its *long-term insurance business technical provisions*, including those in respect of any *property-linked liabilities* or *index-linked liabilities*, and its other *long-term insurance liabilities*.
- 1.5.20** **G** **INSPRU 1.5.18 R** does not prohibit a firm from identifying other assets as being available to meet the liabilities of its *long-term insurance business*. It may transfer such other assets to a *long-term insurance fund* (see **INSPRU 1.5.21 R** and **INSPRU 1.5.22 R**) and the transfer will take effect when it is recorded in the firm's accounting records (see **INSPRU 1.5.23 R**). After the transfer takes effect, a firm may not transfer the assets out of a *long-term insurance fund* except where they represent an *established surplus* (see **INSPRU 1.5.27 R**).
- 1.5.21** **R**
- (1) A firm's long-term insurance assets are the items in (2), adjusted to take account of:
 - (a) outgo in respect of the firm's *long-term insurance business*; and
 - (b) any transfers made in accordance with **INSPRU 1.5.27 R**.
 - (2) The items are:
 - (a) the assets identified under **INSPRU 1.5.18 R** (including assets into which those assets have been converted) but excluding any assets identified as being held to cover liabilities in respect of subordinated debt;
 - (b) any other assets identified by the firm as being available to cover its *long-term insurance liabilities* (including assets into which those assets have been converted) including, if the firm so elects, assets which are excluded under (a);
 - (c) *premiums* and other receivables in respect of *long-term insurance contracts*;
 - (d) other receipts of the *long-term insurance business*; and
 - (e) all income and capital receipts in respect of the items in (2).
- 1.5.22** **R**
- (1) Unless (2) applies, all the *long-term insurance assets* of the firm constitute its long-term insurance fund.
 - (2) Where a firm identifies particular *long-term insurance assets* in connection with different parts of its *long-term insurance business*, the assets identified in relation to each such part constitute separate long-term insurance funds of the firm.

- 1.5.23 **R** A *firm* must maintain a separate accounting record in respect of each of its *long-term insurance funds* (including any *with-profits fund*).
- 1.5.24 **G** *Firms* must ensure that *long-term insurance assets* are separately identified and allocated to a *long-term insurance fund* at all times. Assets in external accounts, for example at banks, custodians, or brokers should be segregated in the *firm's* books and records into separate accounts for *long-term insurance business* and *general insurance business*. Where a *firm* has more than one *long-term insurance fund*, a separate accounting record must be maintained for each fund. Accounting records should clearly document the allocation.
- 1.5.25 **G** Where the surplus arising from business is shared between *policyholders* and shareholders in different ways for different blocks of business, it may be necessary to maintain a separate fund to ensure that *policyholders* are, and will be, treated fairly. For example, if a proprietary company writes some business on a with-profits basis, this should be written in a *with-profits fund* separate from any business where the surplus arising from that business is wholly owned by shareholders.
- 1.5.26 **G** Where a *firm* merges separate funds for different types of business, it will need to ensure that the merger will not result in *policyholders* being treated unfairly. When considering merging the funds, the *firm* should consider the impact on its *PPFM* (see **■ COBS 20.3**) and on its obligations to notify the *FCA* (see **■ SUP 15.3**). In particular, a *firm* would need to consider how any *inherited estate* would be managed and how the fund would be run in future, such that *policyholders* are treated fairly.
- 1.5.27 **R** A *firm* may not transfer assets out of a *long-term insurance fund* unless:
- (1) the assets represent an *established surplus*; and
 - (2) no more than three months have passed since the determination of that surplus.
- 1.5.28 **G** As a result of **■ INSPRU 1.5.27R (2)**, an *actuarial investigation* undertaken to determine an *established surplus* remains in-date for three months from the date as at which the determination of the surplus was made. However, even where the investigation is still in-date, the *firm* should not make the transfer unless there is sufficient surplus at the time of the transfer to allow it to be made without breach of the requirements in *PRA Rulebook: Non Solvency II firms: Insurance Company – Technical Provisions*.
- 1.5.29 **G** **■ INSPRU 1.1.27 R** provides further constraints on the transfer of assets out of a *with-profits fund*. **■ INSPRU 1.1.27 R** 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.

Exclusive use of long-term insurance assets

- 1.5.30 **R** (1) A *firm* must apply or use a *long-term insurance asset* only for the purposes of its *long-term insurance business*.
- (2) For the purpose of (1), applying or using an asset includes coming under any obligation (even if only contingently) to apply or use that asset.

1.5.31 **R** A *firm* must not agree to, or allow, any mortgage or charge on its *long-term insurance assets* other than in respect of, and for the purposes of, a *long-term insurance liability*.

1.5.32 **G** The purposes of the *long-term insurance business* include the payment of *claims*, expenses and liabilities arising from that business, the acquisition of lawful access to fixed assets to be used in that business and the investment of assets. The payment of liabilities may include repaying a loan but only where that loan was incurred for the purpose of the *long-term insurance business*. The purchase or investment of assets may include an exchange at fair *market value* of assets (including *money*) between the *long-term insurance fund* and other 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*.

Payment of financial penalties

1.5.33 **R** If the *FCA* or *PRA* imposes a financial penalty on a *long-term insurer*, the *firm* must not pay that financial penalty from a *long-term insurance fund*.

1.5.34 **G**

Requirements: property-linked funds

1.5.35 **G** ■ INSPRU 3.1.57 R requires a *firm* to cover, as closely as possible, its *property-linked liabilities* by the property to which those liabilities are linked. In order to comply with this *rule*, a *firm* should identify the assets it holds to cover *property-linked liabilities* and should not apply those assets (as long as they are needed to cover the *property-linked liabilities*) for any purpose other than to meet those liabilities.

1.5.36 **R** A *firm* must select, allocate and manage the assets to which its *property-linked liabilities* are linked taking into account:

- (1) the *firm's* contractual obligations to holders of *property-linked policies*; and
- (2) its regulatory duty to treat *customers* fairly, including in the way it makes discretionary decisions as to how it selects, allocates and manages assets.

1.5.37 **G** *Property-linked liabilities* may be linked either to specified assets (with no contractual discretion given to the *firm* as to the choice of assets) or to assets of a specified kind where the selection of the actual assets is left to the *firm*.

Application of INSPRU 1.5 to Lloyd's
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1.5.58 **R**

1.5.59 **R**

**INSPRU 1.2 (Mathematical reserves) and INSPRU 1.3 (With-profits
insurance capital component)**

