INSURANCE (NON LONG-TERM BUSINESS VALUATION AND SOLVENCY) REGULATIONS 2020

Index

Regulation **Page**

PART 3: SOLVENCY CAPITAL REQUIREMENT 28

PART 4: MINIMUM CAPITAL REQUIREMENT 75

PART 5: OWN FUNDS 76

Statutory Document No. 20XX/XXXX

Insurance Act 2008

INSURANCE (NON LONG-TERM BUSINESS VALUATION AND SOLVENCY) REGULATIONS 2020

Laid before Tynwald:	*xxxxxxxxx*
Coming into Operation:	*1 July 2020*

The Isle of Man Financial Services Authority makes the following Regulations under sections 12, 14, 50(1) of, and Schedule 7 to, the Insurance Act 2008, after carrying out the consultation required by section 50(3) of that Act.

1 Title

These Regulations are the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2020.

2 Commencement

These Regulations come into operation on 1 July 2020.

3 Interpretation

In these Regulations—

"**the Act**" means the Insurance Act 2008;

"**active financial market**" means an arm's length financial market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis;

"**approved supervisor**" means—

(a) the Authority;

(b) the insurance supervisory authorities of the United Kingdom;

(c) an insurance supervisory authority of a country in the European Union;

(d) an insurance supervisory authority in a solvency regime which has been assessed by EIOPA and considered to be equivalent, (either fully, provisionally or temporarily) to the requirements of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 relating to the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (O.J. No. L335/1 17.12.09); or

(e) any other insurance supervisory authority approved by the Authority;

"**arm's length**" in relation to a market or transaction, means that the market transaction is assumed to involve only sophisticated parties which are independent of one another with each party having the expertise, resources and information necessary to understand the relevant economic effect of the transaction;

"**basis point**" is a measure equal to 0.01%;

"**BSCR**" is an abbreviation meaning basic solvency capital requirement;

"**CGC**" means the Corporate Governance Code of Practice for Regulated Insurance Entities[1] or the Corporate Governance Code of Practice for Commercial Insurers as applicable[2];

"Class 12 insurer" means an insurer authorised to carry out class 12 business in respect of contracts within classes 3 to 9 and 11;

"core" in relation to a PCC, is its non-cellular part in accordance with the Protected Cell Companies Act 2004, or Companies Act 2006, as the case may be;

[1] SD 880/10 as amended by SD 886/10 and 2015/0317

[2] SD2018/0247

"**credit rating**" of an entity, is an indicator of the entity's ability to pay back a debt and an implicit forecast of the likelihood of the entity defaulting;

"**dormant insurer**" has the meaning given in paragraphs 1 and 3 of Schedule 1;

"**ECAI**" means an External Credit Assessment Institution that evaluates the credit risk of debtors and assigns a credit rating;

"**EEA**" means the European Economic Area;

"**EIOPA**" means the European Insurance and Occupational Pensions Authority;

"**financial statements**" in relation to an insurer, unless the context requires otherwise means its audited financial statements;

"**insurance**" includes assurance and reinsurance;

"**insurer**" unless the context requires otherwise, means an insurer to whom these Regulations apply;

"market participant" means a sophisticated party (as referred to in the definition of "arm's length") that is either a seller of an investment to an active financial market or a buyer of an investment from an active financial market;

"material" in relation to an impact, risk, assumption, asset, liability or own fund item means it is important enough to influence the decisions-making or judgment of the intended user of the information;

"**MCR**" is an abbreviation meaning minimum capital requirement;

"non-Class 12 insurer" means an insurer authorised to carry out insurance business in respect of any of the classes within 3 to 9 and 11, but not class 12;

"non long-term business" means insurance business within classes 3 to 9, 11 and 12 (other than restricted long-term business);

"**NSLT health**" means health insurance business that is not pursued on a similar technical basis to that of life insurance business ('NSLT');

"**OECD**" means the Organisation for Economic Co-operation and Development;

"**pooling arrangement**" means an arrangement whereby several insurers agree to share identified insurance risks in defined proportions. The parties insured by the members of the pooling arrangement are not themselves members of the pooling arrangement;

"related entity" is an entity which is either a subsidiary of the insurer, an entity in which a participation is held by the insurer, or an entity linked to the insurer by a relationship that requires the production of consolidated accounts in respect of those parties;

"resecuritisation position" is a securitisation where the risk associated with the underlying pool of exposures is tranched, and at least one of the underlying exposures is a securitisation position;

"**ring-fenced funds**" are arrangements where an identified set of assets and liabilities are legally segregated from an insurer's total assets and liabilities and as such are managed as though they were a separate undertaking;

"**risk mitigation technique**" is a technique used by an insurer to transfer risk. This includes techniques such as reinsurance contracts, special purpose vehicles and finite reinsurance arrangements;

"**risk profile**" in relation to an insurer, refers to the nature, scale and complexity of the total risks to which the insurer is or may be exposed;

"**SCR**" is an abbreviation meaning Solvency Capital Requirement;

"**securitisation**" is a pool of various types of contractual debt, such as mortgages and loans, where the related cash flows are sold to third party investors as a tradable financial asset and an exposure to a securitisation is therefore a 'securitisation position';

"**special purpose vehicle**" in relation to the risk transfer activities of an insurer, means a financial legal entity, or cell of a protected cell company in accordance with the Protected Cell Companies Act 2004 (or equivalent), which acts as a reinsurer (or similar) to the insurer.

"type 1 securitisation position" is a securitisation position meeting the requirements of paragraph 9(1) of Schedule 4,; and

"type 2 securitisation position" is a securitisation position meeting the requirements of paragraph 9(2) of Schedule 4,.

4 Application

(1) These Regulations apply to the carrying on of insurance business of—

(a) classes 3 to 9 and 11; and

(b) class 12 in respect of contracts within classes 3 to 9 and 11;

and therefore apply to an insurer authorised in respect of any such class, or combination thereof, as applicable.

(2) Reference in paragraph (1) to a numbered class of insurance business is to be construed by a reference to the table in regulation 3(2) of the Insurance Regulations 2018[3].

(3) Where the core of a PCC does not carry out insurance business, the insurer must apply these Regulations as if the core is a Class 12 insurer, unless the PCC has cells carrying out non-Class 12 business, in which case the insurer must apply these Regulations as if the core is a non-Class 12 insurer.

5 Capital requirements

(1) An insurer must calculate its MCR and SCR using these Regulations, as are applicable to its business.

(2) Where an insurer is a dormant insurer it may comply with its MCR and SCR by complying with the requirements of Schedule 1.

6 Expert judgement

(1) Where an insurer makes assumptions about any of the material components of its capital requirements, the assumptions must be reasonable and based on the expertise of persons with relevant knowledge, experience and understanding of the risks inherent in the insurer's business.

(2) An insurer must, taking due account of proportionality using regulation 7, ensure that all internal users of the assumptions referred to in paragraph

[3] SD 2018/0192

(1) are informed about the relevant content, degree of reliability and limitations of those assumptions.

(3) For the purposes of paragraph (2), service providers to whom functions or activities of the insurer have been outsourced are considered to be internal users.

7 Proportionality

(1) An insurer must apply these Regulations in a way which is proportionate to the nature, scale and complexity of the risks to which it is, or may be exposed.

(2) In determining whether the use of a method specified by these Regulations is proportionate, an insurer must carry out—

(a) an assessment of the nature, scale and complexity of the relevant risks underlying its insurance obligations; and

(b) an evaluation in qualitative or quantitative terms of the error introduced in the results of the method due to any deviation between —

(i) the assumptions underlying the method in relation to the risks; and

(ii) the results of the assessment referred to in paragraph (a).

(3) A method is considered to be disproportionate to the nature, scale and complexity of the risks if the error referred to in paragraph (2)(b) is material, unless —

(a) no other method with a smaller error is available and the method is not likely to result in an inadequate estimate of the risks in question; or

(b) the method results in estimates that are more prudent than the estimates that would result from using a proportionate method and the method does not lead to an inadequate estimate of the risks in question.

8 Board report

(1) An insurer must submit a written report to its board of directors at least annually.

(2) The report must —

(a) provide the insurer's board of directors with sufficient information to enable it to adequately understand and assess the appropriateness of the key assumptions, expert judgements and results relating to the valuation of the insurer's technical provisions and capital requirements;

(b) draw conclusions on the appropriateness, accuracy and completeness of the—

(i) methodologies used to value the insurer's assets, liabilities, technical provisions and capital requirements; and

(ii) best estimate assumptions used by the insurer to determine its technical provisions;

(c) include any other factors considered material to the present or future valuation of the insurer's technical provisions and capital requirements;

(d) where an insurer is required to have an actuarial function, document all tasks that have been undertaken by the actuarial function, in particular those activities that are required by the CGC and must include the results of these activities; and

(e) clearly identify any deficiencies and give recommendations to the Board as to how those deficiencies must be remedied.

9 Policyholder behaviour

(1) When determining its technical provisions and capital requirements, an insurer must take into account policyholder behaviour.

(2) An insurer must take sufficient steps to identify relevant policyholders' behaviour and make appropriate assumptions relating to the likelihood of policyholders exercising contractual options.

(3) Assumptions relating to the exercise of contractual options must—

(a) be realistic and based on current and credible information;

(b) be based on analysis of past policyholder behaviour and a prospective assessment of expected future policyholder behaviour; and

(c) take account, either explicitly or implicitly, of the impact that future changes in financial and non-financial conditions may have on the exercise of those options.

10 Participations

(1) An insurer must treat holdings in a related entity as a participation, if —

(a) the insurer's share ownership, directly or by way of control, in that related entity meets the following criteria—

(i) the insurer's percentage holding of voting rights in the related entity represents at least 20% of that related entity's total voting rights; or

(ii) the insurer's percentage holding of all classes of share capital issued by the related entity represents at least 20% of that related entity's issued share capital; or

(b) the insurer is deemed to be able to exert a dominant or significant influence over that related entity.

(2) If the participation is in a related entity which is either an insurer subject to these Regulations or to the solvency regime of an approved supervisor, the assessments under paragraph (1)(a)(i) only relate to paid up ordinary share capital whilst participations under paragraph (1)(a)(ii) relate to both paid-up ordinary share capital and paid-up preference shares.

(3) An insurer is deemed to be able to exert a dominant or significant influence over the related entity if—

(a) the insurer has shareholdings in the related entity that either currently meet the requirements of paragraph 10(1)(a), or could potentially meet those requirements in future if the insurer has the right to increase its shareholdings through the holding of options, warrants or similar instruments or having any other contractual rights to the same or similar effect;

(b) if the related entity is a mutual or mutual-type entity, the insurer holds membership rights or has the potential to increase those rights;

(c) the insurer has representation or right to establish representation on the board of directors of the related entity;

(d) the insurer has involvement in policy-making processes, including decision making about dividends or other distributions of the related entity;

(e) there are material transactions between the insurer and related entity;

(f) there is interchange of managerial personnel between the insurer and the related entity;

(g) there is provision of essential technical information between the insurer and the related entity; or

(h) there is management on a unified basis of the insurer and the related entity.

11 Recognition of ring-fenced funds

(1) An insurer must identify whether it has assets and liabilities that are ring-fenced and comply with the requirements of Schedule 8 accordingly.

(2) In particular Protected Cell Companies must consider whether their structure means the assets and liabilities of each individual cell are ring-fenced.

PART 1: VALUATION OF ASSETS AND LIABILITIES OTHER THAN TECHNICAL PROVISIONS

12 Application

An insurer must value its assets and liabilities for its regulatory balance sheet, in accordance with this Part.

13 Use of relevant accounting standards

(1) An insurer must recognise its assets and liabilities on its regulatory balance sheet, using one of the following approved accounting standards—

(a) the International Financial Reporting Standards ("IFRS") issued by the IFRS Foundation and the International Accounting Standards Board (IASB);

(b) the Generally Accepted Accounting Practice in the UK ("UK GAAP"); or

(c) such other standards as may be approved by the Authority.

(2) If an insurer does not value its assets or liabilities in its financial statements using one of the approved relevant accounting standards, it may, subject to approval from the Authority, recognise and value its assets and liabilities based on the valuation method it uses for preparing its annual or consolidated financial statements provided that—

(a) the valuation method is consistent with regulation 14(1);

(b) the valuation method is proportionate with respect to the nature, scale and complexity of the risks inherent in the business of the insurer; and

(c) the use of a relevant accounting standard in paragraph (1) would be disproportionate with respect to the total administrative expenses involved.

14 Valuation of assets and liabilities

(1) An insurer must use the following approach to value their assets and liabilities—

(a) assets must be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction; and

(b) liabilities must be valued at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction.

(2) When valuing liabilities under paragraph (1)(b), an insurer must not make any adjustment to take account of its own credit standing.

(3) In addition to paragraph (1), an insurer must value its assets and liabilities—

(a) using a relevant accounting standard from regulation 13;

(b) separately for each asset and liability;

(c) based on the assumption that the insurer will pursue its business as a going concern;

(d) by taking into account the characteristics that affect the pricing of that asset or liability, including the condition and location of the asset or liability and restrictions, if any, on its sale or use;

(e) using quoted market prices in active financial markets for the same assets or liabilities; and

(f) allowing for proportionality.

(4) If the approach in paragraph (3)(e) is not possible, the insurer must value its assets and liabilities using quoted market prices in active financial markets for similar assets and liabilities with adjustments input to reflect differences, and those adjustments shall reflect factors specific to the asset or liability.

(5) When using alternative valuation methods to value assets and liabilities, an insurer must rely as little as possible on data specific to the insurer and make maximum use of relevant market data.

(6) To the extent that relevant market data is not readily available, the insurer must use unobservable data reflecting the assumptions that market participants would use when pricing the asset or liability.

(7) If unobservable inputs are used, an insurer must adjust data that is specific to the insurer if reasonable available information indicates that other market participants would use different data or there is something particular to the insurer that is not available to other market participants.

(8) An insurer must recognise any material contingent liabilities within its liabilities.

(9) An insurer must calculate the value of the contingent liabilities as the expected present value of future cash flows required to settle the contingent liability over the lifetime of that contingent liability, using the basic risk-free interest rate term structure in regulation 20.

(10) An insurer must value the following assets at zero—

(a) goodwill; and

(b) intangible assets other than goodwill, unless the intangible asset can be sold separately and the insurer can demonstrate to its board of directors that there is a value for the same or similar assets that has been derived using the method in paragraph (3).

(11) An insurer must recognise deferred tax assets and liabilities in relation to all assets and liabilities that are recognised for solvency and tax purposes within its asset and liabilities.

(12) An insurer must calculate the value of deferred taxes as —

(a) the values ascribed to assets and liabilities using the method in paragraph (3); less

(b) the values ascribed to assets and liabilities as recognised and valued for tax purposes; plus

(c) the value of deferred tax assets arising from the carry forward of—

(i) unused tax credits; and

(ii) unused tax losses.

(13) The value of paragraph (12)(c) must only be positive if it is probable that future taxable profit will be available against which the deferred tax asset can be utilised, taking into account any legal or regulatory requirements on the time limits relating to the carry forward of unused tax losses or the carry forward of unused tax credits.

(14) An insurer must recognise participations meeting the requirements of regulation 10 in its assets and liabilities.

(15) An insurer must calculate the value of participations as the quoted market price in an active financial market.

(16) If the approach in paragraph (15) is not practicable or proportionate, then the insurer must use a relevant alternative approach set out in paragraphs (4) to (7) .

PART 2: VALUATION OF TECHNICAL PROVISIONS

15 Technical provisions

(1) An insurer must establish technical provisions with respect to all of its insurance obligations that fall within the boundaries of a contract, in order to determine its capital requirements.

(2) The value of the technical provisions must correspond to the economic value of the insurer fulfilling its insurance obligations to its policyholders arising over the lifetime of the insurer's portfolio of insurance contracts.

(3) The insurer's technical provisions are—

(a) a best estimate determined using regulation 18; plus

(b) a risk margin calculated using regulation 21.

(4) An insurer must segment its insurance obligations into the lines of business in Schedule 7, and determine its technical provisions for each line of business.

(5) An insurer's board of directors must ensure that the insurer is able to demonstrate the adequacy and appropriateness of the methods applied and the data used to determine the insurer's technical provisions, to be appropriate.

(6) An insurer's technical provisions must take account of the following—

(a) all expenses that might reasonably be expected to be incurred by the insurer in servicing insurance;

(b) inflation, including expense and claims inflation;

(c) all payments to policyholders which the insurer expects to make, whether or not those payments are contractually guaranteed;

(d) relevant information provided by active financial markets; and

(e) generally available data on relevant underwriting risks.

(7) Assumptions underlying the calculation of an insurer's technical provisions must be realistic and shall be considered so if all of the following conditions are met—

(a) the insurer is able to explain and justify each of the assumptions used, taking into account the significance of the assumption, the uncertainty involved in the assumption as well as relevant alternative assumptions;

(b) the insurer has clearly identified the circumstances under which the assumptions would be considered false;

(c) unless otherwise provided in this regulation, the assumptions are based on the characteristics of the portfolio of insurance obligations and, where possible, regardless of the insurer holding the portfolio;

(d) the insurer uses the assumptions consistently over time and within lines of business, without arbitrary changes; and

(e) the assumptions adequately reflect any uncertainty underlying the cash flows.

(8) For the purpose of paragraph (7)(c), an insurer must only use information specific to the insurer, including information on claims management and expenses, if that information reflects the characteristics of the portfolio of insurance obligations better than information that is not limited to the specific insurer, or if the calculation of technical provisions in a prudent, reliable and objective manner without using that information is not possible.

(9) An insurer must validate the calculation of technical provisions, in particular by comparison against experience, at least once a year and more often if there are indications that the data, assumptions or methods used in the calculation are no longer appropriate.

(10) An insurer must document the following processes, and be able to provide the documentation to the Authority on request—

(a) the collection of data and analysis of its quality and other information that relates to the calculation of its technical provisions;

(b) the choice of assumptions used in the calculation of its technical provisions;

(c) the selection and application of methods for the calculation of its technical provisions, including the use of any simplifications; and

(d) the validation of its technical provisions in paragraph (9).

16 Recognition and de-recognition of insurance obligations

(1) An insurer must recognise all of its insurance obligations in the calculation of its technical provisions. This includes all contracts of insurance written by the insurer for the classes of insurance business specified in regulation 4.

(2) An insurer must recognise an insurance obligation at either the date the insurer becomes a party to the contract that gives rise to the obligation or the date the insurance cover begins, whichever date occurs earlier.

(3) An insurer must only recognise the obligations within the boundary of the contract in accordance with regulation 17.

(4) An insurer must derecognise an insurance obligation only when it is fully extinguished, discharged, cancelled or expired.

17 Contract boundary

(1) In regulation 15(1) an insurer must recognise all insurance obligations that fall within the boundary of the contract, in the calculation of its technical provisions, including obligations relating to unilateral rights of the insurer to renew or extend the scope of the contract and obligations that relate to paid premiums.

(2) An insurer must recognise an insurance obligation as belonging to a contract, from the earlier of—

(a) the date the insurer becomes a party to the contract that gives rise to the obligation; or

(b) the date the insurance cover begins.

(3) Unless paragraph (4) applies, an insurer must cease to recognise an obligation as belonging to a contract when it is fully—

(a) extinguished;

(b) discharged;

(c) cancelled; or

(d) expired.

(4) An obligation of the insurer, which relates to cover provided after any of the following dates, does not belong to the contract unless the insurer can compel the policyholder to pay the premium for those obligations—

(a) the future date where the insurer has a unilateral right to terminate the contract;

(b) the future date where the insurer has a unilateral right to reject premiums payable under the contract; or

(c) the future date where the insurer has a unilateral right to amend the premiums or the benefits payable under the contract in such a way that the premium fully reflect the risks covered by the portfolio.

18 Calculation of the best estimate

(1) Unless paragraph (2) applies, an insurer must determine the best estimate as the sum of the expected present value of its future cash-flows, using a cash flow projection that includes all cash in- and out-flows required to settle the insurer's obligations over their lifetime.

(2) Where a Class 12 insurer has demonstrated to its board of directors that it is not practicable or proportionate to use the method in paragraph (1), it may use its accounting provisions to determine the best estimate instead of the approach in paragraph (1).

(3) When using the approach in paragraph (2), an insurer should consider removing all known prudence from the accounting provisions before being used to determine the best estimate. Prudence that has not been, or cannot be, explicitly quantified must not be removed from the accounting

provisions. The approach taken by the insurer must be fully documented, approved by the Board, and available to the Authority on request.

(4) The expected present value of future cash-flows in paragraph (1) is the probability weighted average of future cash-flows, taking account of the time value of money, using the relevant risk-free interest rate term structure, in regulation 20, for the relevant currency of that cash flow.

(5) The calculation of the best estimate must—

(a) be calculated separately for premium provisions and claim provisions;

(b) be calculated gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles. Those amounts must be calculated separately, using regulation 19;

(c) be based upon up-to-date and credible information;

(d) use realistic assumptions that comply with regulation 15(7);

(e) be performed using adequate, applicable and relevant methods; and

(f) be calculated in a transparent manner and in such a way as to ensure that the calculation method and the results derived from it are capable of review by a suitably qualified expert.

(6) The premium provision in paragraph (5)(a) must only relate to future claim events covered by insurance obligations falling within the contract boundary.

(7) The provision for claims outstanding in paragraph (5)(a) must only relate to claim events that have already occurred, regardless of whether the claims arising from those events have been reported or not.

(8) If the insurer has insufficient data meeting the data quality requirements in regulation 22, and therefore cannot meet the requirements of paragraphs (5)(c) and (5)(e), it may use appropriate approximations to calculate the best estimate provided that all of the following requirements are met—

(a) the insufficiency of data is not due to inadequate internal processes or procedures of collecting, storing or validating data used for the valuation of the insurer's technical provisions;

(b) the insufficiency of data cannot be remedied by the use of external data; and

(c) it would not be practicable for the insurer to adjust data to remedy the insufficiency.

(9) The cash flow projection in paragraph (1) must be carried out for each line of business in Schedule 7 and must include all of the following cash flows, to the extent that those cash flows relate to the insurer's obligations—

(a) benefit payments to policyholders;

(b) payments of expenses including—

(i) administrative expenses;

(ii) investment management expenses;

(iii) overhead expenses;

(iv) claims management expenses; and

(v) acquisition expenses; and

(vi) expenses relating to reinsurance contracts and special purpose vehicles;

(c) premium payments and any additional cash flows that result from those premiums; and

(d) payments between the insurer and intermediaries relating to insurance obligations.

(10) The cash flow projection must take into account all expected future developments that will have a material impact on the cash flows required to settle the insurer's insurance obligations over the lifetime of those obligations including —

(a) demographic;

(b) legal;

(c) medical;

(d) technological;

(e) social;

(f) environmental; and

(g) economic developments including inflation.

(11) The cash flow projection must, explicitly or implicitly, take account of all uncertainties in the insurer's cash flows, including all of the following characteristics—

(a) uncertainty in—

(i) the timing, frequency and severity of insured events;

(ii) claim amounts, claims inflation, and in the period needed to settle and pay claims;

(iii) the amount of expenses;

(iv) expected future developments to the extent that it is practicable;

(v) policyholder behaviour; and

(b) dependency between

(i) two or more causes of uncertainty; and

(ii) cash flows on circumstances prior to the date of the cash flow.

(12) An insurer's overhead expenses in paragraph (9)(b)(iii) must be allocated in a realistic and objective manner and on a consistent basis over time to the parts of the best estimate to which they relate.

(13) An insurer must have processes and procedures in place to ensure that its best estimate, and the assumptions underlying its calculation, are regularly compared against relevant experience.

(14) If such comparison identifies systematic deviation between experience and the best estimate, appropriate adjustments must be made to either or both of the method and assumptions being used.

19 Amounts recoverable from reinsurance contracts and special purpose vehicles

(1) The amounts recoverable from the following must each be calculated separately—

(a) special purpose vehicles;

(b) finite reinsurance contracts; and

(c) other reinsurance contracts,

(2) The amounts recoverable from reinsurance contracts and special purpose vehicles must be—

(a) calculated consistently with the boundaries of the contracts to which those amounts relate;

(b) calculated separately for premiums provisions and claims provisions; and

(c) adjusted to take account of expected losses due to the default of the counterparty.

(3) For the purpose of calculating the amounts recoverable from reinsurance contracts and special purpose vehicles in paragraph (2)(a)—

(a) cash flows must only include payments in relation to compensation of insurance events and unsettled insurance claims;

(b) if a deposit has been made for the cash flows, the amounts recoverable must be adjusted accordingly to avoid a double counting of the assets and liabilities relating to the deposit;

(c) if cash flows payable from the special purpose vehicles to the insurer do not directly depend on the claims against the insurer ceding risks, the amounts recoverable from those special purpose vehicles for future claims must only be taken into account to the extent that the structural mismatch between claims and amounts recoverable can be verified in a prudent, reliable and objective manner;

(d) the amounts recoverable from special purpose vehicles must not exceed the aggregate maximum risk exposure of that special purpose vehicle to the insurer where the aggregate maximum risk exposure is the sum of the maximum payments, including expenses that the special purpose vehicles may incur, but excluding expenses that meet both of the following criteria—

(i) the special purpose vehicle has the right to require the insurer which has transferred risks to the special purpose vehicle to pay the expense; and

(ii) the special purpose vehicle is not required to pay the expense unless and until an amount equal to the expense has been received from the insurer which has transferred the risks to the special purpose vehicle; and

(e) the expense of transferring risk to a special purpose vehicle must not be included as an amount recoverable from the special purpose vehicle.

(4) In paragraph (2)(b) the cash flows—

(a) relating to claims provisions must include only the compensation payments relating to the claims accounted for in the gross provisions for claims outstanding of the insurer undertaking ceding risks; and

(b) relating to premium provisions shall include all other payments.

(5) In paragraph (2)(c), unless paragraph (7) applies, the adjustment to take account of expected losses due to default of a counterparty is the expected present value of the change in cash flows underlying the amounts recoverable from that counterparty that would arise if the counterparty defaulted. The change in cash flows must not take into account the effect of any risk mitigating technique that mitigates the credit risk of the counterparty.

(6) The default adjustment must—

(a) take into account the probability of default of all possible default events over the lifetime of the reinsurance contract or arrangement with the special purpose vehicle and whether and how the probability of default varies over time;

(b) be calculated and shown separately from the rest of the amounts recoverable; and

(c) for special purpose vehicles, be calculated on the basis of the credit risk inherent in the relevant assets held by the special purpose vehicle.

(7) Where the approach in paragraph (5) is not proportionate, an insurer may calculate the adjustment for default to be—

(a) the gross best estimate; less

(b) the unadjusted net best estimate, calculated as the best estimate, taking into account the amounts recoverable from reinsurance contracts and special purpose vehicles, without an adjustment for the expected loss due to default of the counterparty.

(8) In paragraph (7)(b), an insurer—

(a) may use methods to derive the unadjusted net best estimate from the gross best estimate without an explicit projection of the cash flows underlying the amounts recoverable from reinsurance contracts and special purpose vehicles; and

(b) must calculate the unadjusted net best estimate for each reinsurance contract or special purpose vehicle under each line of business.

20 Risk-free interest rate term structure

(1) Risk-free interest rate term structures will be published periodically by the Authority.

(2) In relation to the use of a risk-free interest rate term structure—

(a) for durations of less than one year, the annual risk-free interest rate shall be used; and

(b) investment expenses must be allowed for as a cash flow underlying the calculation of technical provisions and not in an adjustment to the risk-free interest rates used to discount technical provisions.

21 Calculation of the risk margin

(1) The risk margin is an amount equivalent to the cost of establishing eligible own-funds equal to the insurer's SCR, over the lifetime of its obligations.

(2) Unless paragraph (3) applies, an insurer's risk margin must be calculated using the following formula—

(a) 5%; multiplied by

(b) the sum over each future year of —

(i) the SCR determined for that year; multiplied by

(ii) an appropriate discounting factor, determined from the basic risk free interest rate in the local currency of the insurer.

(3) Where the method in paragraph (2) is not practicable or proportionate, a Class 12 insurer may instead use one of the following methods—

(a) estimate the amount determined in paragraph (2)(b) using the modified duration of the best estimate for each line of business, gross of amounts recoverable from reinsurance and special purpose vehicles, in order to calculate the present and all future SCRs in a single step; or

(b) estimate the risk margin as a percentage of the best estimate for each line of business, gross of amounts recoverable from reinsurance and special purpose vehicles.

(4) Where an insurer uses an approach in paragraph (3), it must justify and explain the use of this approach, including the derivation of the percentage applied to the best estimate, in the board report in regulation 8.

(5) The calculation in paragraph (2) must include any capital add-on imposed in regulation 24, unless the capital add-on is a result of the insurer's systems of governance not adequately addressing its risk profile.

(6) Where an insurer uses the full approach in paragraph (2) to determine its risk margin, it must do so at least once a year. For subsequent quarterly calculations of the risk margin the insurer may derive the risk margin from the result of the full calculation, without an explicit calculation of the SCR.

22 Data Quality

(1) An insurer must have internal processes and procedures in place to ensure the completeness, accuracy, and appropriateness of the data used in the calculation of its technical provisions.

(2) If data does not comply with paragraph (1) an insurer must appropriately—

(a) document the limitations of the data, including a description of whether and how those limitations will be remedied in the report in regulation 8; and

(b) record and store the non-compliant data before adjustments to remedy limitations are made to it.

PART 3: SOLVENCY CAPITAL REQUIREMENT

23 Solvency Capital Requirement

(1) The SCR is the regulatory capital an insurer is required to hold to be able to meet its obligations over the next 12 months, with a probability as defined by the relevant confidence level—

(a) for Class 12 insurers, a 90% confidence level; otherwise

(b) a 99.5% confidence level.

(2) To comply with regulation 5, an insurer must—

(a) determine its SCR using the standard formula approach in paragraph (5); and

(b) apply any adjustment to its SCR as may be specified by the Authority as a capital add-on in regulation 24.

(3) The SCR for a PCC is the sum of a notional SCR of each cell and of the core, subject to a minimum of the MCR for the PCC determined in Part 4.

(4) The notional SCR of each cell and of the core of the PCC must be calculated in accordance with this Part, as if the cell or core is a standalone authorised insurer in accordance with regulation 4(3).

(5) The insurer's SCR using the standard formula approach is—

(a) its BSCR as determined in regulation 25; plus

(b) for non-Class 12 insurers, the SCR for operational risk determined in regulation 27; plus

(c) any regulatory adjustment specified in writing by the Authority.

24 Capital add-on

(1) The Authority may, in exceptional circumstances, adjust the insurer's SCR by way of a capital add-on if the Authority has concluded during the supervisory review process that an insurer's—

(a) risk profile deviates significantly from the assumptions underlying the standard formula approach; or

(b) systems of governance deviate significantly from the requirements of the CGC, and –

(i) those deviations prevent the insurer from being able to properly identify, measure, monitor, manage and report the risks that it is or could be exposed to; and

(ii) the application of other measures is in itself unlikely to improve the deficiencies sufficiently within an appropriate time-frame.

(2) The imposition of a capital add-on by the Authority will be on an exceptional basis and used only as a measure of last resort, when other supervisory measures are ineffective or inappropriate.

(3) The term exceptional must be understood in the context of the specific situation of each insurer rather than in relation to the number of capital add-ons imposed in the Island's non-life insurance market.

(4) The Authority will communicate its decision to impose a capital add-on in writing to the insurer, stating its reasons.

(5) The Authority may vary or revoke a capital add-on in accordance with this regulation.

(6) The capital add-on will have a numerically positive value and an insurer must provide the Authority with all information it requires to determine such an amount.

(7) The methodology used to determine the capital add-on in the circumstances mentioned in paragraph (1)(a) must comply with regulation 23(1).

(8) In the circumstances mentioned in paragraph (1)(b), the capital add-on must reflect an assessment of the significance of the deviation regarding the system of governance, and will be determined on a case-by-case basis.

(9) At a minimum, the capital add-on will remain in place for as long as the circumstances under which it was imposed are not remedied to the satisfaction of the Authority. If the standardised approach does not adequately reflect the very specific risk profile of an insurer the capital add-on may remain over consecutive years.

(10) If a capital add-on applies to an insurer for reasons which are appropriate for the insurer to remedy, then the insurer must take all reasonable steps to remedy the circumstances that led to the capital add-on requirement, within a timeframe agreed with the Authority.

25 Basic Solvency Capital Requirement

(1) The BSCR in regulation 23(5)(a) is—

(a) the capital requirement for market risk; plus

(b) the capital requirement for counterparty default risk; plus

(c) the capital requirement for underwriting risk; plus

(d) the capital requirement for NSLT health underwriting risk; plus

(e) the capital requirement for intangible asset risk; less

(f) a diversification adjustment determined in Schedule 2.

(2) The capital requirements determined in sub-paragraphs (1)(a) to (1)(e) must be positive.

(3) If an insurer transfers its risks using a risk mitigation technique that meets the requirements of regulation 47, and if the arrangement provides the

insurer with protection against the events occurring in sub-paragraphs (1)(a) to (1)(e), the insurer may allow for the risk-mitigating effect of the technique when determining its capital requirements, in a manner that, without double-counting, captures the economic effect of the protections provided.

(4) Where an insurer allows for the use of a risk mitigation technique in paragraph (3), it must assess whether the risk exposure corresponds completely to the risks underlying the exposure. Where this is not the case basis risk may arise.

(5) If an insurer determines that a particular risk mitigation technique exhibits material basis risk, it may still allow for the technique when determining its capital requirements, provided that it adjusts the relevant capital requirement as follows—

(a) the capital requirement for the relevant risk; plus

(i) 25%; multiplied by

(ii) the hypothetical capital requirement for the relevant risk, determined using the standard formula but assuming the risk mitigation technique isn't used; less

(iii) the capital requirement for the relevant risk.

26 Association of credit assessments to credit quality steps

(1) An insurer must take the nominated external credit assessment for an asset, liability or a counterparty determined in Schedule 9, and assign it to a credit quality step using a table of 7 credit quality steps, numbered 0 to 6, published by the Authority for the purpose of these Regulations.

(2) Where an external credit assessment is not available for an asset, liability or a counterparty, an insurer must assign it a credit quality step of 5, unless stated otherwise in these Regulations.

27 Operational risk capital requirement

(1) The capital requirement for operational risk is—

(a) nil for Class 12 insurers; otherwise

(b) the lower of—

(i) the BSCR multiplied by 0.3; or

(ii) a charge based on a premium and reserve measure.

(2) In sub-paragraph (1)(b)(ii) the charge based on the premium and reserve measure is the higher of—

(a) a charge based on a premium measure; and

(b) a charge based on a reserve measure.

(3) In sub-paragraph (2)(a) the operational risk charge based on the premium measure is—

(a) the insurer's earned premium during the previous 12 months, gross of reinsurance premiums and commission multiplied by 0.03;

plus

(b) the higher of

(i) the insurer's adjusted earnings multiplied by 0.03; and

(ii) 0.

(4) In sub-paragraph (3)(b)(i), the insurer's adjusted earnings are—

(a) the insurer's earned premium in sub-paragraph (3)(a); less

(b) the insurer's earned premium, gross of reinsurance premiums and commission, during the 12 months prior to the previous 12 months, multiplied by 1.2.

(5) In sub-paragraph (2)(b), the operational risk charge based on the reserve measure is the insurer's best estimate provision, gross of amounts recoverable from reinsurance contracts and special purpose vehicles, multiplied by 0.03.

28 Intangible asset risk capital requirement

The capital requirement for intangible assets is the value of the insurer's intangible assets, determined in regulation 14(10)(b), multiplied by 0.8.

29 Market risk

(1) The capital requirement in respect of market risk is—

(a) the capital requirement for interest rate risk; plus

(b) the capital requirement for equity risk; plus

(c) the capital requirement for spread risk; plus

(d) the capital requirement for currency risk; plus

(e) the capital requirement for property risk; plus

(f) plus the capital requirement for concentration risk; less

(g) a diversification adjustment as determined in Schedule 2.

30 Look-through approach

(1) An insurer must assess the economic substance of its market risk exposure inherent in all of its investments, by adopting a "look-through" approach as follows—

(a) the insurer must assess the risks applying to each relevant asset underlying the investment vehicle or fund (as the case may require); and

(b) the market shock scenarios must be applied to each of the underlying assets to calculate the capital requirement for market risk.

(2) The look-through approach does not apply to investments of an insurer in related entities, which are valued using regulation 10.

(3) Where a number of iterations of the look-through approach is required, the number of iterations must be sufficient to ensure that all material market risk is captured.

(4) An insurer must ensure that it is able to access the information required from external asset management firms in a timely manner, so that it can identify the nature of all relevant underlying assets.

(5) Taking due account of proportionality in regulation 7, the full look-through requirements of paragraph (1) may be waived and instead the

market risk capital requirement may be calculated on the basis of the target underlying asset allocation of a collective investment vehicle or fund, provided—

(a) such a target allocation is available to the insurer at the level of detail necessary for calculating the capital requirement; and

(b) the underlying assets are managed according to this target allocation.

(6) For the purposes of paragraph (5), homogeneous data groupings may be used, provided they are applied in a prudent and proportionate manner.

(7) If an insurer cannot apply the approaches in paragraphs (1) and (5), the collective investment entity or fund must be treated as type 2 equity in the equity risk capital requirement calculation in regulation 33.

31 Treatment of participations in BSCR

(1) In regulation 29, when determining the relevant market capital requirements for the equity and subordinated liability components of a participation of the insurer in a related entity, an insurer must—

(a) include subordinated liability holdings of a related entity in the interest rate and spread risk capital requirement calculations;

(b) include equity holdings in the related entity, such as ordinary or preference share capital in the equity risk capital requirement calculation; and

(c) include any other exposures as appropriate in the other market risk capital requirements.

32 Interest rate risk capital requirement

(1) The capital requirement in respect of interest rate risk is the largest resulting capital requirement derived from—

(a) the reduction in value of an insurer's basic own funds following an instantaneous permanent increase in the value of interest rate sensitive items; and

(b) the reduction in value of an insurer's basic own funds following an instantaneous permanent decrease in the value of interest rate sensitive items.

(2) The Interest Rate Risk Capital Factors specify the increase or decrease to be applied to the spot rates at each duration and are determined in Schedule 3.

33 Equity risk capital requirement

(1) In this regulation –

"type 1 equities" comprise equities listed in stock exchanges in the countries which are members of the EEA or the OECD;

"type 2 equities" comprise —

(a) equities listed in stock exchanges in countries which are not members of the EEA or the OECD;

(b) equities which are not listed, hedge funds, commodities and other alternative investments; and

(c) all assets and indirect exposures allocated by the insurer to type 2 equities through use of the approach set out in regulation 30(7), unless that asset is included in the—

(i) interest rate risk capital requirement;

(ii) property risk capital requirement; or

(iii) spread risk capital requirement.

(2) The capital requirement in respect of equity risk is —

(a) the reduction in value of an insurer's basic own funds following the instantaneous permanent reduction in the value of Type 1 equity investments; plus

(b) the reduction in value of an insurer's basic own funds following the instantaneous permanent reduction in the value of Type 2 equity investments; less

(c) a diversification adjustment as determined in Schedule 2.

(3) The Equity Risk Capital Factors specify the reduction to be applied to each type of equity investment and are determined in Schedule 3.

34 Property risk capital requirement

(1) The capital requirement for property risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent reduction in the value of the insurer's exposure to immovable property.

(2) The Property Risk Capital Factors specify the reduction to be applied to the insurer's property exposures and are determined in Schedule 3.

35 Currency risk capital requirement

(1) In this regulation —

"foreign currency" means a currency other than the Manx Pound as defined in the Currency Act 1992;

"currency groups" means a group of foreign currencies; and

"reporting currency" means the currency used for the preparation of the insurer's audited financial statements.

(2) Unless paragraph (5) applies, the capital requirement for currency risk is the reduction in basic own funds following an instantaneous permanent increase in the value of the insurer's exposure to foreign currencies.

(3) For Class 12 insurers, the increase must be applied to the insurer's total foreign currency exposure.

(4) For non-Class 12 insurers, the insurer may choose to either—

(a) apply the increase to its total foreign currency exposure; or

(b) allocate its currency exposure to a set of Currency Groups and then apply the increase to each currency group.

(5) Where the method in paragraph (4)(b) is used, the calculation in (2) is reduced by a diversification adjustment as determined in Schedule 2.

(6) The Currency Risk Capital Factors specify the reduction to be applied to the insurer's currency exposures and are determined in Schedule 3.

36 Spread risk capital requirement

(1) The capital requirement for spread risk for Class 12 insurers and non-Class 12 insurers where the calculation in paragraph (3) is disproportionate in accordance with regulation 7, is the reduction in basic own funds following an instantaneous permanent decrease in the value of the insurer's bonds and loans that are exposed to spread risk set out in paragraph (2).

(2) The Spread Risk Capital Factor specifies the reduction to be applied to the insurer's exposure to bonds and loans and is—

(a) for exposures with credit quality steps 0 to 6 is the sum of the following, determined for each credit quality step—

(i) the proportion of the insurer's exposure to bonds and loans for that credit quality step; multiplied by

(ii) the average duration of the exposure to bonds and loans of that credit quality step, weighted by the market value of the assets; multiplied by

(iii) the Spread Risk Credit Quality Step Factor for that credit quality step determined in Schedule 3;

plus

(b) for any unrated exposures—

(i) the proportion of the insurer's exposure to bonds and loans that are unrated; multiplied by

(ii) the lower of—

(A) the average duration of the exposure to bonds and loans which are unrated, weighted by the market value of the assets, multiplied by

(i) for Class 12 insurers 0.015; otherwise

(ii) 0.03;

and

(B) 1.

(3) Unless paragraph (1) applies, the capital requirement for spread risk for non-Class 12 insurers is—

(a) the capital requirement for spread risk on bonds and loans as determined in paragraph (4); plus

(b) the capital requirement for spread risk on securitisation positions as determined in paragraph (6); plus

(c) the capital requirement for spread risk on credit derivatives as determined in paragraph 36(9)(a).

(4) The capital requirement for spread risk on bonds and loans (including bank deposits that are not cash) is the reduction in basic own funds following an instantaneous permanent decrease in the value of the insurer's bonds and loans that are exposed to spread risk.

(5) The Spread Risk Capital Factor specifies the reduction to be applied to the insurer's exposure to bonds and loans and is determined as the sum of the following, determined for each credit quality step—

(a) for exposures in the form of bonds and loans in the Exposures to Approved Entities table in Schedule 5, the proportion of the insurer's exposure to bonds and loans issued by those entities;

plus

(b) for other exposures—

(i) the proportion of the insurer's exposure to bonds and loans to each credit quality step; multiplied by

(ii) the Spread Risk Credit Quality Step Factor for that credit quality step determined in Schedule 3.

(6) The capital requirement for spread risk on securitisation positions is the reduction in basic own funds following an instantaneous permanent decrease in the value of the insurer's securitisation positions that are exposed to spread risk.

(7) The Spread Risk Capital Factor specifies the reduction to be applied to the insurer's exposure to securitisation positions and is determined as—

(a) for exposures to Type 1 securitisation positions, Type 2 securitisation positions and resecuritisation positions, the sum of—

(i) the proportion of the insurer's exposure to the type of securitisation position for each credit quality step; multiplied by

(ii) the lower of —

(A) the Spread Risk Credit Quality Step Factor for that credit quality step in Schedule 3 multiplied by the modified duration of the securitisation position; and

(B) 1.

(8) In paragraph (7)(a) the modified duration must not be less than 1 year.

(9) The capital requirement for spread risk on credit derivatives, other than those included in paragraphs (12) and (13), is the largest capital requirement resulting from—

(a) the reduction in basic own funds following an instantaneous permanent increase in absolute terms of the credit spread of the instruments underlying the credit derivatives;

(b) the reduction in basic own funds following an instantaneous permanent decrease of the credit spread of the instruments underlying the credit derivatives.

(10) The Spread Risk Capital Factor specifies the increase to be applied to the insurer's exposure to credit derivatives in paragraph (9)(a) and is—

(a) the proportion of the insurer's exposure to the instruments underlying the credit derivatives; multiplied by

(b) the Spread Risk Credit Quality Step Factor for that credit quality step, determined in Schedule 3.

(11) The decrease to be applied to the insurer's exposure to credit derivatives in paragraph (9)(b) is 75%.

(12) The capital requirement for spread risk on credit derivatives which are part of an insurer's risk mitigation policy is nil, as long as the insurer holds either the instruments underlying the credit derivative or another exposure with respect to which the basis risk between that exposure and the instruments underlying the credit derivative is not material to the insurer in any circumstances.

(13) The capital requirement for spread risk on credit derivatives if the underlying financial instrument is a bond or a loan to any entity listed in the Exposures to Approved Entities table set out in Schedule 5, is nil.

37 Market concentration risk capital requirement

(1) The capital requirement in respect of market concentration risk is —

(a) the reduction in value of an insurer's basic own funds following an instantaneous permanent decrease value of the assets corresponding to the insurer's counterparty exposures; less

(b) a diversification adjustment as determined in Schedule 2.

(2) An insurer's counterparty exposures for determining the market concentration risk capital requirement is the higher of—

(a) the part of an insurer's exposure to a single counterparty, should that counterparty default on its obligations, that falls above the Exposure Threshold; and

(b) 0.

(3) The Exposure Threshold is as determined in Schedule 3.

(4) When determining an insurer's exposure above the Exposure Threshold, all assets held by the insurer considered in the equity, spread and property risk capital requirements should be included apart from—

(a) exposures to a counterparty which belongs to the same corporate group as the insurer, provided—

(i) the counterparty is subject to the same (or equivalent) risk evaluation, measurement and control procedures as the insurer;

(ii) the counterparty is established in the Island, the United Kingdom or the European Union; and

(iii) there is no current or foreseen material practical or legal impediment to the prompt transfer of eligible own-funds or repayment of liabilities from the counterparty to the insurer;

(b) deferred tax assets;

(c) intangible assets;

(d) exposures to counterparties on the Exposures to Approved Entities List in Section 5;

(e) exposures in the form of bank deposits that meet all of the following requirements—

(i) the exposure is covered by a government guarantee scheme in the Island or the European Union;

(ii) the guarantee covers the insurer without restriction; and

(iii) there is no double counting of that guarantee in the calculation of the insurer's SCR; and

(f) assets included in the counterparty default risk capital requirement.

(5) In this regulation the following are classed as an exposure to a single counterparty—

(a) exposures to counterparties belonging to the same corporate group; and

(b) exposures to immovable property that are located in the same building.

(6) The Market Concentration Risk Capital Factor specifies the reduction to be applied to the insurer's counterparty exposures, and is the sum of the following, determined for each credit quality step—

(a) the proportion of the insurer's exposure to counterparties of that credit quality step; multiplied by

(b) the Market Concentration Risk Credit Quality Step Factor for that credit quality step determined in Schedule 3.

38 Counterparty default risk capital requirement

(1) The capital requirement in respect of counterparty default risk is—

(a) the capital requirement for an insurer's type 1 exposures; plus

(b) the capital requirement for an insurer's type 2 exposures; less

(c) a diversification adjustment as determined in Schedule 2.

(2) In this regulation the following exposures are classed as an exposure to a single counterparty—

(a) counterparties belonging to the same corporate group; and

(b) immovable property that is located in the same building.

(3) An insurer's Type 1 exposures cover default risk other than on receivables. The following types of exposures are classed as Type 1—

(a) risk mitigation arrangements such as reinsurance arrangements (including stop loss arrangements), special purpose vehicles and insurance securitisations;

(b) derivatives, other than credit derivatives covered in the spread risk submodule;

(c) uncollateralised loans made by the insurer to a company which is a member of the same corporate group as the insurer;

(d) cash at bank;

(e) commitments received by the insurer that have been called up but are unpaid including—

(i) called up but unpaid ordinary share capital and preference shares;

(ii) called up but unpaid legally binding commitments to subscribe and pay for subordinated liabilities;

(iii) called up but unpaid initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type insurers;

(iv) called up but unpaid guarantees;

(v) called up but unpaid letters of credit; and

(vi) called up but unpaid claims that mutual or mutual-type associations may have against their members by way of a call for supplementary contributions; and

(f) legally binding commitments that the insurer has provided or arranged and that may create payment obligations depending on the credit standing or default on a counterparty including guarantees, letters of credit, letters of comfort that the insurer has provided.

(4) An insurer’s Type 2 exposures cover default risk on receivables. The following types of exposures are classed as Type 2—

(a) receivables from intermediaries;

(b) policyholder debtors; and

(c) mortgage loans.

(5) The loss-given default of an exposure is—

(a) for exposures not listed in sub-paragraphs (b) to (d) below, the sum across all counterparties of the higher of—

(i) 0; and

(ii) the best estimate of the amounts recoverable from a counterparty;

plus

(A) an estimate of the impact of the risk mitigation arrangement on the underwriting risk and market risk capital requirements; multiplied by

(B) a Risk Mitigation Factor;

multiplied by

(iii) (1 - a Recovery Rate);

less

(iv) the best estimate of the amount that can be offset in the event of default of that counterparty; multiplied by

(v) an Economic Adjustment Factor;

plus

(b) where the exposure is one of the following, the best estimate of that exposure—

(i) uncollateralised loan to an entity within the same corporate group as the insurer;

(ii) cash at bank;

(iii) a deposit with a ceding insurer;

(iv) commitments received by the insurer that have been called up but are unpaid; and

(v) receivables from an intermediary or policyholder debtor;

plus

(c) for legally binding commitments—

(i) the commitment's nominal value; less

(ii) the commitment's value in the insurer's regulatory balance sheet;

plus

(d) for mortgage loans —

(i) the best estimate of the loan; less

(ii) the risk adjusted value of the mortgage determined in paragraph (16) multiplied by 0.8.

(6) The Recovery Rates, Economic Adjustment Factors and Risk Mitigation Factors are as determined in Schedule 3.

(7) The estimate of the impact of the risk mitigation arrangement in paragraph (5)(a)(ii)(A) is—

(a) the hypothetical capital requirement that would apply if the risk mitigation arrangement did not exist; less

(b) the capital requirement determined using these regulations.

(8) The minimum loss-given default for an exposure is nil.

(9) Where an insurer has an exposure for which the underlying risk is subject to a pooling arrangement, the insurer must contact the Authority who will provide a method to determine the loss-given-default.

(10) The amount offset in the event of default in paragraph (5)(a)(iv), is the best estimate of the liabilities that the insurer can offset in the case of default of that counterparty to the extent that they can be offset or recovered in the event of default, such as—

(a) the risk adjusted value of collateral posted against that counterparty;

(b) the risk adjusted value of a mortgage loan; or

(c) the recoverable due from a counterparty where the insurer is not contractually obliged to meet an obligation in the event of a default.

(11) To be able to offset, a written legal right of offset must be in place and no offsetting is allowed if the liabilities are expected to be met before the exposure is cleared.

(12) Where the type 1 exposure is a loan to an insurer's parent, and the insurer has a legally effective contractual arrangement in place which enables it to reduce the loan balance outstanding by an amount required to settle claims under the policy in the event of default of the loan repayment, the insurer can offset outstanding claim amounts against the loss-given-default of the Type 1 exposure.

(13) The risk-adjusted value of collateral in paragraph (9) is —

(a) if the insurer has the unilateral right to liquidate or retain, in a timely manner, the collateral in the event of a default of the counterparty or other third party holding the collateral on behalf of the counterparty—

(i) the best estimate of the assets held as collateral; less

(ii) an estimate of the impact of the collateral on the market risk capital requirements, determined using the approach in paragraph (7);

(b) if the insurer has the unilateral right to liquidate or retain the collateral in the event of a default of the counterparty but does not have the right to liquidate or retain the collateral in the event of a default of the third party holding the collateral on behalf of the counterparty, the risk-adjusted value of a collateral determined in paragraph (a) multiplied by 0.9; otherwise

(c) 0.

(14) On approval from the Authority and where the requirements of paragraph (13)(a) are met, the insurer may estimate the risk adjusted value of its collateral as the market value of the collateral multiplied by 0.85.

(15) On approval from the Authority and where the requirements of paragraph (13)(b) are met, the insurer may estimate the risk adjusted value of its collateral as the market value of the collateral multiplied by 0.75.

(16) The risk-adjusted value of mortgage in sub-paragraph (5)(d)(ii) is—

(a) the value of the mortgage loan; less

(b) an estimate of the impact of the mortgage on the market risk capital requirements, determined using the approach in paragraph (7).

(17) The capital requirement for counterparty default risk on type 1 exposures is the reduction in basic own funds following an instantaneous permanent decrease in the value of the insurer's type 1 exposures.

(18) The capital requirement for counterparty default risk on type 1 exposures is the sum over all counterparties of—

(a) the standard deviation of the insurer's loss given default of its type 1 exposures; multiplied by

(b) the Type 1 Exposure Capital Factor as determined in Schedule 3.

(19) The standard deviation of the insurer's loss given default is—

(a) the sum over all combinations of probabilities of default of —

(i) the Probability of Default Factor A for a particular combination; multiplied by

(ii) the loss given default assigned to one probability of default; multiplied by

(iii) the loss given default assigned to the other probability of default;

plus

(b) the sum over all probabilities of default of—

(i) the Probability of Default Factor B; multiplied by

(ii) the square of the loss given default assigned to that probability of default.

(20) The capital requirement for counterparty default risk on type 2 exposures is the reduction in basic own funds following an instantaneous permanent decrease in the value of the insurer's type 2 exposures.

(21) The capital requirement for counterparty default risk on type 2 exposures is—

(a) the insurer's loss-given-default for receivables from intermediaries that have been due for more than 3 months; multiplied by

(i) for Class 12 insurers: 0.45; otherwise

(ii) 0.9;

plus

(b) the total loss-given-default from all other type 2 exposures; multiplied by

(i) for Class 12 insurers: 0.075;

(ii) otherwise: 0.15.

39 Underwriting risk capital requirement

(1) The capital requirement for underwriting risk is the lower of—

(a) the capital requirement for premium and reserve risk; plus

(b) the capital requirement for lapse risk; plus

(c) the capital requirement for catastrophe risk for non-Class 12 insurers; less

(d) a diversification adjustment as determined in Schedule 2;

and

(e) the insurer's retention limit on an aggregate stop loss risk mitigation arrangement; less

(f) any settled claims.

(2) In sub-paragraph (1)(e), the stop loss risk mitigation arrangement must meet the requirements of regulation 48(4) in order for it to be taken into account.

40 Premium and Reserve risk capital requirement

(1) The capital requirement for premium and reserve risk is—

(a) the standard deviation; multiplied by

(b) the volume measure; multiplied by

(c) the Premium and Reserve Factor as determined in Schedule 3.

(2) An insurer must allocate its business to the segments in the Premium and Reserve Risk Segment table in Schedule 3.

(3) The volume measure is the sum over all applicable segments, of the combined volume measure for each segment.

(4) The combined volume measure for a segment is—

(a) the premium volume measure for that segment as determined in paragraph (5); plus

(b) the reserve volume measure for that segment as determined in paragraph (8);

multiplied by

(c) a geographical diversification adjustment as determined in Schedule 3.

(5) Unless the requirements of paragraph (6) are met, the premium volume measure for a particular segment is—

(a) the higher of—

(i) the expected present value of premiums to be earned by an insurer in the 12 months after the valuation date; and

(ii) the premiums earned by an insurer in the 12 months before the valuation date;

plus

(b) for existing contracts, the expected present value of premiums to be earned by an insurer, after the 12 months following the valuation date;

plus

(c) for contracts where the initial recognition date falls in the 12 months after the valuation date—

(i) for contracts whose initial term is one year or less, the expected present value of premiums to be earned by the insurer, excluding the premiums to be earned during the 12 months after the initial recognition date;

(ii) for contracts whose initial term is more than one year, 30% of the expected present value of premiums to be earned by an insurer, after the 12 months following the valuation date.

(6) The premiums in paragraph (5) must be net, after deduction of premiums for reinsurance contracts that meet the requirements of regulation 47, and commission.

(7) Where the management of the insurer has established effective control mechanisms to ensure that its earned premiums for each segment during the 12 months after the valuation date will not exceed those in paragraph (5)(a)(i), the insurer may calculate the premium volume measure assuming the premium amount in paragraph (5)(a)(ii) is nil.

(8) The reserve volume measure for a particular segment is the best estimate of outstanding claim amounts, net of the amount recoverable from risk mitigation contracts that meet the requirements of regulation 47.

(9) The standard deviation in paragraph (1)(a) is—

(a) the result of the aggregation formula in Schedule 2, applied to the combined volume measure and the combined standard deviation, for each applicable segment;

divided by

(b) the volume measure determined in paragraph (3).

(10) The combined standard deviation for a segment is—

(a) the result of the aggregation formula in Schedule 2, applied to the premium volume measure, reserve volume measure, premium standard deviation and reserve standard deviation for that segment;

divided by

(i) the premium volume measure for that segment; plus

(ii) the reserve volume measure for that segment.

(11) The premium standard deviation is —

(a) the Premium Risk Standard Deviation Factor determined in Schedule 3; less

(b) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to.

(12) The reserve standard deviation is—

(a) the Reserve Risk Standard Deviation Factor determined in Schedule 3; less

(b) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to, where the claims reserves for that segment meet, or almost meet, the cap.

41 Lapse risk capital requirement

(1) The capital requirement for lapse risk is the reduction in value of an insurers basic own funds following an instantaneous permanent decrease in the profit anticipated from future insurance contracts.

(2) The Lapse Capital Requirement Factor determines the decrease to be applied and is—

(a) for Class 12 insurers: 20%;

(b) otherwise: 40%.

(3) When determining the capital requirement, an insurer’s contracts can be grouped, as long as within each grouping, profitable contracts are not offset by unprofitable ones.

42 Catastrophe risk capital requirement

(1) For Class 12 insurers the catastrophe risk capital requirement is nil.

(2) Otherwise, the catastrophe risk capital requirement is—

(a) the capital requirement for natural catastrophe risk; plus

(b) the capital requirement for non-proportional property reinsurance risk; plus

(c) the capital requirement for man-made catastrophe risk; plus

(d) the capital requirement for other non-life catastrophe risk, less

(e) a diversification adjustment determined in Schedule 2.

Natural catastrophe risk

(3) The capital requirement for natural catastrophe risk is—

(a) the capital requirement for windstorm risk; plus

(b) the capital requirement for earthquake risk; plus

(c) the capital requirement for flood risk; plus

(d) the capital requirement for hail risk; plus

(e) the capital requirement for subsidence risk; less

(f) a diversification adjustment determined in Schedule 2.

(4) The capital requirement for windstorm risk applies to—

(a) insurance obligations of lines of business 3 or 15 as set out in Schedule 7 that cover onshore property damage by windstorm; and

(b) insurance obligations of lines of business 4 or 16 that cover windstorm risk.

(5) The capital requirement for windstorm risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) 1.75; multiplied by

(b) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (4); multiplied by

(c) a geographical diversification factor determined in Schedule 3; less

(d) an adjustment to reduce the loss to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(e) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(6) The capital requirement for earthquake risk applies to—

(a) insurance obligations of lines of business 3 or 15 that cover onshore property damage by earthquake; and

(b) insurance obligations of lines of business 4 or 16 that cover earthquake risk.

(7) The capital requirement for earthquake risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date on the contracts in paragraph (6); multiplied by

(b) 1.2; multiplied by

(c) a geographical diversification factor determined in Schedule 3; less

(d) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(e) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(8) The capital requirement for flood risk applies to—

(a) insurance obligations of lines of business 2 or 14 that cover flood risk;

(b) insurance obligations of lines of business 3 or 15 that cover onshore property damage by flood; and

(c) insurance obligations of lines of business 4 or 16 that cover flood risk.

(9) The capital requirement for flood risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (8) multiplied by 1.1; multiplied by

(b) a geographical diversification factor determined in paragraph 8(7) of Schedule 3,; less

(c) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(d) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(10) The capital requirement for hail risk applies to—

(a) insurance obligations of lines of business 2 or 14 that cover hail risk;

(b) insurance obligations of lines of business 3 or 15 that cover onshore property damage by hail; and

(c) insurance obligations of lines of business 4 or 16 that cover hail risk.

(11) The capital requirement for hail risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) 0.3; multiplied by

(b) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (10); multiplied by

(c) a geographical diversification factor determined in paragraph 8(7) of Schedule 3,; less

(d) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(e) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(12) The capital requirement for subsidence risk applies to obligations of lines of business 4 or 16 that cover subsidence risk of residential buildings.

(13) The capital requirement for subsidence risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the gross sum insured by the insurer, on the contracts in paragraph (12) multiplied by 0.0005; less

(b) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(c) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

Non-proportional property reinsurance risk

(14) The capital requirement for non-proportional property reinsurance risk applies to non-proportional property reinsurance obligations (line of business 27), other than non-proportional reinsurance obligations relating to insurance obligations included in lines of business 6 and 18.

(15) The capital requirement for non-proportional property reinsurance risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) 2.5; multiplied by

(b) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (14); multiplied by

(c) a geographical diversification factor determined in Schedule 3; less

(d) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(e) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

Man-made catastrophe risk

(16) The capital requirement for man-made catastrophe risk is—

(a) the capital requirement for motor risk; plus

(b) the capital requirement for fire risk; plus

(c) the capital requirement for marine risk; plus

(d) the capital requirement for aviation risk; plus

(e) the capital requirement for liability risk;

(f) a capital requirement for credit and suretyship risk; less

(g) a diversification adjustment determined in Schedule 2.

(17) The capital requirement for motor vehicle liability risk applies to obligations of lines of business 1 and 13 that cover motor vehicle liability risk.

(18) The capital requirement for motor vehicle liability risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss must be determined gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles and is—

(a) 50,000; multiplied by

(b) The higher of —

(i) 120; and

(ii) the square root of—

(A) the number of vehicles insured with a deemed policy limit above £20 million;

plus

(B) 0.05; multiplied by

(C) the number of vehicles insured with a deemed policy limit of £20 million or below;

plus

(D) 0.95; multiplied by

(E) The lower of—

(i) 20,000; and

(ii) the number of vehicles insured with a deemed policy limit of £20 million or below.

less

(c) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(d) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(19) The number of motor vehicles covered by proportional reinsurance obligations must be weighted by the insurer's proportional share of the obligations.

(20) The deemed policy limit is the overall limit of the motor vehicle liability insurance policy or, where no such overall limit is specified in the terms and conditions of the policy, the sum of the limits for damage to property and for personal injury. Where the policy limit is specified as a maximum per victim, the deemed policy limit shall be based on the assumption of ten victims.

(21) The capital requirement for marine risk is—

(a) the capital requirement for marine vessel collision risk; plus

(b) the capital requirement for marine platform explosion risk; less

(c) a diversification adjustment determined in Schedule 2.

(22) Marine vessel includes any sea worthy vessel (such as tankers, bulkers, container ships, roll on roll offs, cruise ships, and fishing vessels) where the maximum hull value insured is more than £250,000.

(23) The capital requirement for marine vessel collision risk applies to insurance obligations of lines of business 3, 15 or 26 that cover vessel collision.

(24) The capital requirement for marine vessel collision risk is the reduction in value of an insurer's basic own funds following an instantaneous

permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the maximum across all insured vessels of—

(i) the gross sum insured for marine hull insurance in relation to a vessel; plus

(ii) the gross sum insured for marine liability insurance in relation to that vessel; plus

(iii) the gross sum insured for oil pollution insurance in relation to that vessel;

less

(b) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(c) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(25) The capital requirement for platform explosion risk applies to insurance obligations of lines of business 3, 15 or 26 that cover platform explosions.

(26) The capital requirement for platform explosion risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the maximum across all insured offshore platforms of—

(i) the gross sum insured of obligations to compensate for property damage to a platform; plus

(ii) the gross sum insured of obligations to compensate for expenses for the removal of wreckage from a platform; plus

(iii) the gross sum insured of obligations to compensate for loss of production income from a platform; plus

(iv) the gross sum insured of obligations to compensate for expenses of capping the well or making the well secure, on a platform; plus

(v) the gross sum insured of liability and reinsurance obligations, for a platform; less

(b) an adjustment to reduce the loss to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(c) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(27) The capital requirement for aviation risk applies to insurance obligations of lines of business 3, 15 and 26 that relate to aviation hull and aviation liability risk.

(28) The capital requirement for aviation risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the maximum across all insured aircrafts of—

(i) the gross sum insured for aviation hull insurance in relation to an aircraft; plus

(ii) the gross sum insured for aviation liability insurance in relation to an aircraft;

less

(b) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(c) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(29) The capital requirement for fire risk applies to insurance obligations of lines of business 4 and 16 that cover damage to a building due to fire or explosion, including as a result of terrorist attacks.

(30) The capital requirement for fire risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the maximum, across all fire concentration risks, of the gross sum insured for damage to a building due to fire or explosion; less

(b) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(c) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(31) A fire concentration risk relates to a set of buildings where all buildings are partly or fully located within a radius of 200 meters.

(32) The capital requirement for liability risk applies to insurance obligations that fall within the liability risk groups in Schedule 3.

(33) The capital requirement for liability risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the sum of the following for each liability group—

(i) the estimate of the gross premiums to be earned by the insurer during the 12 months after the valuation date in relation to obligations of a particular liability group; multiplied by

(ii) the liability risk factor for that liability group as determined in Schedule 3;

less

(iii) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(iv) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer;

less

(b) a diversification adjustment determined in Schedule 2.

(34) The capital requirement for credit and suretyship risk applies to insurance obligations of lines of business 6 and 18 that cover default risk.

(35) The capital requirement for credit and suretyship risk is—

(a) the capital requirement for risk of a large credit default; plus

(b) the capital requirement for recession risk; less

(c) a diversification adjustment determined in Schedule 2.

(36) The capital requirement for the risk of a large credit default is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract resulting from the default of the two largest exposures under the contract. The amount of the loss is—

(a) the largest loss given default of each credit insurance exposure, assuming that the loss given default is 10% of the gross sum insured; plus

(b) the second largest loss given default of each credit insurance exposure, assuming that the loss given default is 10% of the gross sum insured; less

(c) an adjustment to reduce the loss to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(d) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(37) The determination of the two largest exposures of the insurer must be based on a comparison of the net loss given default of the credit insurance exposures.

(38) The capital requirement for recession risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the best estimate of the gross premiums to be earned by the insurer during the 12 months after the valuation date; less

(b) an adjustment to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(c) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

Other non-life catastrophe risk

(39) The capital requirement for other non-life catastrophe risk applies to insurance obligations that fall within the other non-life catastrophe risk groups as determined in Schedule 3.

(40) The capital requirement for other non-life catastrophe risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the sum of the following for each other non-life catastrophe risk group—

(i) the estimate of the gross premiums to be earned by the insurer during the 12 months after the valuation date in relation to insurance obligations of a particular other non-life catastrophe risk group; multiplied by

(ii) the other non-life catastrophe risk factor for that other non-life catastrophe risk group as determined in Schedule 3;

less

(iii) an adjustment to reduce the loss to reflect contracts that place a cap on the level of risk that the insurer is exposed to; less

(iv) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer;

less

(b) a diversification adjustment determined in Schedule 2.

43 NSLT Health risk capital requirement

(1) The capital requirement for NSLT health risk is the lower of—

(a) the capital requirement for NSLT health premium and reserve risk; plus

(b) the capital requirement for NSLT health lapse risk; plus

(c) the capital requirement for NSLT health catastrophe risk (not applicable for Class 12 insurers); less

(d) a diversification adjustment as determined in Schedule 2.

and

(i) the insurer's retention limit on an aggregate stop loss risk mitigation arrangement; less

(ii) any settled claims.

(2) In paragraph (1)(d)(i), a stop loss risk mitigation arrangement must meet the requirements of regulation 48(4) in order for it to be taken into account.

44 NSLT Health premium and reserve risk capital requirement

(1) The capital requirement for NSLT Health premium and reserve risk is—

(a) the standard deviation; multiplied by

(b) the volume measure; multiplied by

(c) the NSLT Health Premium and Reserve Factor as determined in Schedule 3.

(2) An insurer must allocate its business to the segments in the NSLT Health Premium and Reserve Risk Segment table in Schedule 3.

(3) The volume measure is the sum over all segments of the combined volume measure for each segment.

(4) The combined volume measure for a particular segment is—

(a) the premium volume measure for that segment determined in paragraph (5); plus

(b) the reserve volume measure for that segment determined in paragraph (8);

multiplied by

(c) a geographical diversification adjustment determined in Schedule 3.

(5) Unless the requirements of paragraph 44(6) are met, the premium volume measure for a particular segment is—

(a) the higher of—

(i) the expected present value of premiums to be earned by an insurer in the 12 months after the valuation date; and

(ii) the premiums earned by an insurer in the 12 months before the valuation date;

plus

(b) for existing contracts, the expected present value of premiums to be earned by an insurer, after the 12 months following the valuation date;

plus

(c) for contracts where the initial recognition date falls in the 12 months after the valuation date—

(i) for contracts whose initial term is one year or less, the expected present value of premiums to be earned by an insurer, excluding the premiums to be earned during the 12 months after the initial recognition date;

(ii) for contracts whose initial term is more than one year, 30% of the expected present value of premiums to be earned by an insurer, after the 12 months following the valuation date.

(6) Where the management of the insurer has established effective control mechanisms to ensure that its earned premiums for each segment during the 12 months after the valuation date will not exceed those in paragraph sub-paragraph 5(a)(i), the insurer may calculate the premium volume measure assuming the premium amount in paragraph 5(a)(ii) is nil.

(7) Premiums must be net, after deduction of premiums for reinsurance contracts that meet the requirements of regulation 47, and commission.

(8) The reserve volume measure for a particular segment is the best estimate of claim amounts outstanding in respect of that segment.

(9) Claim amounts must be net of the amount recoverable risk mitigation arrangements that meet the requirements of regulation 47.

(10) The standard deviation in sub-paragraph (1)(a) is—

(a) the result of the aggregation formula in Schedule 2, applied to the combined volume measure and the combined standard deviation, for all segments applicable to the insurer;

divided by

(b) the volume measure determined in paragraph (3).

(11) The combined standard deviation for a segment is—

(a) the result of the aggregation formula in Schedule 2, applied to the premium volume measure, reserve volume measure, premium standard deviation and reserve standard deviation for that segment;

divided by

(i) the premium volume measure for that segment; plus

(ii) the reserve volume measure for that segment.

(12) The premium standard deviation is—

(a) the Health Premium Risk Standard Deviation Factor in Schedule 3; less

(b) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to.

(13) The reserve standard deviation is—

(a) the Health Reserve Risk Standard Deviation Factor in Schedule 3; less

(b) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to, where the claims reserves for that segment meet, or almost meet, the cap.

45 NSLT Health Lapse risk capital requirement

(1) The capital requirement for NSLT health lapse risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent decrease in the profit anticipated from future insurance contracts.

(2) The NSLT Health Lapse Capital Requirement Factor determines the decrease to be applied and is—

(a) for Class 12 insurers: 20%;

(b) otherwise: 40%.

(3) When determining the capital requirement, an insurer's contracts can be grouped, as long as within each grouping profitable contracts are not offset by unprofitable ones.

46 NSLT Health catastrophe risk capital requirement

(1) For Class 12 insurers, the NSLT health catastrophe risk capital requirement is nil.

(2) Otherwise, the NSLT health catastrophe risk capital requirement is—

(a) the capital requirement for mass accident risk; plus

(b) the capital requirement for accident concentration risk; plus

(c) the capital requirement for pandemic risk; less

(d) a diversification adjustment determined in Schedule 2.

(3) The capital requirement for mass accident risk applies to health insurance obligations other than workers' compensation insurance and reinsurance obligations.

(4) The capital requirement for mass accident risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the sum of the following for each country in which the insurer has insurance obligations—

(i) the Country Ratio Factor as determined in Schedule 3; multiplied by

(ii) the sum over all event types of—

(A) the Event Type Ratio Factor as determined in Schedule 3; multiplied by

(B) the total sum insured for that event type in that country;

less

(iii) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to; less

(iv) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer;

less

(b) a diversification adjustment determined in Schedule 2.

(5) The capital requirement for accident concentration risk applies to workers' compensation insurance obligations and to group income protection insurance obligations.

(6) The capital requirement for accident concentration risk is the reduction in value of an insurer's basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) the sum of the following for each country in which the insurer has insurance obligations—

(i) the sum over all event types of—

(A) the Event Type Ratio Factor as determined in Schedule 3; multiplied by

(B) the total sum insured for that event type for the largest accident risk concentration in each country.

less

(ii) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to; less

(iii) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer;

less

(b) a diversification adjustment determined in Schedule 2.

(7) The largest accident risk concentration in a country is the largest number of persons for which all of the following conditions are met:

(a) the insurer has a workers' compensation insurance obligation or a group income protection insurance obligation in relation to each of the persons;

(b) the obligations in relation to each of the persons cover at least one of the relevant event types; and

(c) the persons are working in the same building.

(8) When determining the sum insured in sub-paragraphs (4)(a)(ii)(B) and (6)(a)(i)(B)—

(a) where the insurance contract provides for recurring benefit payments the sum insured must be the best estimate of the benefit payments in case of event type;

(b) where the benefits of an insurance contract depend on the nature or extent of any injury resulting from that event type, the sum insured must be based on the maximum benefits obtainable under the contract which are consistent with the event; and

(c) for medical expense insurance obligations, the sum insured must be based on an estimate of the average amounts paid in case of an event type, assuming the insured person is disabled for the duration specified and taking into account the specific guarantees the obligations include.

(9) The capital requirement for pandemic risk applies to health insurance obligations, other than workers’ compensation insurance obligations.

(10) The capital requirement for pandemic risk is the reduction in value of an insurers basic own funds following an instantaneous permanent loss in relation to the insurance contract. The amount of the loss is—

(a) 0.000075; multiplied by

(b) the total sum insured payable across all insured lives, in the event they suffer a permanent work disability caused by an infectious disease;

less

(c) an adjustment to reflect contracts within the segment that place a cap on the level of risk that the insurer is exposed to; less

(d) an adjustment to reduce the loss to reflect any applicable risk mitigating techniques employed by the insurer.

(11) Where the insurance contract provides for recurring benefit payments the sum insured must be the best estimate of the benefit payments assuming that the insured person is permanently disabled and will not recover.

47 Qualitative criteria for risk mitigation techniques

(1) An insurer must only allow for a risk mitigation technique when determining its capital requirements, if that technique meets the following qualitative criteria—

(a) the technique must provide for effective risk transfer to a party other than the insurer. To this effect the contractual arrangement must—

(i) ensure that the extent of the cover provided by the risk mitigation technique and the transfer of the insurer's risk are clearly defined and incontrovertible; and

(ii) not result in material basis risk or in the creation of other risks, unless this is adequately reflected in the calculation of an insurer's capital requirements;

(b) the contractual arrangement of the risk mitigation technique is legally effective and enforceable in all relevant jurisdictions;

(c) the insurer has taken all appropriate steps to ensure the effectiveness of the risk mitigation technique and its adequacy and appropriateness to address the risks related to that risk mitigation technique;

(d) the insurer is able to monitor the effectiveness of the risk mitigation technique and the related risks on an ongoing basis;

(e) the insurer has, in the event of a default, insolvency or bankruptcy of the counterparty, a direct claim on that counterparty;

(f) there is no double counting of risk mitigation effects in the insurer's eligible own-funds and in the calculation of its SCR;

(g) where the insurer uses insurance risk mitigation, the requirements of regulation 48 are met; and

(h) where the insurer uses financial risk mitigation, the requirements of regulations 49, 50 and 51 are met.

(2) Unless paragraph 47(3) is met, the risk mitigation effect of the risk mitigation technique must remain in force for at least 12 months following the valuation date.

(3) If the risk mitigation technique is in force for a period shorter than 12 months, but an insurer intends to replace it at the time of its expiry with a similar arrangement, the risk mitigation technique may be fully taken into account provided—

(a) the insurer has a written and in force policy on the replacement or adjustment of that risk mitigation technique;

(b) the replacement of the risk mitigation technique must not take place more often than every 3 months;

(c) the replacement of the risk mitigation technique is not conditional on any future event that is outside of the control of the insurer;

(d) if the replacement of the risk mitigation technique is conditional on any future event that is within the control of the insurer, then the conditions must be clearly documented in the written procedure referred to in sub-paragraph (a);

(e) the replacement of the risk mitigation technique is realistic and consistent with the insurer's current business practice and business strategy;

(f) the risk that the risk mitigation technique cannot be replaced due to an absence of liquidity in the market is not material;

(g) the risk that the cost of replacing the risk mitigation technique increases during the 12 months following the valuation date is reflected in the capital requirements;

(h) the replacement of the risk mitigation technique would not be contrary to requirements that apply to future management actions;

(i) the initial contractual maturity is not shorter than one month in cases where the insurer transfers risks through the purchase or issuance of financial instruments; and

(j) the initial contractual maturity is not shorter than three months where the insurer transfers underwriting risks using reinsurance contracts or special purpose vehicles, unless otherwise agreed with the Authority,

otherwise, the technique may only be taken into account in proportion to the period that the risk mitigation technique is in force.

48 Insurance Risk Mitigation

(1) The counterparty to the reinsurance contract must be either—

(a) an insurer who meets its SCR under these Regulations or an equivalent approach in the jurisdiction of an approved supervisor; or

(b) an insurer, who doesn't comply with sub-paragraph (a), but has been assigned to credit quality step 3 or better.

(2) If a counterparty to a reinsurance contract is an insurer that fails to meet its capital requirements, after the reinsurance contract has been entered into, the protection offered by the risk mitigation technique may still be partially recognised by an insurer, provided that the insurer can demonstrate to its board of directors—

(a) that the counterparty has submitted a realistic recovery plan to its supervisory authorities; and

(b) the counterparty can restore compliance within the timeframe defined in the relevant regulations of its supervisory authority.

(3) If paragraph (2) applies, the effect of the risk mitigation technique must be reduced by the percentage by which the counterparty's eligible own-funds falls below its capital requirements.

(4) For an aggregate stop loss arrangement to be considered a recognisable risk mitigation arrangement, the contract must provide for complete compensation for aggregated losses of the insurer that relate to claims during a specified time period and that are larger than a specified retention level.

49 Financial risk mitigation

(1) An insurer must be able to value the relevant assets and liabilities that are subject to the risk mitigation technique and, if the risk mitigation technique includes the use of financial instruments, the financial instruments, reliably, using regulation 14.

(2) If the risk mitigation technique includes the use of financial instruments, the financial instrument must have a credit quality step of 3 or better.

(3) If the risk mitigation technique is not a financial instrument, the counterparties to the risk mitigation technique must have a credit quality step of 3 or better.

50 Additional requirements for collateral arrangements

(1) In this regulation "collateral arrangement" is an arrangement under which collateral providers, for the purposes of securing or otherwise covering the performance of a relevant obligation, do one of the following—

(a) transfer full ownership of the collateral to the collateral taker; or

(b) provide collateral by way of security in favour of, or to, a collateral taker, and the legal ownership of the collateral remains with the collateral provider or a custodian when the security right is established.

(2) Collateral arrangements can only be recognised as a risk mitigation technique if—

(a) the insurer has the right to liquidate or retain, in a timely manner, the collateral in the event of a default, insolvency or bankruptcy or other credit event of the counterparty;

(b) there is sufficient certainty as to the protection achieved by the collateral because either—

(i) the collateral is of sufficient credit quality, sufficient liquidity and is sufficiently stable in value; or

(ii) the collateral is guaranteed by a counterparty, other than a counterparty referred to in regulation 37(4)(a) and 37(4)(e) that has been assigned a risk factor for concentration risk of 0%;

(c) there is no material positive correlation between the credit quality of the counterparty to collateral arrangement and the value of the collateral; and

(d) the collateral offered under the arrangement is not securities issued by the insurer's counterparty or a participation of that counterparty.

(3) If a collateral arrangement of an insurer involves collateral being held by a custodian or other third party, the insurer must ensure that all of the following criteria are met—

(a) the relevant custodian or other third party segregates the assets held as collateral from its own assets;

(b) the segregated assets are held by a deposit-taking institution that has a credit quality step of 3 or better;

(c) the segregated assets are individually identifiable and can only be changed or substituted with the consent of the insurer or a person acting as a trustee in relation to the insurer's interest in those assets;

(d) the insurer has the right to liquidate or retain, in a timely manner, the segregated assets in the event of a default, insolvency or bankruptcy or other credit event relating to the custodian or other third party holding the collateral on behalf of the relevant counterparty; and

(e) the segregated assets must not be used to pay, or to provide collateral in favour of, a person other than the insurer or as directed by the insurer.

51 Additional requirements for guarantees

(1) An insurer can only recognise a guarantee as a risk mitigation technique if —

(a) the credit protection provided by the guarantee is direct from the counterparty providing the protection (the "guarantor") to the insurer;

(b) the extent of the credit protection offered under the guarantee is clearly defined and incontrovertible;

(c) the guarantee does not contain any clause where the fulfilment of which is outside the direct control of the insurer, that—

(i) would allow the guarantor to cancel the protection unilaterally;

(ii) would increase the effective cost of protection as a result of a deterioration in the credit quality of the protected exposure;

(iii) could prevent the guarantor from being obliged to pay out in a timely manner in the event that the counterparty of the exposure covered by the guarantee ("the original obligor"), defaults on its obligations due; and

(iv) could allow the guarantor to reduce the duration of the guarantee.

(d) on the default, insolvency or bankruptcy, or other credit event of the original obligor, the insurer has the right to pursue, in a timely manner, the guarantor for any monies due under the claim that is covered by the guarantee and the payment by the guarantor must not be subject to the insurer first having to pursue the original obligor;

(e) the guarantee is an explicitly documented obligation assumed by the guarantor; and

(f) the guarantee fully covers all types of regular payments the original obligor is expected to make in respect of the claim.

PART 4: MINIMUM CAPITAL REQUIREMENT

52 Minimum capital requirement

(1) An insurer must hold, at all times, eligible basic own-funds of an amount that is equal to or greater than its MCR, determined in this regulation.

(2) Except for PCCs, an insurer's MCR is—

(a) for Class 12 insurers, the higher of—

(i) the insurer's SCR determined in Part 3 of these Regulations multiplied by 0.75;

and

(ii) £100,000

(b) otherwise, the higher of—

(i) the insurer's SCR determined in Part 3 of these Regulations multiplied by 0.35;

and

(ii) £500,000

(3) For PCCs —

(a) the MCR is the higher of—

(i) the sum of the notional MCR of each cell and of the core;

and

(A) where the PCC contains only class 12 cells: £100,000; otherwise

(B) £500,000.

(b) the notional MCR of each cell and of the core of a PCC must be calculated in accordance with this Part, as if the cell or core was a stand-alone insurer;

(c) for clarity, the minimum MCR amounts do not apply at individual cell or core level.

PART 5: OWN FUNDS

53 Eligible capital resources

(1) An insurer's capital resources, or "own-funds" are the excess of its assets over its liabilities, as valued in Regulation 14.

(2) An insurer's own-funds consists of—

(a) its basic own-funds determined in regulation 57; plus

(b) its ancillary own-funds determined in regulation 58 and approved by the Authority in regulation 60.

(3) The total own-funds of a PCC is the sum of the notional own-funds of each cell and of the core.

54 Eligibility

An own-fund item is 'ineligible' unless it meets the following, and is therefore 'eligible'—

(a) the item must be permanently available, or can be called up on demand, to fully meet the insurance obligations of the insurer on a going concern basis, as well as in the case of winding-up;

(b) in the case of winding-up, the total amount of the item is available to meet the insurance obligations of the insurer and the repayment of the item is refused to its holder until all other obligations of the insurer, including its insurance obligations towards policyholders, have been met;

(c) the item must be of sufficient duration, when compared to the duration of the relevant insurance obligations of the insurer. In particular, the average duration of an insurer's own-funds must not be significantly less than the average duration of the insurer's liabilities; and

(d) the item must be absent of—

(i) requirements or incentives to redeem its nominal sum;

(ii) mandatory fixed charges payable by the insurer;

(iii) encumbrances; or

(iv) any other factor that might prejudice, or appear to prejudice, the own-fund item's permanent availability, subordination or sufficiency of duration.

55 Use of eligible own-funds to meet capital requirements

(1) An insurer must determine the quality of its eligible own funds using Schedule 10, with Tier 1 being the highest quality and Tiers 2 and 3 reducing in quality thereafter.

(2) At a minimum an insurer must hold eligible own-funds of sufficient quality as follows—

(a) to meet its SCR—

(i) 50% or more must be Tier 1 items;

(ii) if applicable, the remainder must be either Tier 2 or Tier 3 items, subject to the restriction in paragraph (iii);

(iii) no more than 15% can be Tier 3 items; and

(b) to meet its MCR —

(i) 80% or more must be Tier 1 items;

(ii) if applicable, the remainder must be Tier 2 items.

(3) Of the Tier 1 items in paragraph (2)(a)(i), no more than 20% can be—

(a) items referred to in paragraph 1(1)(c) of Schedule 10;

(b) items referred to in paragraph 1(1)(e) of Schedule 10; and

(c) items referred to in paragraph 1(1)(h) of Schedule 10.

56 PCC specifics

(1) For a cell, the notional own-funds to meet the notional SCR must be calculated in accordance with this Part, as if it were a stand-alone insurer, subject to a maximum of the SCR for that cell. For clarity this means that excess cell capital is not available to meet the total SCR of the PCC.

(2) For a cell, where the notional own-funds to meet the notional SCR are less than the notional SCR and the cell has recourse to the capital of the core, subject to paragraph (4), core capital may be notionally allocated to the cell.

(3) For the core, the notional own-funds to meet the notional SCR must be calculated in accordance with this Part, as if it were a stand-alone insurer, less the total of any capital notionally allocated to the cells.

(4) The total core capital notionally allocated to all cells must not exceed the core's own-funds (before any reallocation) over that required to meet its notional SCR.

(5) For a cell the notional own-funds to meet the notional MCR must be calculated in accordance with this Part, as if it were a stand-alone insurer, subject to a maximum of the MCR for that cell. For clarity this means that excess cell capital is not available to meet the total MCR of the PCC.

(6) For a cell, where the notional own-funds to meet the notional MCR are less than the notional MCR and the cell has recourse to the capital of the core, subject to paragraph (4), core capital may be notionally allocated to the cell.

(7) For the core, the notional own-funds to meet the notional MCR must be calculated in accordance with this Part, as if it were a stand-alone insurer, less the total of any capital notionally allocated to the cells.

(8) The total core capital notionally allocated to all cells must not exceed the core's own-funds (before any reallocation) over that required to meet its notional MCR.

57 Basic own-funds items

(1) An insurer's eligible own-funds that meet the requirements below are classed as basic own-funds—

(a) the item is listed in paragraphs 1(1), 2(1) or 3(1) of Schedule 10;

(b) the item does not include features that may cause the insolvency of the insurer or may accelerate the process of the insurer becoming insolvent;

(c) the item is free from encumbrances and is not connected with any other transaction that could result in that item not complying with regulation 0;

(d) the legal or contractual arrangements governing the item allows for the cancellation of distributions in relation to that item if—

(i) the insurer is not in compliance with its capital requirements as defined by section 12A of the Act; or

(ii) the distribution would cause such non-compliance; and

(e) the item is only repayable or redeemable at the option of the insurer and the repayment or redemption of the item is subject to prior approval by the Authority.

(2) An insurer's basic own funds must include amounts relating to expected profits in future premiums relating to existing contracts that are expected to be received in the future, where the insurer has anticipated these premiums in the calculation of its technical provisions.

58 Ancillary own-funds

(1) An insurer's eligible own-funds that meet the requirements of this regulation are classed as ancillary own-funds—

(a) the item is one of the following—

(i) unpaid and uncalled ordinary share capital; initial funds; member's contributions or the equivalent basic own-fund item for mutual and mutual type insurers; and preference shares;

(ii) letters of credit or guarantees provided to the insurer;

(iii) any future claims which mutual or mutual type associations may have against their members by way of a call for supplementary contributions, within the following 12 months; and

(iv) any other legally binding financial commitments provided to the insurer.

(b) the item can be called up on demand by the insurer to meet its insurance obligations;

(c) the item meets the eligibility requirements of regulation 54;

(d) the item is not a basic own-fund item, as determined in regulation 57; and

(e) the item has been approved by the Authority in regulation 60.

(2) An insurer's ancillary own-fund items are each classified as Tier 2 or Tier 3 as follows—

(a) if the item displays the features of a Tier 1 basic own-fund item in Schedule 10, once it has been called up and paid in, it is classed as Tier 2; otherwise

(b) it is classed as Tier 3.

59 Authority's approval of basic own-funds

The classification of eligible basic own-fund items of an insurer that are not included in the list of basic own-funds items in paragraphs 1(1), 2(1) or 3(1) of Schedule 10, but that meet the relevant requirements of those paragraphs, is subject to the approval of the Authority.

60 Approval of ancillary own-funds

(1) The eligibility of an insurer's ancillary own-funds is subject to the approval of the Authority. The approval includes—

(a) the amount ascribed to an ancillary own-fund item; and

(b) the classification of an ancillary own-fund item as Tier 2 or Tier 3.

(2) The amount ascribed to an ancillary own-fund item is either—

(a) a monetary amount for each ancillary own-fund item; or

(b) a method to be used to determine the amount of each ancillary own-fund item, in which case approval of the amount determined using that method shall be granted for a specified period of time.

PART 6: REVOCATIONS

61 Revocation

MADE [DATE]

K. BADGEROW

Chief Executive, Isle of Man Financial Services Authority

L. BOYLE

Chairperson, Isle of Man Financial Services Authority

SCHEDULE 1

CAPITAL REQUIREMENTS FOR DORMANT INSURERS

(1) A dormant insurer is an insurer that, although authorised under the Act, is not carrying on insurance business.

(2) No dormant insurer may carry on insurance business without the approval of the Authority.

(3) Any dormant insurer that carries on insurance business without the approval of the Authority is no longer considered a dormant insurer and, at a minimum, will be in breach of the requirement of paragraph (2).

(4) The SCR and MCR for a dormant insurer is to maintain assets in excess of its liabilities.

SCHEDULE 2

Diversification Adjustment and Correlation Matrices

1 Diversification adjustment

(1) The diversification adjustment for use in the standard formula approach is—

$$Diversification\ adjustment = undiversified\ amount - \ diversified\ amount$$

Where—

(a) the undiversified amount is the result of the standard formula calculation before the diversification adjustment is applied;

(b) the diversified amount is determined using the aggregation formula—

$$Aggregation\ Formula = \sqrt{\sum_{x,y} Corr_{x,y} \cdot C_x \cdot C_y}$$

Where—

(i) $\sum x, y$ is the sum over all combinations of variables;

(ii) $Corr_{x,y}$ is the correlation between variables x and y. Where there are multiple variables, x and y make up the rows and columns of a correlation matrix;

(iii) C_x, C_y is the value corresponding to variable x and variable y;

(c) $Corr_{x,y} = 1$ is equivalent to full correlation and leads to no diversification benefit; and

(d) $Corr_{x,y} = 0$ is equivalent to no correlation and leads to full diversification benefit.

2 Correlation Matrix: SCR Standard Formula Approach

(1) $Corr_{x,y}$ for use in the diversification adjustment in regulation 25(1)(f) is—

(a) for Class 12 insurers—

	Market	Default	Health	Non-Life
Market	1	0	0	0
Default	0	1	0	0.25
Health	0	0	1	0
Non-Life	0	0.25	0	1

(b) otherwise—

	Market	Default	Health	Non-Life
Market	1	0.25	0.25	0.25
Default	0.25	1	0.25	0.5
Health	0.25	0.25	1	0
Non-Life	0.25	0.5	0	1

3 Correlation Matrix: Market Risk

(1) $Corr_{x,y}$ for use in the diversification adjustment in regulation 29(1)(g) is—

(a) for Class 12 insurers—

	Interest	Equity	Property	Spread	Currency	Concentration
Interest	1	A	A	A	0	0
Equity	A	1	0.5	0.5	0	0
Property	A	0.5	1	0.25	0	0
Spread	A	0.5	0.25	1	0	0
Currency	0	0	0	0	1	0
Concentration	0	0	0	0	0	1

(b) otherwise—

	Interest	Equity	Property	Spread	Currency	Concentration
Interest	1	A	A	A	0.25	0
Equity	A	1	0.75	0.75	0.25	0
Property	A	0.75	1	0.5	0.25	0
Spread	A	0.75	0.5	1	0.25	0
Currency	0.25	0.25	0.25	0.25	1	0
Concentration	0	0	0	0	0	1

(c) The factor A is —

(i) 0 when the capital requirement for interest rate risk determined in regulation 32, is derived from the capital requirement for the risk of an increase in the interest rate term structure;

(ii) for Class 12 insurers, 0.25; otherwise

(iii) 0.5.

4 Correlation Matrix: Equity Risk

(1) $Corr_{x,y}$ for use in regulation 33(2)(c) is—

(a) for Class 12 insurers—

	Type 1	**Type 2**
Type 1	1	0.5
Type 2	0.5	1

(b) otherwise—

	Type 1	**Type 2**
Type 1	1	0.75
Type 2	0.75	1

5 Correlation Matrix: Currency Risk

(1) $Corr_{x,y}$ for use in regulation 35 is—

(a) for Class 12 insurers there is no applicable correlation matrix;

(b) otherwise—

(i) if the insurer is using the method in regulation 35(4)(a) then there is no applicable correlation matrix;

(ii) otherwise—

Group	1	2	3	4	5	6	7	8	9	10
1	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
2	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
3	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5
4	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5
5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5
6	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5
7	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5
8	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5
9	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5
10	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1

6 Correlation Matrix: Market Concentration Risk

(1) $Corr_{x,y}$ for use in regulation 37(1)(b) is—

	Concentration A	Concentration B
Concentration A	1	0
Concentration B	0	1

7 Correlation Matrix: Counterparty Default Risk

(1) $Corr_{x,y}$ for use in regulation 38(1)(c) is—

(a) for Class 12 insurers—

	Type 1	Type 2
Type 1	1	0.5
Type 2	0.5	1

(b) otherwise—

	Type 1	Type 2
Type 1	1	0.75
Type 2	0.75	1

8 Correlation Matrix: Underwriting Risk

(1) $Corr_{x,y}$ for use in regulation 39(1)(d) is—

(a) for Class 12 insurers—

	Premium and Reserve	Lapse
Premium and Reserve	1	0
Lapse	0	1

(b) otherwise—

	Premium and Reserve	Lapse	Catastrophe
Premium and Reserve	1	0	0.25
Lapse	0	1	0
Catastrophe	0.25	0	1

9 Correlation Matrix: Premium and Reserve Risk – Standard Deviation

(1) For use in regulation 40(9), $Corr_{x,y}$ is—

(a) for Class 12 insurers —

	Segment											
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**25**	**26**	**27**
1	1	0.25	0.25	0	0.25	0	0.25	0	0.25	0	0	0
2	0.25	1	0	0	0	0	0.25	0.25	0.25	0	0	0
3	0.25	0	1	0	0	0	0	0.25	0.25	0	0.25	0
4	0.25	0	0	1	0	0	0	0.25	0.25	0	0.25	0.25
5	0.25	0	0	0	1	0.25	0.25	0	0.25	0.25	0	0
6	0	0	0	0	0.25	1	0.25	0	0.25	0.25	0	0
7	0.25	0.25	0	0	0.25	0.25	1	0	0.25	0.25	0	0
8	0	0.25	0.25	0.25	0	0	0	1	0.25	0	0	0.25
9	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1	0	0.25	0
25	0	0	0	0	0.25	0.25	0.25	0	0	1	0	0
26	0	0	0.25	0.25	0	0	0	0	0.25	0	1	0
27	0	0	0	0.25	0	0	0	0.25	0	0	0	1

(b) otherwise —

Segment												
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**25**	**26**	**27**
1	1	0.5	0.5	0.25	0.5	0.25	0.5	0.25	0.5	0.25	0.25	0.25
2	0.5	1	0.25	0.25	0.25	0.25	0.5	0.5	0.5	0.25	0.25	0.25
3	0.5	0.25	1	0.25	0.25	0.25	0.25	0.5	0.5	0.25	0.5	0.25
4	0.25	0.25	0.25	1	0.25	0.25	0.25	0.5	0.5	0.25	0.5	0.5
5	0.5	0.25	0.25	0.25	1	0.5	0.5	0.25	0.5	0.5	0.25	0.25
6	0.25	0.25	0.25	0.25	0.5	1	0.5	0.25	0.5	0.5	0.25	0.25
7	0.5	0.5	0.25	0.25	0.5	0.5	1	0.25	0.5	0.5	0.25	0.25
8	0.25	0.5	0.5	0.5	0.25	0.25	0.25	1	0.5	0.25	0.25	0.5
9	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.25	0.5	0.25
25	0.25	0.25	0.25	0.25	0.5	0.5	0.5	0.25	0.25	1	0.25	0.25
26	0.25	0.25	0.5	0.5	0.25	0.25	0.25	0.25	0.5	0.25	1	0.25
27	0.25	0.25	0.25	0.5	0.25	0.25	0.25	0.5	0.25	0.25	0.25	1

10 Correlation Matrix: Combined Standard Deviation

(1) For use in regulation 40(10)(a), $Corr_{x,y}$ is—

(a) for Class 12 insurers—

	Premium risk	**Reserve risk**
Premium risk	1	0.25
Reserve risk	0.25	1

(b) otherwise—

	Premium risk	**Reserve risk**
Premium risk	1	0.5
Reserve risk	0.5	1

11 Correlation Matrix: Catastrophe Risk

(1) For use in regulation 42(2)(e), $Corr_{x,y}$ is—

	Natural Cat	NP Prop Cat	Man-Made Cat	Other Cat
Natural Cat	1	1	0	0
NP Prop Cat	1	1	0	0
Man-Made Cat	0	0	1	0
Other Cat	0	0	0	1

12 Correlation Matrix: Natural Catastrophe Risk

(1) For use in regulation 42(3)(f), $Corr_{x,y}$ is—

	Windstorm	Earthquake	Flood	Hail	Subsidence
Windstorm	1	0	0	0	0
Earthquake	0	1	0	0	0
Flood	0	0	1	0	0
Hail	0	0	0	1	0
Subsidence	0	0	0	0	1

13 Correlation Matrix: Man-Made Catastrophe Risk

(1) For use in 42(16)(g), $Corr_{x,y}$ is—

	Motor	Fire	Marine	Aviation	Liability	Credit
Motor	1	0	0	0	0	0
Fire	0	1	0	0	0	0
Marine	0	0	1	0	0	0
Aviation	0	0	0	1	0	0
Liability	0	0	0	0	1	0
Credit	0	0	0	0	1	1

14 Correlation Matrix: Man-Made Marine Catastrophe Risk

(1) For use in regulation 42(21)(c), $Corr_{x,y}$ is defined as—

	Vessel	**Platform**
Vessel	1	0
Platform	0	1

15 Correlation Matrix: Man-Made Liability Catastrophe Risk

(1) For use in regulation 42(33)(b), $Corr_{x,y}$ is defined as—

Liability Group	**1**	**2**	**3**	**4**	**5**
1	1	0	0.5	0.25	0.5
2	0	1	0	0.25	0.5
3	0.5	0	1	0.25	0.5
4	0.25	0.25	0.25	1	0.5
5	0.5	0.5	0.5	0.5	1

Where—

1 = Professional malpractice liability insurance obligations

2 = Employers liability insurance obligations

3 = Directors and officers insurance obligations

4 = Personal liability insurance obligations

5 = Non-proportional liability reinsurance obligations

16 Correlation Matrix: Man-made Credit and Suretyship Catastrophe Risk

(1) For use in regulation 42(35)(c), $Corr_{x,y}$ is—

	Default	**Recession**
Default	1	0
Recession	0	1

17 Correlation Matrix: Other Catastrophe Risk

(1) For use in regulation 42(40)(b), $Corr_{x,y}$ is—

$CorrOther$	1	2	3	4	5
1	1	1	0	0	0
2	1	1	0	0	0
3	0	0	1	0	0
4	0	0	0	1	0
5	0	0	0	0	1

18 Correlation Matrix: Health Risk

(1) For use in regulation 43(1)(d), $Corr_{x,y}$ is—

	Underwriting	Catastrophe
Underwriting	1	0.25
Catastrophe	0.25	1

(2) For use in regulation 43(1)(d), $Corr_{x,y}$ is—

	Premium and Reserve	Lapse
Premium and Reserve	1	0
Lapse	0	1

(3) For use in regulation 44(11), $Corr_{x,y}$ is —

(a) for Class 12 insurers—

	Medical expense	Income protection	Workers' comp	NP health reins
Medical expense	1	0.25	0.25	0.25
Income protection	0.25	1	0.25	0.25
Workers' comp	0.25	0.25	1	0.25
NP health reins	0. 25	0.25	0.25	1

(b) otherwise—

	Medical expense	Income protection	Workers' comp	NP health reins
Medical expense	1	0.5	0.5	0.5
Income protection	0.5	1	0.5	0.5
Workers' comp	0.5	0.5	1	0.5
NP health reins	0. 5	0. 5	0.5	1

(4) For use in regulation 46(2)(d), $Corr_{x,y}$ is—

	Mass accident	Concentration	Pandemic
Mass accident	1	0	0
Concentration	0	1	0
Pandemic	0	0	1

(5) For use in regulations 46(4)(b) and 46(6)(b) $Corr_{x,y}$ is—

	Country A	Country B
Country A	1	0
Country B	0	1

SCHEDULE 3

Factors, Tables and Lists

1 Interest Rate Risk Capital Factors

(1) The Interest Rate Risk Capital Factors for use in regulation 32(2) are, for Class 12 insurers —

Maturity *t* (years)	**Increase Factor**	**Decrease Factor**
1	35%	-37.5%
2	35%	-32.5%
3	32%	-28%
4	29.5%	-25%
5	27.5%	-23%
6	26%	-21%
7	24.5%	-19.5%
8	23.5%	-18%
9	22%	-16.5%
10	21%	-15.5%
11	19.5%	-15%
12	18.5%	-14.5%
13	17.5%	-14%
14	17%	-14%
15	16.5%	-13.5%
16	15.5%	-14%
17	15%	-14%
18	14.5%	-14%
19	13.5%	-14.5%
20	13%	-14.5%
90	10%	-10%

(a) for maturities that are —

(i) not specified, the factors above must be linearly interpolated;

(ii) shorter than 1 year, the year 1 factor must be used; and

(iii) longer than 90 years the year 90 factor must be used.

(2) Otherwise —

Maturity *t* (years)	**Increase Factor**	**Decrease Factor**
1	70%	-75%
2	70%	-65%
3	64%	-56%
4	59%	-50%
5	55%	-46%
6	52%	-42%
7	49%	-39%
8	47%	-36%
9	44%	-33%
10	42%	-31%
11	39%	-30%
12	37%	-29%
13	35%	-28%
14	34%	-28%
15	33%	-27%
16	31%	-28%
17	30%	-28%
18	29%	-28%
19	27%	-29%
20	26%	-29%
90	20%	-20%

(a) for maturities that are —

(i) not specified, the factors above must be linearly interpolated; or

(ii) shorter than 1 year, the 1 year factor must be used; or

(iii) longer than 90 years the 90 year factor must be used.

2 Equity Risk Capital Factors

(1) The Equity Risk Capital Factors for use in regulation 33(3) are, for Class 12 insurers —

	Type 1	Type 2
Factor	19%	24%

(2) Otherwise—

	Type 1	Type 2
Factor	39%	49%

3 Property Risk Capital Factor

(1) The Property Risk Capital Factor for use in regulation 34(2) is, for Class 12 insurers, 12%.

(2) Otherwise 25%.

4 Currency Risk Capital Factors

(1) The currency groupings for use in regulation 35(4)(b) are —

Foreign Currency Group Table 1			
1	**2**	**3**	**4**
Euro	US Dollar	Singapore Dollar	Australian Dollar
Swiss Franc	Chinese Yuan Renminbi	Indian Rupee	New Zealand Dollar
Swedish Krona	Hong Kong Dollar	Malaysian Ringgit	South African Rand
Norwegian Krone	Taiwan Dollar	Thai Baht	
Danish Krone	Saudi Riyal		
Polish Zloty			
Czech Koruna			
Hungarian Forint			
Bulgarian Lev			
Croatian Kuna			
Romanian Leu			

Foreign Currency Group Table 2					
5	**6**	**7**	**8**	**9**	**10**
Canadian Dollar	Japanese Yen	Russian Ruble	Turkish Lira	South Korean Won	Icelandic Krona
Brazilian Real					
Mexican Peso					
Chilean Peso					
Colombian Peso					

(2) If an insurer has material exposures to one or more currencies other than those specified in the foreign currency group table, it must notify the Authority and obtain the Authority's written approval as to the foreign currency group in which the exposure must be included.

(3) If an insurer has a material exposure to a particular Currency Group (for example where the insurer's reporting currency is Euro instead of Manx Pound), and the conditions in paragraph (4) are met, the insurer can exchange its exposure to Manx Pounds for the exposure to that currency group in the calculation in regulation 35(4)(b).

(4) The conditions referred to in paragraph (3) are—

(a) in respect of the insurer's overall cash inflows, more than 50% of the present value of future cash inflows are in that Currency Group;

(b) in respect of the cash flows of the Currency Group, the present value of future cash inflows of that Currency Group exceeds the present value of future cash outflows of that Currency Group; and

(c) in addition to sub-paragraph (b), the present value of future cash inflows would continue to exceed the present value of future cash outflows following the application of the more adverse of the stresses in the scenario set out in regulation 35(2), applied to Currency Group against the Manx Pound.

(5) The Currency Risk Capital Factors to be applied to the insurer's foreign currency exposures are—

(a) for Class 12 insurers: 12%;

(b) otherwise: 25%.

5 Spread Risk Factors

(1) The Spread Risk Credit Quality Step Factors to be used in regulation 36(2) are, for Class 12 insurers—

Credit quality step	**0**	**1**	**2**	**3**	**4**	**5**	**6**
Factor	0.4%	0.5%	0.7%	1.2%	2.2%	3.7%	3.7%

(2) Otherwise—

Credit quality step	**0**	**1**	**2**	**3**	**4**	**5**	**6**
Factor	0.9%	1.1%	1.4%	2.5%	4.5%	7.5%	7.5%

(3) For non-Class 12 insurers that do not meet regulation 36(1)—

(a) the Spread Risk Credit Quality Step Factors to be used for exposures to bonds and loans in regulation 36(5)(b)(ii) are—

	Credit quality step					
Dur$_i$	**0**	**1**	**2**	**3**	**4**	**5, 6**
≤ 5	$0.9\% \cdot dur_i$	$1.1\% \cdot dur_i$	$1.4\% \cdot dur_i$	$2.5\% \cdot dur_i$	$4.5\% \cdot dur_i$	$7.5\% \cdot dur_i$
5 <dur ≤ 10	$4.5\% + 0.5\% \cdot (dur_i - 5)$	$5.5\% + 0.6\% \cdot (dur_i - 5)$	$7.0\% + 0.7\% \cdot (dur_i - 5)$	$12.5\% + 1.5\% \cdot (dur_i - 5)$	$22.5\% + 2.5\% \cdot (dur_i - 5)$	$37.5\% + 4.2\% \cdot (dur_i - 5)$
10 <dur ≤ 15	$7.0\% + 0.5\% \cdot (dur_i - 10)$	$8.5\% + 0.5\% \cdot (dur_i - 10)$	$10.5\% + 0.5\% \cdot (dur_i - 10)$	$20.0\% + 1.0\% \cdot (dur_i - 10)$	$35.0\% + 1.8\% \cdot (dur_i - 10)$	$58.5\% + 0.5\% \cdot (dur_i - 10)$
15 <dur ≤ 20	$9.5\% + 0.5\% \cdot (dur_i - 15)$	$11.0\% + 0.5\% \cdot (dur_i - 15)$	$13.0\% + 0.5\% \cdot (dur_i - 15)$	$25.0\% + 1.0\% \cdot (dur_i - 15)$	$44.0\% + 0.5\% \cdot (dur_i - 15)$	$61.0\% + 0.5\% \cdot (dur_i - 15)$
> 20	$12.0\% + 0.5\% \cdot (dur_i - 20)$	$13.4\% + 0.5\% \cdot (dur_i - 20)$	$15.5\% + 0.5\% \cdot (dur_i - 20)$	$30.0\% + 0.5\% \cdot (dur_i - 20)$	$46.6\% + 0.5\% \cdot (dur_i - 20)$	$63.5\% + 0.5\% \cdot (dur_i - 20)$

Where

(i) dur_i is the modified duration for that exposure;

(ii) the modified duration must always be greater than 1.

(iii) for variable interest rate bonds or loans, dur_i must be equivalent to the modified duration of a fixed interest rate bond or loan of the same maturity and with coupon payments equal to the forward interest rate.

(b) the Spread Risk Credit Quality Step Factors to be used for exposures to Type 1 securitisation positions, Type 2 securitisation positions and resecuritisation positions in regulation 36(7)(a)(ii)(A) are—

	Spread Risk Credit Quality Step Factor		
Credit Quality Step	**Type 1 Securitisation Positions**	**Type 2 Securitisation Positions**	**Resecuritisation Positions**
0	2.1%	12.5%	33.0%
1	3.0%	13.4%	40.0%
2	3.0%	16.6%	51.0%
3	3.0%	19.7%	91.0%
4	N/A	82.0%	100.0%
5,6	N/A	100.0%	100.0%

(c) the Spread Risk Credit Quality Step Factors to be used in regulation 36(10)(b) are—

Credit quality step	**Spread Risk Credit Quality Step Factor**
0	+130 basis points
1	+150 basis points
2	+260 basis points
3	+450 basis points
4	+840 basis points
5,6	+1620 basis points
Unrated	+500 basis points

6 Market Concentration Risk Factors

(1) The Exposure Threshold Factors for use in regulation 37(3) are—

Credit Quality Step	**Exposure Threshold Factor**
0	3.0%
1	3.0%
2	3.0%
3	1.5%
4	1.5%
5	1.5%
6 or unrated	1.5%

(a) the weighted average credit quality step for the single counterparty must be used. This is the rounded-up average of the credit quality steps of its exposures to the counterparties that fall within the single counterparty, weighted by the value of each exposure.

(2) The Market Concentration Risk Credit Quality Factors for use in regulation 37(6)(b) are—

(a) for Class 12 insurers—

Credit quality step	0	1	2	3	4	5	6	Unrated
Factor	6%	6%	10%	13%	36%	36%	36%	36%

(a) otherwise—

Credit quality step	0	1	2	3	4	5	6	Unrated
Factor	12%	12%	21%	27%	73%	73%	73%	73%

7 Counterparty Default Risk Factors

(1) The Recovery Rates and Risk Mitigation Factors for use in regulation 38 are—

Type 1 Exposure	Recovery Rate	Risk Mitigation Factor
Reinsurance arrangements and insurance securitisations where < 60% of assets are subject to collateral arrangements	50%	50%
Reinsurance arrangements and insurance securitisations where 60% or more of assets are subject to collateral arrangements	10%	50%
Derivatives	10%	100%

(2) The Economic Adjustment Factor in regulation 38 takes into account the economic effect of the risk mitigation arrangement and is determined as follows:

(a) if, in the case of the insolvency of the counterparty, the determination of the insurer's proportional share of the counterparty's insolvency estate in excess of the collateral does not take into account that the insurer receives collateral, the factor is 100%; or else

(b) for reinsurance arrangements: 50%;

(c) for derivatives: 90%.

(3) For use in regulation 38(18)(b), the Type 1 Exposure Factor is —

Type 1 Exposure Factors	Class 12 insurers	Other Insurers
Band 1	1.5	3
Band 2	2.5	5
Band 3	0.5	1

(a) Band 1: The standard deviation is no more than 7% of the insurer's total loss given default across its counterparties;

(b) Band 2: The standard deviation is more than 7% but no more than 20% of the insurer's total loss given default across its counterparties;

(c) Band 3: The standard deviation is greater than 20% of the insurer's total loss given default across its counterparties;

(4) For use in regulation 38(19)(a)(i) the Probability of Default Factors are—

Probability of Default Factor A

Probability of Default Factor	0.00%	0.01%	0.05%	0.10%	0.20%	0.24%	0.50%	1.20%	4.20%
0.00%	0.001%	0.001%	0.002%	0.002%	0.002%	0.002%	0.002%	0.002%	0.002%
0.01%	0.001%	0.004%	0.007%	0.007%	0.008%	0.008%	0.008%	0.008%	0.008%
0.05%	0.002%	0.007%	0.020%	0.027%	0.032%	0.033%	0.036%	0.038%	0.038%
0.10%	0.002%	0.007%	0.027%	0.027%	0.032%	0.033%	0.036%	0.073%	0.075%
0.20%	0.002%	0.008%	0.032%	0.040%	0.053%	0.056%	0.066%	0.135%	0.146%
0.24%	0.002%	0.008%	0.033%	0.056%	0.087%	0.096%	0.129%	0.158%	0.174%
0.50%	0.002%	0.008%	0.036%	0.066%	0.114%	0.129%	0.198%	0.278%	0.342%
1.20%	0.002%	0.008%	0.038%	0.073%	0.135%	0.158%	0.278%	0.471%	0.712%
4.20%	0.002%	0.008%	0.038%	0.075%	0.146%	0.174%	0.342%	0.712%	1.568%

Probability of Default Factor B

Probability of Default	Factor B
0.002%	0.001%
0.01%	0.006%
0.05%	0.030%
0.10%	0.060%
0.20%	0.120%
0.24%	0.144%
0.50%	0.300%
1.20%	0.715%
4.20%	2.455%

(5) For use in paragraph (4) the Probability of Default Factor is—

(a) for counterparties for which a credit assessment is available —

Credit quality step	0	1	2	3	4	5	6
$\boldsymbol{PD_i}$	0.002%	0.01%	0.05%	0.24%	1.20%	4.2%	4.2%

(b) for banks, incorporated in the Isle of Man and licensed under the Financial Services Act 2008 to conduct deposit taking activity, for which a credit assessment is not available, the probability of default is 0.5%;

(c) if a letter of credit, a guarantee or an equivalent arrangement is provided to fully secure an exposure of the insurer and this arrangement complies with regulation 47, the provider of that letter of credit, guarantee or equivalent arrangement may be considered as the counterparty on the secured exposure for the purposes of assessing the probability of default of a counterparty;

(d) where the insurer has made an uncollateralised loan to an undertaking within the same corporate group, where that undertaking has not been assigned a credit rating, but the parent of the group does have a credit rating, the insurer can use the rating of the parent when assessing the probability of default of the counterparty, but only when that undertaking is substantially acting as the treasury function for the group;

(e) for unrated counterparties that are part of the same corporate group as the insurer, where there is a non-public rating available that could be used to assign a credit quality step then the insurer may use that rating, subject to obtaining approval from the Authority; and

(f) where a reinsurance contract has a legally enforceable cut-through liability clause, or similar binding agreement, to a retroceding insurer, the insurer may use the credit quality step of the retroceding insurer when determining the probability of default.

8 Underwriting Risk Factors

(1) The Premium and Reserve Factor for use in regulation 40(1)(c) is—

(a) for Class 12 insurers, 1.3;

(b) otherwise, 3.

(2) The Premium and Reserve Risk Segment table for use in regulation 40(2) is—

	Segment
1, 13	Motor vehicle liability insurance and proportional reinsurance
2, 14	Other motor insurance and proportional reinsurance
3, 15	Marine, aviation and transport insurance and proportional reinsurance
4, 16	Fire and other damage to property insurance and proportional reinsurance
5, 17	General liability insurance and proportional reinsurance
6, 18	Credit and suretyship insurance and proportional reinsurance
7, 19	Legal expenses insurance and proportional reinsurance
8, 20	Assistance and its proportional reinsurance
9, 21	Miscellaneous financial loss insurance and proportional reinsurance
25	Non-proportional casualty reinsurance
26	Non-proportional marine, aviation and transport reinsurance
27	Non-proportional property reinsurance

(3) The geographical diversification adjustment for a line of business in regulation 40(4)(c) is—

(a) 0.75; plus

(b) 0.25; multiplied by

(i) the sum over all geographical regions of

(A) the square of;

(i) the volume measure for premium risk in that region; plus

(ii) the volume measure for reserve risk in that region;

divided by

(ii) the square of

(A) the total volume measure for premium risk across all regions; plus

(B) the total volume measure for reserve risk across all regions.

(4) The geographical diversification adjustment for lines of business 6, 25, 26 and 27 is 1.

(5) An insurer may choose not to take benefit of the geographical diversification adjustment when determining their volume measure. In this case the geographical diversification adjustment is 1 for all segments.

(6) The Premium Risk Standard Deviation Factors and Reserve Risk Standard Deviation Factors for each segment are—

Segment	Premium Risk Standard Deviation Factor (gross of reinsurance)	Reserve Risk Standard Deviation Factor (net of reinsurance)
1, 13	8%	9%
2, 14	8%	8%
3, 15	15%	11%
4, 16	6%	10%
5, 17	11%	11%
6, 18	12%	19%
7, 19	7%	12%
8, 20	9%	20%
9, 21	13%	20%
25	17%	20%
26	17%	20%
27	17%	20%

(7) The geographical diversification adjustment in regulations 42(5)(c), 42(7)(c), 42(9)(b) and 42(11)(c) is—

(a) 0.5; plus

(b) 0.5; multiplied by

(i) the sum over all geographical regions of the square of the volume measure for premium risk in that region;

divided by

(ii) the square of the total volume measure for premium risk across all regions;

where—

(c) the premium measure is defined in regulations 42(5)(c), 42(7)(c), 42(9)(b) and 42(11)(c) and the geographical regions are defined in Schedule 6.

(8) The liability risk groups for use in regulation 42(32) are—

(a) professional malpractice liability insurance obligations which include liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities arising out of professional malpractice in relation to clients and patients. This excludes professional malpractice liability insurance and reinsurance for self-employed craftspersons or artisans;

(b) employers liability insurance obligations that include liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities of employers arising out of death, illness, accident, disability or infirmity of an employee in the course of their employment;

(c) directors and officers insurance obligations that include liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities of directors and officers of a company, arising out of the management of that company, or losses of the company itself to the extent it indemnifies its directors and officers in relation to such liabilities

(d) personal liability insurance obligations that includes liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities of natural persons in their capacity of being private householders. This excludes—

(i) obligations included in the liability risk groups set out in sub-paragraphs (a) to (c) above;

(ii) personal liability insurance and proportional reinsurance; and

(iii) professional malpractice liability insurance and reinsurance for self-employed craftspersons or artisans; and

(e) non-proportional liability reinsurance obligations in line of business 25 which relate to insurance obligations in lines of business 5 and 17.

(9) The Liability Risk Factors for use in regulation 42(33)(a)(ii) are—

Liability group	Factor
[1]	100%
[2]	160%
[3]	160%
[4]	100%
[5]	210%

where

[1]= Professional malpractice liability insurance obligations

[2]= Employers liability insurance obligations

[3]= Directors and officers insurance obligations

[4]= Personal liability insurance obligations

[5]=Non-proportional liability reinsurance obligations

(10) the other non-life catastrophe risk groups for use in regulation 42(39) are—

(a) insurance obligations in lines of business 3 and 15 other than marine and aviation insurance;

(b) non-proportional reinsurance obligations included in line of business 26 other than marine and aviation reinsurance;

(c) insurance obligations included in lines of business 9 and 21 other than extended warranty insurance obligations provided that the portfolio of these obligations is highly diversified and these obligations do not cover the costs of product recalls;

(d) non-proportional reinsurance obligations in line of business 25 other than general liability reinsurance; and

(e) non-proportional reinsurance obligations relating to insurance obligations included in lines of business 6 and 18.

(11) In paragraph 10(c) 'extended warranty insurance obligation' means insurance obligations which cover the cost of repair or replacement in the event of a breakdown of a consumer good used by the individuals in a private capacity and which may also provide additional cover against eventualities such as accidental damage, loss or theft and assistance in setting up, maintaining and operating the good.

(12) The Other Catastrophe Risk Factors for use in regulation 42(40)(a)(ii) are—

Other Group	Factor
(a)	100%
(b)	250%
(c)	40%
(d)	250%
(e)	250%

9 NSLT Health Risk Factors

(1) The NSLT Health Premium and Reserve Factor in regulation 44(1)(c) is—

(a) for Class 12 insurers, 1.3;

(b) otherwise, 3.

(2) The NSLT Health Premium and Reserve Risk Segment table for use in regulation 44(2) is—

	Segment
10, 22	Medical expense insurance and proportional reinsurance
11, 23	Income protection insurance and proportional reinsurance
12, 24	Workers' compensation insurance and proportional reinsurance
28	Non-proportional health reinsurance

(3) The geographical diversification adjustment in regulation 44(4)(c) is—

(a) 0.75;

plus

(b) 0.25; multiplied by

(i) the sum over all geographical regions of

(A) the square of;

(i) the volume measure for premium risk in that region; plus

(ii) the volume measure for reserve risk in that region.

divided by

(ii) the square of

(A) the total volume measure for premium risk across all regions; plus

(B) the total volume measure for reserve risk across all regions.

(4) The geographical diversification adjustment for lines of business 28 is 1.

(5) An insurer may choose not to take benefit of the geographical diversification adjustment when determining their volume measure. In this case the geographical diversification adjustment is 1 for all segments.

(6) The NSLT Health Premium Risk Standard Deviation Factors and Health Reserve Risk Standard Deviation Factors for each segment are—

Segment	**Health Premium Risk Standard Deviation Factor (gross of reinsurance)**	**Health Reserve Risk Standard Deviation Factor (net of reinsurance)**
10, 22	5%	5%
11, 23	8.5%	14%
12, 24	8%	11%
28	17%	20%

(7) The Country Ratio Factor in regulation 46(4)(a)(i) is—

	Factor	**Country**	**Factor**
Austria	0.30%	**Latvia**	0.20%
Belgium	0.25%	**Lithuania**	0.20%
Bulgaria	0.30%	**Luxembourg**	1.05%
Croatia	0.40%	**Malta**	2.15%
Cyprus	1.30%	**Netherlands**	0.15%
Czech Republic	0.10%	**Norway**	0.25%
Denmark	0.35%	**Poland**	0.10%
Estonia	0.45%	**Portugal**	0.30%
Finland	0.35%	**Romania**	0.15%
France	0.05%	**Slovakia**	0.30%
Germany	0.05%	**Slovenia**	0.40%

Greece	0.30%	**Spain**	0.10%
Hungary	0.15%	**Sweden**	0.25%
Iceland	2.45%	**Switzerland**	0.25%
Ireland	0.95%	**United Kingdom**	0.05%
Italy	0.05%		

(8) The Event Type Ratio Factor in regulation 46(4)(a)(ii)(A) is—

Event type	**Factor**
Death caused by an accident	10%
Permanent disability caused by an accident	1.5%
Disability lasting 10 years, caused by an accident	5%
Disability lasting 12 months, caused by an accident	13.5%
Medical treatment caused by an accident	30%

(9) The Event Type Ratio Factor in regulations 46(4)(a)(ii)(A) and 46(6)(a)(i)(A) is —

Event type	**Factor**
Death caused by an accident	10%
Permanent disability caused by an accident	1.5%
Disability lasting 10 years, caused by an accident	5%
Disability lasting 12 months, caused by an accident	13.5%
Medical treatment caused by an accident	30%

SCHEDULE 4

Requirements of securitisation positions in the Spread Risk SCR

(1) Type 1 securitisation positions are securitisation positions that meet all of the following—

(a) the position has been assigned to credit quality step 3 or better;

(b) the securitisation is listed in a regulated market of a country which is a member of the EEA or the OECD;

(c) the position is in the most senior tranche or tranches of the securitisation, which possess the highest level of seniority at all times during the ongoing life of the transaction;

(d) the underlying exposures have been acquired in a manner that is enforceable against any third party and are beyond the reach of the seller and its creditors including in the event of the seller's insolvency;

(e) the transfer of the underlying exposures must not be subject to material claw back provisions in the jurisdiction where the is incorporated;

(f) the documentation governing the securitisation includes continuity provisions for servicing providers, derivative counterparties or liquidity providers, if applicable;

(g) all the assets underlying the securitisation belong to only one of the following categories—

(i) residential mortgages or fully guaranteed residential loans issued by a counterparty of credit quality step 2 or above, excluding any mortgages or loans in default;

(ii) loans to small and medium-sized enterprises and consumers;

(iii) auto loans and leases for the financing of motor vehicles, trailers, agricultural or forestry tractors, motor cycles or motor tricycles and tracked vehicles;

(iv) leased property; or

(v) credit card receivables;

(h) the underlying exposures do not include transferable financial instruments or derivatives except derivatives used to hedge currency risk or interest rate risk;

(i) the repayment of the securitisation position is not structured to depend predominantly on the sale of assets securing the underlying exposures; however, this must not prevent those exposures from being subsequently rolled over or refinanced;

(j) if the securitisation has been set up without a revolving period or the revolving period has terminated and if an enforcement or an acceleration notice has been delivered, principal receipts from the underlying exposures are passed to the holders of the securitisation positions via sequential amortisation of the securitisation positions and no substantial amount of cash is trapped on each payment date;

(k) if the securitisation has been set up with a revolving period, the transaction documentation provides for appropriate early amortisation events, which must include at a minimum all of the following—

(i) a deterioration in the credit quality of the underlying exposures;

(ii) a failure to generate sufficient new underlying exposures of at least similar credit quality; and

(iii) the occurrence of an insolvency-related event with regard to the insurer or the servicer;

(l) in the case of securitisations backed by residential mortgages, the creditor makes a thorough assessment of the borrower's creditworthiness, and that assessment has taken appropriate account of factors relevant to verifying the prospect of the borrower to meet their obligations under the credit agreement.

(2) Type 2 securitisation positions are all securitisation positions that do not qualify as either type 1 securitisation positions or resecuritisation positions.

SCHEDULE 5

Exposures to approved entities list

(1) Isle of Man Government;

(2) European Central Bank;

(3) the central government or central bank of an EU Member State, denominated and funded in the domestic currency of that Member State;

(4) instruments issued by a multilateral development bank including—

(a) the International Bank for Reconstruction and Development;

(b) the International Finance Corporation;

(c) the Inter-American Development Bank;

(d) the Asian Development Bank;

(e) the African Development Bank;

(f) the Council of Europe Development Bank;

(g) the Nordic Investment Bank;

(h) the Caribbean Development Bank;

(i) the European Bank for Reconstruction and Development;

(j) the European Investment Bank;

(k) the European Investment Fund;

(l) the Multilateral Investment Guarantee Agency;

(m) the International Finance Facility for Immunisation; and

(n) the Islamic Development Bank; and

(5) exposures to international organisations including—

(a) the European Community;

(b) the International Monetary Fund; and

(c) the Bank for International Settlements ; and

(6) exposures that are fully, unconditionally and irrevocably guaranteed by the—

(a) European Investment Bank;

(b) European Investment Fund;

(c) Isle of Man Government;

(d) European Central Bank; and

(e) central government or central bank of an EU Member State, denominated and funded in the domestic currency of that Member State.

SCHEDULE 6

Geographical Regions

	Region	Territories that the region consists of
1	**Northern Europe**	Denmark (except Greenland), Estonia, Finland, Guernsey, Iceland, Ireland, Isle of Man, Jersey, Latvia, Lithuania, Norway, Sweden, United Kingdom (except Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn Islands, Saint Helena, Turks and Caicos Islands)
2	**Western Europe**	Austria, Belgium, France (except French Guiana, French Polynesia, Guadeloupe, Martinique, Mayotte, New Caledonia, Réunion, Saint Barthélemy, Saint Martin, Saint Pierre and Miquelon, Wallis and Futuna), Germany, Liechtenstein, Luxembourg, Monaco, Netherlands (except Aruba, Bonaire, Curaçao, Saba, Saint Eustatius, Saint Maarten), Switzerland
3	**Eastern Europe**	Belarus, Bulgaria, Czech Republic, Hungary, Moldova, Poland, Romania, Russia, Slovakia, Ukraine
4	**Southern Europe**	Albania, Andorra, Bosnia and Herzegovina, Croatia, Cyprus, the former Yugoslav Republic of Macedonia, Gibraltar, Greece, Italy, Malta, Montenegro, Portugal, San Marino, Serbia, Slovenia, Spain, Vatican City State
5	**Central and Western Asia**	Armenia, Azerbaijan, Bahrain, Georgia, Iraq, Israel, Jordan, Kazakhstan, Kuwait, Kyrgyzstan, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Tajikistan, Turkey, Turkmenistan, United Arab Emirates, Uzbekistan, Yemen
6	**Eastern Asia**	China, Japan, Mongolia, North Korea, South Korea, Taiwan
7	**South and South-Eastern Asia**	Afghanistan, Bangladesh, Bhutan, Brunei, Burma/Myanmar, Cambodia, India, Indonesia, Iran, Laos, Malaysia, Maldives, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, East Timor, Vietnam
8	**Oceania**	American Samoa, Australia, Cook Islands, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, Micronesia, Nauru, New Caledonia, New Zealand, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Pitcairn

		Islands, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu, Wallis and Futuna
9	**Northern Africa**	Algeria, Benin, Burkina Faso, Cameroon, Cape Verde, Central African Republic, Chad, Côte d'Ivoire, Egypt, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Libya, Mali, Mauritania, Morocco, Niger, Nigeria, Saint Helena, Senegal, Sierra Leone, South Sudan, Sudan, Togo, Tunisia
10	**Southern Africa**	Angola, Botswana, Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mayotte, Mozambique, Namibia, Congo, Réunion, Rwanda, São Tomé and Príncipe, Seychelles, Somalia, South Africa, Swaziland, Uganda, Tanzania, Zambia, Zimbabwe
11	**North America excluding USA**	Bermuda, Canada, Greenland, Saint Pierre and Miquelon
12	**Caribbean and Central America**	Anguilla, Antigua & Barbuda, Aruba, Bahamas, Barbados, Belize, Bonaire, British Virgin Islands, Cayman Islands, Costa Rica, Cuba, Curaçao, Dominica, Dominican Republic, El Salvador, Grenada, Guadeloupe, Guatemala, Haiti, Honduras, Jamaica, Martinique, Mexico, Montserrat, Nicaragua, Panama, Puerto Rico, Saint Barthélemy, Saba, Saint Kitts and Nevis, Saint Lucia, Saint Martin, Saint Vincent and the Grenadines, Sint Eustatius, Sint Maarten, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands
13	**East South America**	Brazil, Falkland Islands, French Guiana, Guyana, Paraguay, Suriname, Uruguay
14	**North, South and West South America**	Argentina, Bolivia, Chile, Colombia, Ecuador, Peru, Venezuela
15	**North-east USA**	Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island,Vermont
16	**South-east USA**	Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Puerto Rico, South Carolina, Tennessee, Virginia, West Virginia

17	**Mid-west USA**	Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Wisconsin
18	**Western USA**	Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Texas, Utah, Washington, Wyoming
19	**Unallocated Region**	Not directly allocated to any of regions 1 to 18.

SCHEDULE 7

Lines of Business

LoB	Name	Obligations
1	Motor vehicle liability	All liabilities arising out of the use of motor vehicles operating on land including carrier's liability.
2	Other motor insurance	All damage to or loss of land vehicles including railway rolling stock.
3	Marine, aviation and transport	All damage or loss to sea, lake, river and canal vessels, aircraft, and damage to or loss of goods in transit or baggage irrespective of the form of transport. Liabilities arising out of the use of aircraft, ships, vessels or boats on the sea, lakes, rivers or canals including carrier's liability.
4	Fire and other damage to property	All damage to or loss of property other than those included in 2 and 3 due to fire, explosion, natural forces including storm, hail or frost, nuclear energy, land subsidence and events such as theft.
5	General liability	All liabilities other than those in 1 and 3.
6	Credit and suretyship	Insolvency, export credit, instalment credit, mortgages, agricultural credit, direct and indirect suretyship.
7	Legal expense	Legal expenses and cost of litigation.
8	Assistance	Assistance for persons who get into difficulties while travelling, while away from home.
9	Miscellaneous financial loss	Employment risk, insufficiency of income, bad weather, continuing general expenses, unforeseen trading expenses, loss of market value, rent or revenue, benefits, other indirect trading, other financial loss (non-trading) as well as any other risk not covered by 1 to 8 or 10 to 12.
10	NSLT medical expense	Medical expense other than obligations included in 12.
11	NSLT income protection	Income protection other than obligations included in 12.
12	NSLT Workers compensation	Health insurance obligations which relate to accidents at work, industrial injury and occupational diseases.
13-24	Proportional reinsurance obligations which relate to the lines of business 1 to 12	
25	Non-proportional casualty reinsurance	Non-proportional reinsurance obligations relating to obligations included in 1 and 5.

26	Non-proportional marine, aviation and transport reinsurance	Non-proportional reinsurance obligations relating to obligations included in 3.
27	Non-proportional property reinsurance	Non-proportional reinsurance obligations relating to obligations included in 2, 4 and 6 to 9.
28	Non-proportional health reinsurance	Non-proportional reinsurance obligations relating to obligations included in 10 to 12.

SCHEDULE 8

Requirements of ring-fenced funds

1 Recognition of assets and liabilities in a ring-fenced fund

(1) Where an insurer has ring fenced funds, it must identify the assets and liabilities of those ring-fenced funds and comply with the requirements of the rest of this Schedule.

(2) The assets in a ring-fenced fund of an insurer are those arising from the investment of premiums received by the insurer in relation to the contracts which comprise the ring-fenced fund, along with any other payments into and assets provided to the fund.

(3) The liabilities in a ring-fenced fund comprise those liabilities attributable to the insurance contracts or risks covered by the ring-fenced fund.

(4) An insurer must attribute liabilities to the ring-fenced fund only if honouring those liabilities would entail an appropriate and permitted use of the restricted assets or eligible own-funds.

2 Materiality and valuation of a ring-fenced fund

(1) An insurer must determine whether a ring-fenced fund is material by considering—

(a) the nature of the risks arising from or covered by the ring-fenced fund;

(b) the nature of the assets and liabilities within the ring-fenced fund including the following—

(i) the amount of restricted own-funds within the ring-fenced fund;

(ii) volatility of these those amounts over time; and

(iii) proportion of its total own-funds represented by restricted own-funds;

(c) the proportion of the insurer's total assets and SCR that the ring-fenced fund represents, both individually for each ring-fenced fund and on a combined basis with the insurer's other ring-fenced funds; and

(d) the likely impact of the ring-fenced fund on the calculation of the insurer's SCR due to the reduced scope for risk diversification.

(2) An insurer must determine technical provisions for each of its material ring-fenced funds using regulation 15.

3 Determining the SCR for ring-fenced funds

(1) An insurer must calculate a notional SCR for each material ring-fenced fund and its residual assets and liabilities.

(2) If the insurer has determined it has a non-material ring-fenced fund, the assets and liabilities of that ring-fenced arrangement must be included within the residual of the insurer's portfolio.

(3) An insurer's SCR is—

(a) the notional SCRs for each ring-fenced fund; plus

(b) the SCR for the residual.

(4) If the ring-fenced fund is determined to have a negative notional SCR, the notional SCR must be set to zero before being aggregated with positive notional SCRs.

(5) An insurer must determine its notional SCRs before making any adjustment to its basic own-funds, to avoid circularity in the calculation.

(6) An insurer must calculate its notional SCRs using regulation 25, with the exception that for the capital requirements involving multiple stresses, the stress that has the most negative impact on the insurer's basic own-funds as a whole must be used to determine the insurer's capital requirement.

(7) For paragraph (6), the stress that has the most negative impact on the insurer's basic own-funds as a whole under a scenario, is determined by aggregating the capital requirement for each stress within that scenario, across each ring-fenced fund and the residual and then considering which stress determines the capital requirement under that scenario.

4 Adjustments to eligible basic-own funds for ring-fenced funds

(1) Ring-fenced funds are classed as restricted own-funds.

(2) Future transfers attributable to shareholders are not classed as restricted own-fund items.

(3) Where a material ring-fenced fund exists, the amount by which the value of the insurer's restricted own-fund items in respect of that ring-fenced fund exceed the notional SCR of the ring-fenced fund must be deducted from the reconciliation reserve calculation in paragraph 1(2) of this Schedule.

(4) If a ring-fenced fund is deemed immaterial, the insurer must reduce its eligible basic own-funds by the total amount of restricted own-fund items in respect of that ring-fenced fund.

SCHEDULE 9

Requirements for the use of external credit assessments

(1) An insurer must only use external credit assessment issued by an ECAI that is approved by the Authority.

(2) An insurer can nominate a different ECAI for each of its asset, liability and counterparty exposures. When nominating an EACI the following requirements must be met—

(a) an insurer must use the same EACI for all exposures of a particular type;

(b) an insurer must use its nominated ECAIs in a continuous and consistent way over time;

(c) an insurer must only use nominated ECAI credit assessments that take into account all amounts of principal and interest owed to it;

(d) if only one credit assessment is available for a securitisation position it must be assumed that no credit assessment is available;

(e) if two credit assessments are available for the same item and they differ, the assessment providing the lowest quality rating must be used;

(f) if more than two credit assessments are available for the same item and they all differ, the insurer must only consider the two assessments that provide the lowest quality ratings, and then apply paragraph (e); and

(g) both solicited and unsolicited credit assessments from ECAIs must be taken into account.

(3) Credit assessments from a nominated ECAI for issuers within a corporate group must not be used as the credit assessment for another issuer within the same corporate group.

SCHEDULE 10

Assessing the quality of own-fund items into Tier 1, Tier 2 and Tier 3

1 Tier 1 own-fund items

(1) The following own-fund items are classed as Tier 1, if they meet all of the features in paragraph (3)—

(a) paid-up ordinary share capital and the paid-up related share premium account;

(b) paid-up initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type entities;

(c) paid-up subordinated mutual member accounts;

(d) surplus funds that are not considered as insurance liabilities;

(e) paid-up preference shares and the paid-up related share premium account;

(f) the reconciliation reserve;

(g) any other item that has been approved by the Authority in regulation 59; and

(h) paid-up subordinated liabilities.

(2) The reconciliation reserve in paragraph (1)(f) is—

(a) the insurer's total basic own funds; less

(b) the amount of own shares held by the insurer, both direct and indirect holdings; less

(c) foreseeable dividends and distributions from the insurer; less

(d) the items in paragraphs (1)(a) to (1)(e), (1)(g), 2(1)(a) to 2(1)(e) and 3(1)(a) to 3(1)(d).

(3) The required features for an own-fund item to be classed as Tier 1 are—

(a) the item is either—

(i) immediately available to meet the insurer's obligations; or

(ii) becomes available at the point the insurer has insufficient eligible capital resources to meet its capital requirements and does not hinder the recapitalisation of the insurer;

(b) for items referred to in paragraphs (1)(a), (1)(b), (1)(c), (1)(e) and (1)(h)—

(i) the item does not include incentives to repay or redeem that item in a way that increases the likelihood that the insurer will repay or redeem that item if it has the option to do so; and

(ii) the item provides the insurer with full flexibility over the distributions of the basic own-fund item;

(c) for items referred to in paragraphs (1)(a) and (1)(b)—

(i) the item ranks after all other claims in the event of winding-up proceedings of the insurer;

(ii) the item either does not have a fixed maturity date or, if the insurer has a fixed maturity, is of the same maturity as the insurer;

(iii) In sub-paragraph (b)(ii), full flexibility over the distributions is provided if all of the following conditions are met—

(A) there is no obligation for the insurer to make distributions;

(B) non-payment of distributions does not constitute an event of default of the insurer;

(C) the cancellation of distributions imposes no restrictions on the insurer;

(D) there is no preferential distribution treatment regarding the order of distribution payments and the terms of the contractual arrangement governing the item do not provide preferential rights to the payment of distributions; and

(E) distributions are only paid out of distributable items;

(d) for basic own-fund items referred to in paragraphs (1)(c), (1)(e) and (1)(h)—

(i) the item ranks—

(A) to the same degree as, or ahead of, items in paragraphs (1)(a) and (1)(b);

(B) after Tier 2 and Tier 3 items; and

(C) after the claims of all policyholders and non-subordinated creditors.

(ii) the item possesses one of three mechanisms, to be triggered when the insurer is significantly not in compliance with its SCR—

(A) the nominal or principal amount of the item is written down in such a way that all of the following are reduced—

(i) the claim of the holder in the event of winding-up proceedings;

(ii) the amount required to be paid on repayment or redemption of that item; and

(iii) any distributions paid on that item.

(B) the item automatically converts into an item listed in paragraphs (1)(a) and (1)(b) and the provisions governing the conversion specify either—

(i) the rate of conversion and a limit on the permitted amount of conversion; or

(ii) a range within which the instruments will convert into an item listed in paragraphs (1)(a) and (1)(b);

(C) another mechanism that achieves an equivalent outcome to those in sub-paragraphs (A) and (B) above.

(iii) the item does not have a fixed maturity date;

(iv) the first contractual opportunity to repay or redeem the item does not occur before 5 years from the date of its issuance;

(v) the item may only allow for repayment or redemption of that item between 5 and 10 years after the date of issuance if an insurer's SCR is exceeded by a margin deemed appropriate by the Authority; and

(vi) in paragraph (b)(ii), full flexibility over the distributions is provided if all of the following conditions are met—

(A) the insurer has full discretion at all times to cancel distributions in relation to the item for an unlimited period and on a noncumulative basis and the insurer may use the cancelled payments without restriction to meet its obligations as they fall due;

(B) there is no obligation to substitute the distribution by a payment in any other form;

(C) there is no obligation to make distributions in the event of a distribution being made on another own-fund item;

(D) non-payment of distributions does not constitute an event of default of the insurer;

(E) the cancellation of distributions imposes no restrictions on the insurer; and

(F) distributions are only paid out of distributable items.

2 Tier 2 own-funds

(1) The following own-fund items are classed as Tier 2, if they meet all of the features in paragraph (2)—

(a) ordinary share capital and the related share premium account;

(b) initial funds, members' contributions or the equivalent basic own-fund item for a mutual or mutual-type insurer;

(c) subordinated mutual member accounts;

(d) preference shares and the related share premium account; and

(e) any other item that has been approved as Tier 2 by the Authority in regulation 59; or

(f) subordinated liabilities.

(2) The required features for an own-fund item to be classed as Tier 2 are—

(a) the item ranks after the claims of all policyholders and non-subordinated creditors of the insurer;

(b) the item is undated or has an original maturity of at least 10 years;

(c) the first contractual opportunity to repay or redeem the item does not occur before 5 years from the date of issuance;

(d) the item may include limited incentives to repay or redeem that item, provided that these do not come into effect before 10 years from the date of issuance, as long as these incentives do not prevent any of the other requirements of this regulation from being met;

(e) the item provides for the suspension of repayment or redemption of that item in circumstances if—

(i) the insurer is not in compliance with its SCR; or

(ii) the repayment or redemption of that item would cause such non-compliance; and

(f) the basic own-fund item meets the Tier 1 features set out in paragraph 1(3), but the limit set in regulation 55(3) for items of its type, is exceeded so it is instead classified as Tier 2.

3 Tier 3 basic own-funds– list of own-fund items

(1) The following basic own-fund items are classed as Tier 3 if they meet all of the features in paragraph (2)—

(a) subordinated mutual member accounts;

(b) preference shares and the related share premium account;

(c) an amount equal to the value of net deferred tax assets; and

(d) any other item that has been approved as Tier 3 by the Authority in regulation 59; or

(e) subordinated liabilities.

(2) The required features for an own-fund item to be classed as Tier 3 are—

(a) the item ranks after the claims of all policyholders and non-subordinated creditors of the insurer;

(b) the item is undated or has an original maturity of at least 5 years, and where the maturity date is the first contractual opportunity to repay or redeem the item;

(c) the item may include limited incentives to repay or redeem that item.