



INSURANCE (LONG-TERM BUSINESS VALUATION AND SOLVENCY) REGULATIONS 2021

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Insurance Act 2008

INSURANCE (LONG-TERM BUSINESS VALUATION AND SOLVENCY) REGULATIONS 2021¹

Laid before Tynwald: 18 January 2022
Coming into Operation: 30 June 2022

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.

PART 1: INTRODUCTORY AND GENERAL REQUIREMENTS

1 Title

These Regulations are the Insurance (Long-Term Business Valuation and Solvency) Regulations 2021.

2 Commencement

These Regulations come into operation on 30 June 2022.

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**” has the same meaning as in the Insurance Regulations 2021¹ with the addition of 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,

¹ SD 2021/0278

resources and information necessary to understand the relevant economic effect of the transaction;

“**basic own-fund item**” has the meaning given in regulation 110.

“**basis point**” is a measure equal to 0.01%;

“**best estimate**” has the meaning given in regulation 21(1);

“**BSCR**” means basic solvency capital requirement, as determined under regulation 33;

“**cell**” has the same meaning as in the Insurance Regulations 2021;

“**CGC**” means the Corporate Governance Code of Practice for Insurers 2021²;

“**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;

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

“**covered bond**” means a security issued by a credit institution which is collateralised against a pool of assets, where, in the event of a failure of the issuer, those assets can cover claims at any point in time;

“**credit quality step**” means a credit quality step set out in a table of credit quality steps, numbered 0 to 6, published by the Authority for the purpose of these Regulations;

“**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 by the term “dormant authorised insurer” in the Insurance Regulations 2021;

“**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;

“**eligible own-fund item**” in relation to the own-fund items of an insurer, has the meaning given in regulation 108;

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

² SD 880/10 as amended by SD 886/10 and 2015/0317 and SD 2021/0276

- “**IC**” has the meaning given in the Insurance Regulations 2021;
- “**ICC**” has the meaning given in the Insurance Regulations 2021;
- “**insurer**”, unless the context requires otherwise, means an insurer to whom these Regulations apply and in relation to —
- (a) a PCC it may mean the PCC, the core of the PCC, or a specific cell of the PCC; and
 - (a) an ICC it may mean the ICC, or an IC.
- “**insurance**” to avoid any doubt and unless the context requires otherwise, includes assurance and reinsurance;
- “**loss-given-default**” means the average loss suffered by the insurer, resulting from the default of a counterparty of the insurer;
- “**marked-to-model**” is an asset valuation technique where the price of an asset is determined by a financial model as opposed to an active financial market, due to the market for that financial instrument not being available;
- “**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;
- “**mortgage loans**” has the meaning given in regulation 62;
- “**non-cellular**”, in relation a PCC, means the business of the PCC not attributed to a cell of the PCC;
- “**NSLT health**” means health insurance business that is not pursued on a similar technical basis to that of life insurance business and a reference to ‘NSLT’ is to be construed accordingly;
- “**OECD**” means the Organisation for Economic Co-operation and Development;
- “**related entity**” is an entity which is —
- (a) a subsidiary of the insurer;
 - (b) an entity in which a participation is held by the insurer; or
 - (c) an entity linked to the insurer by a relationship that requires the production of consolidated accounts in respect of the insurer and the related entity;

“**resecuritisation position**” is a securitisation where the risk associated with the underlying pool of exposures is tranching, and at least one of the underlying exposures is a securitisation position;

“**restricted own-funds**” means own-funds that have a reduced capacity to absorb losses on a going concern basis due to their lack of transferability within an insurer for one or more of reasons given in regulation 117;

“**ring-fenced funds**” are arrangements where an identified set of assets and liabilities are managed as though they were a separate undertaking, and must not include conventional index-linked, unit-linked or reinsurance business;

“**risk mitigation technique**” is a technique used by an insurer to transfer underwriting risk and 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 as determined under Part 4;

“**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**’;

“**single name exposures**” are –

- (a) exposures of an insurer to counterparties that are connected to another counterparty in a way as may result (or appear to result) in a potential correlation of those exposures, including in the ways referred to in this regulation; and
- (b) are referred to as “single name” simply to reflect that relationship irrespective of whether the parties concerned have the same name or not;

“**SLT health**” means health insurance business that is pursued on a similar technical basis to that of life insurance business and a reference to “SLT” must be construed accordingly;

“**solvency ratio**” in relation to an insurer, is the ratio of the amount of its eligible own-funds to its SCR determined under these Regulations, or for a counterparty of the insurer who is also an insurer, such equivalent items in accordance with the corresponding solvency regime of the approved supervisory authority of that insurer’s home jurisdiction;

“**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;

“**surplus funds**” are accumulated profits which have not been made available for distribution to policyholders; and

“**type 1 exposures**” and “**type 2 exposures**” have the meaning given in regulation 61.

4 Application

- (1) These Regulations apply to the carrying on of insurance business of—
 - (a) classes 1, 2 and 10; and
 - (b) class 12 in respect of contracts within classes 1, 2 and 10;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 of the Insurance Regulations 2021.

5 Capital requirements

An insurer must calculate its MCR and SCR in accordance with these Regulations.

6 Expert judgement

- (1) Where an insurer makes assumptions about any of the material components of its SCR or MCR calculation (as applicable), 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 the principles of proportionality in regulation 8, ensure that all internal users of the assumptions referred to in paragraph (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 Actuary’s report

- (1) An insurer must ensure that it obtains from its appointed actuary a written report (or reports), to be submitted to its board of directors at least annually.
- (2) The report(s) must —
 - (a) document all tasks that have been undertaken by the actuarial function, in particular those activities that are required by the CGC;

- (b) include the results of these activities;
 - (c) clearly identify any deficiencies; and
 - (d) give recommendations to the Board as to how those deficiencies should be remedied.
- (3) The report(s) must 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 SCR.
- (4) In the report(s) the actuary must draw conclusions on the appropriateness, accuracy and completeness of the —
- (a) methodologies used to determine the value of the insurer's assets, liabilities, eligible own-funds and technical provisions;
 - (b) best estimate assumptions used by the insurer to determine its technical provisions; and
 - (c) valuation of the insurer's SCR.
- (5) The report(s) must also include any other factors which the actuary considers are material to the present or future valuation of the insurer's technical provisions and SCR.

8 Proportionality

- (1) An insurer must apply these Regulations in a way that is proportionate to the nature, scale and complexity of the risks underlying its insurance obligations.
- (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 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 the following—
 - (i) the assumptions underlying the method in relation to the risks; and
 - (ii) the results of the assessment referred to in sub-paragraph (a).
- (3) The assessment must include all risks which affect the amount, timing or value of the cash in- and out-flows required to settle the insurer's insurance obligations over their lifetime.
- (4) For the purpose of the calculation of the risk margin, the assessment must include all risks referred to in regulation 24(6)(h) over the lifetime of the underlying insurance obligations.

- (5) The assessment must be restricted to the risks that are relevant to that part of the calculation of the insurer's technical provisions to which the method is applied.
- (6) 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 one of the following conditions is met—
 - (a) no other method with a smaller error is available and the method is not likely to result in an underestimation of the amount of technical provisions; 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.

9 Policyholder behaviour

- (1) An insurer must consider policyholder behaviour when determining its technical provisions and capital requirements by taking sufficient steps to identify relevant policyholders' behaviour and making appropriate assumptions relating to the likelihood of policyholders exercising contractual options.
- (2) 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.
- (3) Such analysis must take into account the following—
 - (a) how beneficial the exercise of the options was and will be to the policyholders under circumstances at the time of exercising the option;
 - (b) the influence of past and future economic conditions;
 - (c) the impact of past and future management actions;
 - (d) if relevant, how past projections compared to the actual outcome; and
 - (e) any other circumstances that are likely to influence a decision whether to exercise the option.
- (4) The likelihood that policyholders will exercise contractual options will only be considered to be independent of the elements referred to in

paragraph (3) where there is empirical evidence to support such an assumption.

- (5) Policyholders' behaviour must not be assumed to be independent of—
- (a) active financial markets;
 - (b) the insurer's treatment of customers; or
 - (c) publicly available information,
- unless there is empirical evidence to support such an assumption.

10 Participations

- (1) An insurer must treat holdings in an entity as a participation, if —
- (a) the insurer's share ownership, directly or by way of control, in that entity meets the following criteria —
 - (i) the insurer's percentage holding of voting rights in the entity represents at least 20% of that entity's total voting rights; or
 - (ii) the insurer's percentage holding of all classes of share capital issued by the entity represents at least 20% of that entity's issued share capital; or
 - (b) the insurer is deemed under paragraph (3) to be able to exert a dominant or significant influence over that entity.
- (2) Where the entity is supervised by 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 an entity if—
- (a) the insurer has shareholdings in the entity that either currently meet the requirements of paragraphs (1)(a)(i) and (1)(a)(ii), 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) where the 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 entity;
- (d) the insurer has involvement in policy-making processes, including decision making about dividends or other distributions of the entity;
- (e) there are material transactions between the insurer and the entity;
- (f) there is interchange of managerial personnel between the insurer and the entity;
- (g) there is provision of essential technical information between the insurer and the entity; or
- (h) there is management on a unified basis of the insurer and the entity.

PART 2: VALUATION OF ASSETS AND LIABILITIES OTHER THAN TECHNICAL PROVISIONS

11 Application

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

12 Use of relevant accounting standards

An insurer must recognise its assets and liabilities on its regulatory balance sheet in accordance with one of the accounting standards in regulation 6 of the Insurance Regulations 2021.

13 Valuation of assets and liabilities

- (1) An insurer must value its assets at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction.
- (2) An insurer must value its liabilities at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction.
- (3) When valuing liabilities under paragraph (2) an insurer must not make any adjustment to take account of its own credit standing.
- (4) In addition to the requirements of paragraphs (1) and (2), an insurer must value its assets and liabilities—

- (a) using a relevant accounting standard under regulation 12;
 - (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.
- (5) If it is not possible for an insurer to comply with paragraph (4)(e), 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 must reflect factors specific to the asset or liability.
- (6) If the use of quoted market prices in active financial markets for the same assets or liabilities 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 must reflect factors specific to the asset or liability including—
- (a) the condition and location of the asset or liability;
 - (b) the extent to which the similar asset or liability is comparable to the asset or liability; and
 - (c) the volume or level of activity in the markets within which the similar asset or liability is observed.
- (7) If the requirements referred to in paragraph (6) are not satisfied, an insurer may, subject to the approval of the Authority, use an alternative valuation method, such as the ‘marked-to-model’ approach set out in regulation 14.
- (8) 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 including the following—
- (a) quoted prices for identical or similar assets or liabilities in markets that are not active;
 - (b) data other than quoted prices that is observable for the asset or liability, including interest rates and yield curves observable at commonly quoted intervals, implied volatilities and credit spreads; or

- (c) market-corroborated data, which may not be directly observable, but is based on or supported by observable market data,
and all such market data must be adjusted for the factors referred to in paragraph (6).
- (9) To the extent that relevant observable inputs are not available, including in circumstances where there is little, if any, market activity for the asset or liability at the valuation date, the insurer must use unobservable data reflecting the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.
- (10) 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.
- (11) When assessing the assumptions about risk, as referred to in paragraph (9), an insurer must take into account the risk inherent in the specific valuation technique used to measure fair value and the risk inherent in the inputs of that valuation technique.
- (12) An insurer must recognise any material contingent liabilities within its liabilities.
- (13) An insurer must calculate the value of a material contingent liability as equal to 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 23.
- (14) 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 under paragraph (4).
- (15) An insurer must recognise and value deferred tax assets and liabilities in relation to all assets and liabilities that are recognised for solvency and tax purposes within its assets and liabilities.
- (16) An insurer must calculate the value of deferred taxes as —
- (a) the values ascribed to assets and liabilities under paragraph (4); 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 unused tax credits and unused tax losses.

- (17) The value specified in paragraph (16)(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.
- (18) An insurer must recognise participations meeting the requirements of regulation 10 in its assets and liabilities.
- (19) An insurer must calculate the value of a participation as the quoted market price in an active financial market.
- (20) If it is not practicable or proportionate for an insurer to comply with paragraph (19), the insurer must use a relevant alternative approach set out in paragraphs (5) to (11).

14 Recognition of marked-to-model asset portfolios

- (1) An insurer may determine the value of the assets backing a portfolio of its life insurance obligations, using the marked-to-model approach as an alternative valuation method to that required by regulation 13(6), subject to obtaining approval from the Authority, and only when all of the following conditions are met—
 - (a) the insurer has assigned a portfolio of assets, consisting of bonds or assets with similar cash flow characteristics, to cover the best estimate of the portfolio of insurance obligations, and maintains that assignment over the lifetime of the obligations, except for the purpose of maintaining the replication of expected cash flows between assets and liabilities where the cash flows have materially changed;
 - (b) the portfolio of insurance obligations and the assigned portfolio of assets are identified, organised and managed separately from the other activities of the insurer and the assigned portfolio of assets cannot be used to cover losses arising from other activities of the insurer;
 - (c) the expected cash flows of the assigned portfolio of assets (net of expected defaults) replicate the expected cash flows of the portfolio of insurance obligations in the same currency, with no material basis mismatch;
 - (d) there are no future premium payments in the portfolio of insurance obligations;
 - (e) the portfolio of insurance obligations only includes longevity risk, expense risk, revision risk and/or mortality risk;
 - (f) if the portfolio of insurance obligations includes mortality risk, the best estimate of the portfolio increases by no more than 5% under a mortality risk shock specified in paragraph (j);

- (g) there are no policyholder options as defined in regulations 77(2) and 77(3) in the portfolio of insurance obligations, or only a surrender option where the surrender value does not exceed the value of the assets valued under regulation 13;
 - (h) the cash flows of the assigned portfolio of assets are fixed and cannot be changed by the issuers of the assets or any third parties, except where—
 - (i) cash flows are linked to inflation and these assets replicate the cash flows of the portfolio of insurance obligations which are linked to inflation; or
 - (ii) issuers have the right to change the cash flows of the asset in such a manner that the investor receives sufficient compensation to allow it to obtain the original cash flows by reinvesting in assets of an equivalent or better credit quality;
 - (i) the portfolio of insurance obligations consists of the whole of the obligations of each contract in the portfolio; and
 - (j) the mortality shock is the more onerous of the following two shocks, applied to contracts for which an increase in mortality rates increases the best estimate—
 - (i) an instantaneous permanent increase in mortality rates of 15%; and
 - (ii) an instantaneous increase to mortality rates (expressed as percentages) by an absolute value of 0.15%, in the 12 months following the valuation date.
- (2) If the asset portfolio includes risks which are not covered by the SCR under regulation 28 then the insurer may not mark the asset portfolio to model.
- (3) The marked-to-model portfolio is treated in the same way as a ring-fenced fund when determining its SCR, under regulation 100.

15 Recognition of assets and liabilities in a ring-fenced fund

- (1) When valuing its assets under regulation 13, where an insurer has ring-fenced funds, it must identify the assets and liabilities of those ring-fenced funds in accordance with the rest of this regulation.
- (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. These

include the technical provisions including any future discretionary benefits which the insurer expects to pay.

- (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.
- (5) The reduced transferability of the assets of a ring-fenced fund must be reflected in the calculation of reconciliation reserve in regulation 114.

PART 3: VALUATION OF TECHNICAL PROVISIONS

16 Technical provisions

- (1) In order to determine its capital requirements, an insurer must establish technical provisions which, at a minimum, correspond to the economic value of fulfilling the insurance obligations under its insurance contracts, written for the classes of insurance business specified in regulation 4, over the lifetime of the contracts.
- (2) In paragraph (1), insurance obligations include obligations relating to unilateral rights of the insurer to renew or extend the scope of a contract and obligations that relate to paid premiums.
- (3) An insurer must apply regulations 17 and 18 to determine which insurance obligations must be included within its technical provisions.
- (4) An insurer must calculate its technical provisions as the sum of a best estimate determined under regulation 21 and a risk margin determined under regulation 24.
- (5) An insurer must value the best estimate and the risk margin separately.
- (6) An insurer must determine technical provisions for each of its material ring-fenced funds, and for the remainder of its insurance obligations where the remainder must include ring-fenced funds that have not been deemed material.
- (7) An insurer must be able to demonstrate to its board of directors the appropriateness of the level of its technical provisions, as well as the applicability and relevance of the methods applied, and the adequacy of the underlying statistical data used, in determining those provisions.
- (8) An insurer's technical provisions must take account of—
 - (a) all expenses that might reasonably be expected to be incurred by the insurer in servicing insurance obligations in accordance with regulation 21(10)(c);
 - (b) inflation, including expense and claims inflation;
 - (c) all payments to policyholders, including future discretionary benefits, which the insurer expects to make, whether or not those

- payments are contractually guaranteed, unless those payments are surplus funds;
- (d) relevant information provided by active financial markets; and
 - (e) generally available data on relevant underwriting risks.
- (9) The surplus funds of an insurer can only be considered to be insurance liabilities of the insurer under paragraph (8)(c) to the extent that the surplus funds are not included as a Tier 1 basic own-fund item under regulation 114.
- (10) Assumptions underlying the calculation of an insurer's technical provisions must be realistic and will only 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 can clearly identify 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 homogeneous risk groups, without arbitrary changes; and
 - (e) the assumptions adequately reflect any uncertainty underlying the cash flows.
- (11) For the purpose of paragraph (10)(c), an insurer must only use information specific to the insurer, including information on claims management and expenses, if —
- (a) that information reflects the characteristics of the portfolio of insurance obligations better than information that is not limited to the specific insurer; or
 - (b) the calculation of technical provisions in a prudent, reliable and objective manner without using that information is not possible.
- (12) An insurer must set assumptions on future active financial market parameters and scenarios (as applicable) that are appropriate and consistent with the purpose of regulation 12.
- (13) If an insurer uses the marked-to-model approach under regulation 14, the model used to produce projections of future active financial market parameters must comply with all of the following requirements—

- (a) the model must generate asset prices that are consistent with asset prices observed in an active financial market;
 - (b) the model must assume no arbitrage opportunities exist; and
 - (c) the calibration of the model's parameters and scenarios must be consistent with the relevant risk-free interest rate term structure used to calculate the insurer's technical provisions.
- (14) An insurer must assess the impact of changes to its assumptions regarding the effect of future management actions on the valuation of its technical provisions. If changes in an assumption on future management actions has a significant impact on the technical provisions, the insurer must be able to explain the reason for this impact and how the impact is taken into account in its decision making process.
- (15) 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. The results of this validation must be included within the report referred to in regulation 7.
- (16) An insurer must carry out the validation required by paragraph (15) individually for the gross best estimate, amounts recoverable from reinsurance contracts and special purpose vehicles, and the risk margin.
- (17) 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, including the choice of relevant assumptions about the allocation of expenses;
 - (c) the selection and application of actuarial and statistical methods for the calculation of its technical provisions, including the use of any simplifications; and
 - (d) the validation of its technical provisions under paragraph (15).
- (18) For the purposes of paragraph (17)(a) , the documentation must include detailed description of the data used to determine the insurer's technical provisions including—
- (a) data groupings used and how they impact the result;
 - (b) the collection of data, how it was analysed and its quality;
 - (c) if data is not used consistently over time, an explanation of its inconsistent use and a justification; and

- (d) any data issues which are considered material to the valuation of the insurer's technical provisions.
- (19) For the purposes of paragraph (17)(b), the documentation must include a detailed description of the best estimate assumptions used to determine the insurer's technical provisions including—
- (a) a directory of the economic and demographic assumptions used;
 - (b) assumptions regarding the use of future management actions;
 - (c) assumptions about policyholder behaviour;
 - (d) limitations of assumptions used;
 - (e) processes in place to review assumptions;
 - (f) an explanation of significant changes in assumptions and an estimation of the impact of material changes; and
 - (g) a comparison of the best estimate against experience including a review of the quality of past best estimate assumptions and how the insight of past experience has been used to improve current calculations.

17 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 derecognise an insurance obligation only when it is fully extinguished, discharged or cancelled or has expired.

18 Contract boundary

- (1) When determining the technical provision for a contract of insurance, an insurer must only recognise insurance obligations falling within the boundary of that contract, as specified under paragraphs (2) and (3).
- (2) An insurer must recognise an insurance obligation as belonging to a contract from the earlier of the date the insurer becomes a party to the contract that gives rise to the obligation or the date the insurance cover begins.
- (3) Subject to paragraphs (4), (5) and (6) as applicable, an obligation of the insurer that relates to insurance cover provided by an insurer 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.
- (4) In the case of obligations where an individual risk assessment of the obligations relating to the insured person of the contract is carried out at the inception of the contract and that assessment cannot be repeated before amending the premiums or benefits, the insurer must assess at the level of the contract whether the premiums fully reflect the risk.
 - (5) An insurer must not take into account any restrictions of any of its unilateral rights as referred to in paragraph (3) or any limitations of the extent to which premiums or benefits can be amended that have no discernible effect on the economics of the contract.
 - (6) An insurer must, for the purposes of paragraph (3), only consider that premiums fully reflect the risks covered by a portfolio of its insurance contracts if there is no circumstance under which the amount of the benefits and expenses potentially payable under the portfolio exceeds the amount of the premiums potentially payable under the portfolio.

19 Homogeneous risk groups

- (1) An insurer must segment its insurance obligations into homogeneous risk groups when calculating its technical provisions.
- (2) The assignment of an insurance obligation to a homogeneous risk group must reflect the nature of the risks relating to the obligation.
- (3) If an insurance contract covers risks across homogenous risk groups, the insurance obligations under the contract must, if possible, be unbundled into the appropriate risk group.
- (4) If an insurance contract includes health insurance obligations and other insurance obligations under the contract, those obligations must, if possible, be unbundled.

20 Future management actions

- (1) The assessment of an insurer's technical provisions, including the methods and techniques for the estimation of the future cash flows of the insurer, may take account of potential realistic future actions which may be taken by the management of the insurer.

- (2) In paragraph (1), an assumed future management action may only be considered to be realistic if it meets all of the following conditions—
 - (a) it is determined in an objective manner;
 - (b) it is consistent with the insurer’s current business practice and business strategy, including the use of risk mitigation techniques;
 - (c) where there is sufficient evidence that the insurer will change its practices or strategy, the assumption is consistent with the new practices or strategy;
 - (d) it is consistent with the insurer’s other assumptions on future management actions;
 - (e) it is not contrary to any obligations of the insurer towards its policyholders, or to legal requirements applicable to the insurer;
 - (f) it takes account of any public indications by the insurer as to the actions that it would expect to take or not take; and
 - (g) it takes account of the time needed to implement the management actions and any expenses caused by them.
- (3) An insurer must be able to verify, and take such actions as are adequate and appropriate to verify, that assumptions about its future management actions are realistic through suitable means, including—
 - (a) a comparison of assumed future management actions with management actions actually taken previously by the insurer;
 - (b) a comparison of future management actions taken into account in the insurer’s current and past calculations of the best estimate; and
 - (c) an assessment of the impact of changes in the assumptions of future management actions on the value of the insurer’s technical provisions.
- (4) An insurer must be able to explain any relevant deviations in relation to paragraphs (3)(a) and (3)(b) upon request of the Authority and, if changes in an assumption on future management actions has a significant impact on the technical provisions, the reasons for that sensitivity and how the sensitivity is taken into account in the decision-making process of the insurer.
- (5) In relation to its future management actions an insurer must establish and maintain a comprehensive future management actions plan, approved by its board of directors which provides for all of the following—
 - (a) the identification of future management actions that are relevant to the valuation of the insurer’s technical provisions;
 - (b) the identification of the specific circumstances in which the insurer would reasonably expect to carry out each respective future management action referred to in paragraph (a);

- (c) the identification of the specific circumstances in which the insurer may not be able to carry out each respective future management action referred to in paragraph (a), and a description of how those circumstances are considered in the calculation of its technical provisions;
- (d) the order in which future management actions referred to in paragraph (a) would be carried out and the insurer's governance requirements applicable to those future management actions;
- (e) a description of any on-going work required to ensure that the insurer is in a position to carry out each respective future management action referred to in paragraph (a);
- (f) a description of how the future management actions referred to in paragraph (a) have been reflected in the calculation of the insurer's technical provisions; and
- (g) a description of the applicable internal reporting procedures that cover the future management actions referred to in paragraph (a) included in the insurer's calculation of its technical provisions.

21 Calculation of the best estimate

- (1) 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) The expected present value of future cash-flows 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 under regulation 23 for the relevant currency of that cash flow.
- (3) The calculation of the best estimate must—
 - (a) be calculated gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles which must be calculated separately, under regulation 22;
 - (b) be calculated separately for obligations in different currencies;
 - (c) be based upon up-to-date and credible information;
 - (d) use realistic assumptions under regulation 16(10);
 - (e) take into account future discretionary benefits which are expected to be made, whether or not those payments are contractually guaranteed;
 - (f) take into account all financial guarantees and contractual options included in the insurer's insurance contracts;

- (g) take into account all factors which may affect the likelihood that the insurer's policyholders will exercise contractual options or realise the value of financial guarantees.
 - (h) be performed using adequate, applicable and relevant actuarial and statistical methods based on their appropriateness to reflect the risks which affect the underlying cash flows of the insurer and the nature of the insurance obligations; and
 - (i) 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 qualified expert.
- (4) In paragraph (3)(c), information must only be considered to be credible if an insurer can evidence the credibility of the information taking into account the consistency and objectivity of that information, the reliability of the source of the information and the transparency of the way in which the information is generated and processed.
- (5) The actuarial and statistical methods in paragraph (3)(h) must be consistent with, and make use of, all relevant data available for the calculation of the best estimate.
- (6) If a calculation method is based on grouped contract data, an insurer must ensure that the grouping of contracts creates homogeneous risk groups that appropriately reflect the risks of the individual contracts included in those groups, under regulation 19.
- (7) An insurer must analyse the extent to which the present value of its cash flows depends both on the expected outcome of future events and developments and on how the actual outcome in certain scenarios could deviate from the expected outcome.
- (8) If the present value of an insurer's cash flows depends on future events and developments the insurer must use a method to calculate the best estimate for cash flows which reflects those dependencies.
- (9) If an insurer has insufficient data meeting the data quality requirements in regulation 26, and therefore cannot apply a reliable actuarial method, 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.

- (10) The cash flow projection under paragraph (1) must include all of the following cash flows, as applicable and to the extent that those cash flows relate to the insurer's existing insurance obligations —
- (a) benefit payments to policyholders;
 - (b) payments that the insurer will incur in providing contractual benefits that are paid in kind;
 - (c) payments of expenses including—
 - (i) administrative expenses;
 - (ii) investment management expenses;
 - (iii) overhead expenses incurred in servicing the insurance obligations;
 - (iv) claims management expenses;
 - (v) acquisition expenses; and
 - (vi) expenses relating to reinsurance contracts and special purpose vehicles;
 - (d) premium payments and any additional cash flows that result from those premiums;
 - (e) payments between the insurer and intermediaries relating to insurance obligations;
 - (f) payments between the insurer and investment firms in relation to contracts with index-linked and unit-linked benefits; and
 - (g) taxation payments which are, or are expected to be, charged to policyholders or are required to settle the insurance obligations.
- (11) 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 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.
- (12) 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 the timing, frequency and severity of insured events;
 - (b) uncertainty in claim amounts, including uncertainty in claims inflation, and in the period needed to settle and pay claims;
 - (c) uncertainty in the amount of expenses;
 - (d) uncertainty in expected future developments to the extent that it is practicable;
 - (e) uncertainty in policyholder behaviour;
 - (f) dependency between two or more causes of uncertainty; and
 - (g) dependency of cash flows on circumstances prior to the date of the cash flow.
- (13) An insurer's overhead expenses 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.
- (14) Where an insurer is open to new business, expenses must be projected on the assumption that the insurer will continue to write new business in the future.
- (15) If future discretionary benefits in paragraph (3)(e) depend on the assets held by an insurer, the insurer must—
- (a) base the calculation of the best estimate on the assets it currently holds;
 - (b) assume future changes of its asset allocation under regulation 20; and
 - (c) ensure that the assumptions on the future returns of the assets are consistent with the relevant risk-free interest rate term structure under regulation 23 and the valuation of the assets under regulation 12.
- (16) An insurer must be able to separately identify the value of any relevant future discretionary benefits within the best estimate.
- (17) In paragraph (3)(g), any assumption made by the insurer with respect to policyholder behaviour must meet the requirements of regulation 9.
- (18) The cash flow projection under paragraph (1) must be carried out separately for each insurance contract.
- (19) If the approach in paragraph (18) would produce an undue burden on an insurer, under regulation 19 the insurer may carry out the projection by

grouping contracts, provided that the grouping complies with all of the following requirements—

- (a) there are no significant differences in the nature and complexity of the risks underlying the contracts that belong to the same group;
- (b) the grouping of contracts does not misrepresent the risk underlying the contracts and does not misstate their expenses; and
- (c) the grouping of contracts is likely to give approximately the same results for the best estimate calculation as a calculation on a per contract basis, in particular in relation to financial guarantees and contractual options included in the contracts.

22 Recoverables from reinsurance contracts and special purpose vehicles

- (1) In regulation 21(3)(a) 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 insurance or reinsurance contracts to which those amounts relate; and
 - (b) 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) cash flows must only include payments in relation to compensation of insurance events and unsettled insurance claims;
 - (b) payments in relation to other events or settled insurance claims must be accounted for outside the amounts recoverable from reinsurance contracts and special purpose vehicles;
 - (c) 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;
 - (d) 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;
- (e) 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 an amount equal to the expense has been received from the insurer which has transferred the risks to the special purpose vehicle; and
 - (f) 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 sub-paragraph (2)(b), unless paragraph (8) or paragraph (11) 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.
- (5) The change in cash flows in paragraph (4) must not take into account the effect of any risk mitigating technique that mitigates the credit risk of the counterparty.
- (6) The adjustment to take account of expected losses due to default of a counterparty in paragraph (4) 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 carried out separately by each counterparty and for each homogeneous risk group;

- (c) be calculated and shown separately from the rest of the amounts recoverable; and
- (d) 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) The average loss resulting from a default of a counterparty in paragraph (6) must not be assessed at lower than 50% of the amounts recoverable excluding the adjustment, unless there is a reliable basis for another assessment.
- (8) Where the method of calculating the adjustment described in paragraph (4) is not proportionate, an insurer may calculate the adjustment for default to be the gross best estimate less the unadjusted net best estimate.
- (9) The unadjusted net best estimate is determined 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.
- (10) When determining the unadjusted net best estimate in paragraph (9), an insurer 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.
- (11) In paragraph (4), an insurer may alternatively calculate the adjustment for expected losses due to default of the counterparty for a specific counterparty and homogeneous risk group as follows—

$$Adj_{CD} = -\max\left(0; 0.5 \cdot \frac{PD}{1 - PD} \cdot Dur_{mod} \cdot BE_{rec}\right)$$

where—

- (a) PD denotes the probability of default of that counterparty during the following 12 months;
- (b) Dur_{mod} denotes the modified duration of the amounts recoverable from reinsurance contracts with that counterparty in relation to that homogeneous risk group; and
- (c) BE_{rec} denotes the amounts recoverable from reinsurance contracts with that counterparty in relation to that homogeneous risk group.

23 Risk-free interest rate term structure

- (1) An insurer must use the risk-free interest rate term structures published periodically by the Authority to determine its technical provisions.
- (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 must be used; and
- (b) investment expenses must be allowed for as a cash flow underlying the calculation of technical provisions under regulation 21(10)(c) and not in an adjustment to the risk-free interest rates used to discount technical provisions.

24 Calculation of the risk margin

- (1) The risk margin is an estimation of the opportunity cost resulting from an insurer having to establish and hold eligible own-funds equal to its SCR, over the lifetime of its insurance obligations. In particular, the calculation must take the diversification of the whole portfolio into account.
- (2) The calculation of the risk margin must be based on a projection of the SCR that takes the risk mitigation of reinsurance contracts and special purpose vehicles into account.
- (3) An insurer's risk margin ('RM') must be calculated using the following formula—

$$RM = CoC \cdot \sum_{t \geq 0} \frac{SCR_{RI}(t)}{(1 + r_{t+1})^{t+1}}$$

where—

- (a) *CoC* denotes the cost-of-capital rate under paragraph (4);
 - (b) $SCR_{RI}(t)$ denotes the SCR of the reference insurer after t years, determined under paragraph (6);
 - (c) r_{t+1} denotes the basic risk-free interest rate in the local currency (as defined in regulation 47) of the insurer for the maturity of $t + 1$ years.
- (4) The cost-of-capital rate is set at 5%.
 - (5) An insurer must allocate its risk margin to the relevant homogeneous risk groups in regulation 19 in accordance with the contribution of each risk group to the insurer's SCR.
 - (6) The calculation of the risk margin is based on all of the following assumptions (if applicable)—
 - (a) the whole portfolio of insurance obligations of the insurer that calculates the risk margin (the original insurer) is taken over by another insurer (the reference insurer);
 - (b) the transfer of insurance obligations includes any reinsurance contracts and arrangements with special purpose vehicles relating to those obligations;
 - (c) the reference insurer does not have any insurance obligations or eligible own-funds before the transfer takes place;

- (d) after the transfer, the reference insurer does not assume any new insurance obligations;
 - (e) after the transfer, the reference insurer raises eligible own-funds equal to the SCR necessary to support the insurance obligations over the lifetime of those obligations;
 - (f) after the transfer, the reference insurer has assets which amount to the sum of its SCR and of the technical provisions net of the amounts recoverable from reinsurance contracts and special purpose vehicles;
 - (g) the assets are selected in such a way that they minimise the capital requirement for market risk to which the reference insurer is exposed;
 - (h) the SCR of the reference insurer captures all of the following risks—
 - (i) underwriting risk with respect to the transferred business;
 - (ii) if it is material, the market risk referred to in paragraph (g), other than interest rate risk;
 - (iii) default risk with respect to reinsurance contracts, arrangements with special purpose vehicles, intermediaries, policyholders and any other material exposures which are closely related to the insurance obligations; and
 - (iv) operational risk;
 - (i) the loss-absorbing capacity of technical provisions in the reference insurer corresponds for each risk to the loss-absorbing capacity of technical provisions in the original insurer;
 - (j) there is no loss-absorbing capacity of deferred taxes for the reference insurer; and
 - (k) the reference insurer will, subject to paragraphs (d) and (e), adopt future management actions that are consistent with the assumed future management actions of the original insurer.
- (7) The SCR of the original insurer is assumed to be equal to the SCR of the reference insurer under the assumptions set out in paragraph (6).
- (8) The calculation must include any capital add-on imposed in regulation 29, unless the capital add-on is a result of the insurer's systems of governance not adequately addressing its risk profile.
- (9) An insurer must determine the risk margin using the approach in this regulation at least once a year.
- (10) Under paragraph (9), and in accordance with regulation 8, for subsequent quarterly calculations of the risk margin an insurer may derive the risk margin from the result of the full calculation determined under paragraph

(9), without an explicit calculation of the formula referred to in paragraph (3).

25 Optional simplified calculation of the risk margin

An insurer may use simplified methods when it calculates the risk margin under regulation 24, including one or more of the following—

- (a) methods which use approximations for the amounts included in the calculation of $SCR_{RI}(t)$; or
- (b) methods which approximate the discounted sum of the amounts included in the calculation of $SCR_{RI}(t)$, without calculating each of those amounts separately.

26 Data Quality

- (1) An insurer must have internal processes and procedures in place to ensure the completeness under paragraph (2), accuracy under paragraph (3), and appropriateness under paragraph (4) of the data used in the calculation of its technical provisions.
- (2) Data used in the calculation of an insurer's technical provisions must only be considered to be complete if both of the following conditions are met—
 - (a) the data includes sufficient historical information to assess the characteristics of the underlying risks and to identify trends in the risks; and
 - (b) the data is available for each of the relevant homogeneous risk groups used in the calculation of the insurer's technical provisions and no relevant data is excluded from being used in the calculation of the insurer's technical provisions without justification.
- (3) Data used in the calculation of an insurer's technical provisions must only be considered to be accurate if all of the following conditions are met—
 - (a) the data is free from material errors;
 - (b) data from different time periods used for the same estimation are consistent; and
 - (c) the data is recorded in a timely manner and consistently over time.
- (4) Data used in the calculation of an insurer's technical provisions must only be considered to be appropriate if all of the following conditions are met—
 - (a) the data is consistent with the purposes for which it will be used;
 - (b) the amount and nature of the data ensures that the estimations made in the calculation of the technical provisions on the basis of the data do not include a material estimation error;

- (c) the data is consistent with the assumptions underlying the actuarial and statistical techniques that are applied to it in the calculation of the technical provisions;
 - (d) the data appropriately reflect the risks to which the insurer is exposed with regard to its relevant insurance obligations;
 - (e) the data was collected, processed and applied in a transparent and structured manner, based on a documented process that comprises all of the following—
 - (i) the definition of criteria for the quality of data and an assessment of the quality of data, including specific qualitative and quantitative standards for different data sets;
 - (ii) the use of and setting of assumptions made in the collection, processing and application of data; and
 - (iii) the process for carrying out data updates, including the frequency of updates and the circumstances that trigger additional updates; and
 - (f) the insurer must ensure that its data is used consistently over time in the calculation of the technical provisions.
- (5) An insurer may use data from an external source provided that, in addition to fulfilling the requirements set out in this regulation, all of the following requirements are met—
- (a) the insurer is able to demonstrate to its board of directors that the use of that data is more suitable than the use of data which are exclusively available from an internal source;
 - (b) the insurer must know the origin of that data and the assumptions or methodologies used to process that data;
 - (c) the insurer must identify any trends in that data and the variation, over time or across data, of the assumptions or methodologies in the use of that data; and
 - (d) the insurer is able to demonstrate to its board of directors that the assumptions and methodologies referred to in paragraphs (b) and (c) reflect the characteristics of the insurer’s insurance obligations.

27 Limitations of data

- (1) If data does not comply with regulation 26, an insurer must document appropriately the limitations of the data, including a description of whether and how those limitations will be remedied and of the functions within the system of governance of the insurer responsible for that process.

- (2) Matters relating to the limitations of the data described in paragraph (1) must be included in the reporting of deficiencies in regulation 7(2).
- (3) Before adjustments to remedy limitations are made to it, data that does not comply with regulation 26 must be recorded and stored appropriately.

PART 4: SOLVENCY CAPITAL REQUIREMENT

28 Solvency Capital Requirement

- (1) The SCR for a dormant insurer is the amount of regulatory capital an insurer is required to hold so that its assets exceed its technical provisions.
- (2) The SCR for an insurer, other than a dormant insurer, corresponds to the Value-at-Risk of its basic own-funds subject to a confidence level of 99.5% over a one-year period.
- (3) An insurer must calculate its SCR on the presumption that the insurer will pursue its business as a going concern, using the standard formula approach in paragraph (6).
- (4) An insurer's SCR has been calibrated to ensure all quantifiable risks to which the insurer is exposed are taken into account and covers unexpected losses relating to existing business of the insurer.
- (5) The standard formula approach used to determine an insurer's SCR is the sum of —
 - (a) its SCR determined using the standard formula approach in paragraph (6); and
 - (b) any adjustment as may be specified by the Authority as a capital add-on under regulation 29.
- (6) The insurer's SCR using the standard formula approach is —

$$SCR = \sqrt{BSCR^2 + BSCR \cdot SCR_{op_UL} + SCR_{op_UL}^2} + Adj + SCR_{op_nonUL} + SCR_{op_non-life}$$

where—

- (a) BSCR is determined under regulation 33;
- (b) *Adj* is determined under regulation 35;
- (c) SCR_{op_UL} and SCR_{op_nonUL} are determined under regulation 37; and
- (d) $SCR_{op_non-life}$ is the non long-term business operational risk SCR determined under the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021³ (applicable only for insurers who are also authorised to write classes 3 to 9 insurance business)

³ SD 2021/0274

- (7) If an insurer has material ring-fenced funds, determined under regulation 118, or has marked-to-model portfolios, the insurer must determine its SCR using the approach set out in regulation 100.

29 Capital add-on

- (1) Under regulation 28(5)(b) 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;
 - (b) systems of governance deviate significantly from the requirements of the CGC and 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; or
 - (c) systems of governance deviate significantly from the requirements of the CGC and 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 should 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 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 under 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 28(2).
- (8) In the circumstances mentioned in paragraph (1)(b) or (1)(c), 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.

30 Scenario based calculations

- (1) In this regulation a rolling hedge arrangement is where an in force risk mitigation technique is replaced at the time of its expiry with a similar arrangement regardless of the solvency position of the insurer.
- (2) An insurer must calculate its SCR using scenario based calculations, where each scenario represents a risk under the standard formula approach in regulation 28.
- (3) A scenario applies an instantaneous stress to the assets, liabilities and technical provisions of the insurer.
- (4) If the application of a scenario results in a reduction in an insurer's basic own-funds, then the insurer is required to hold an amount of capital equal to the reduction. Such an amount is the capital requirement for that risk.
- (5) If the application of a scenario results in an increase in an insurer's basic own-funds then the insurer is not required to hold capital for that risk and the capital requirement is zero.
- (6) When applying the stresses underlying a scenario an insurer —
 - (a) must not take into account risk mitigation techniques that rely on the insurer taking future action, such as dynamic hedging strategies and future management actions at the time the stress is applied;
 - (b) must distinguish dynamic hedging strategies and future management actions from rolling hedge arrangements;
 - (c) must not change the risk margin included in the insurer's technical provisions;
 - (d) must not change the value of the insurer's deferred tax assets and liabilities;
 - (e) must not change the value of future discretionary benefits included in the insurer's technical provisions; and
 - (f) must allow for the impact of the scenario on the value of any risk mitigation technique in use by the insurer.
- (7) Following the application of a scenario an insurer —
 - (a) can allow for recovery in its portfolio of business (if applicable);

- (b) can take account of any future management actions that may be taken after the application of the scenario, as long as the management action complies with the requirements of regulation 20; and
 - (c) must take account of any material adverse impact of a scenario or management actions, if applicable, on the likelihood that policyholders will exercise contractual options.
- (8) An insurer may use simplified methods to recalculate its technical provisions allowing for the impact of a scenario provided that the simplified method does not lead to a material misstatement of the insurer's capital requirements.
- (9) If an insurer transfers its underwriting risks using reinsurance contracts or special purpose vehicles that meet the requirements of regulation 101, and if these arrangements provide the insurer with protection against the events in the scenario-based calculations, the risk-mitigating effects of these arrangements must be allocated to the scenario-based calculations in a manner that, without double-counting, captures the economic effect of the protections provided.
- (10) The recognition of risk mitigation techniques in the calculation of the insurer's SCR must reflect the economic substance of the technique used and must be restricted to risk mitigation techniques that effectively transfer the risk outside the insurer.
- (11) If the effectiveness of a risk mitigation technique is undermined by the existence of material basis risk, as defined in regulation 31, in particular because of a currency mismatch, the insurer must reflect the material basis risk in the calculation of its SCR, otherwise the risk mitigation technique must not be recognised.
- (12) If an insurer transfers its underwriting risks using finite reinsurance, these contracts must only be recognised in the insurer's scenario based calculations to the extent underwriting risk is transferred to the counterparty of the contract.

31 Basis risk

- (1) Basis risk arises from the situation in which a risk exposure covered by a risk mitigation technique does not correspond completely to the risk exposure of the insurer.
- (2) Basis risk is material if it leads to a misstatement of the risk-mitigating effect in an insurer's BSCR that could influence the decision making or judgement of the intended user of that information.
- (3) A particular example of basis risk arises from a currency mismatch, where the risk exposure covered by the risk mitigation technique is expressed in a currency different to the risk exposure actually held by an insurer.

- (4) If there is a material currency mismatch risk for a risk mitigation technique used against an underwriting risk exposure, an insurer may still take into account the risk mitigation technique in determining its SCR, provided that the risk mitigation technique complies with regulation 101, and the currency risk is not already included in the currency risk capital requirement.
- (5) An insurer must allow for currency mismatch risk, for each foreign currency (as defined in regulation 47) it is exposed to, in the respective underwriting risk capital requirement by adding 25% of the difference between the following to the standard formula capital requirement for that risk exposure —
 - (a) the hypothetical capital requirement for the relevant underwriting risk that would result from a simultaneous occurrence of the scenario for the underwriting risk capital requirement and the scenario for the currency risk capital requirement set out in regulation 47; and
 - (b) the capital requirement for the relevant underwriting risk.
- (6) If the risk mitigation technique covers more than one underwriting risk, the calculation in paragraph (5) must be carried out for each of those risks.
- (7) If the risk mitigation technique is a non-proportional reinsurance contract or a special purpose vehicle, the capital requirement resulting from the calculations in paragraph (6) must not exceed 25% of the capacity of that risk mitigation technique.

32 Association of credit assessments to credit quality steps

- (1) Schedule 1 has effect and sets out the requirements for use of external credit assessments by an insurer.
- (2) An insurer must take the nominated external credit assessment for an asset, liability or a counterparty determined under Schedule 1, and assign it to a credit quality step.
- (3) Where an external credit assessment is not available a credit quality step of 5 must be assigned, unless stated otherwise in these Regulations.

33 Basic Solvency Capital Requirement

- (1) The BSCR in regulation 28(6)(a) is an aggregation of the capital requirements for a set of prescribed risks, allowing for diversification between risks.
- (2) The BSCR includes capital requirements for the following risks—
 - (a) market risk;
 - (b) counterparty default risk;
 - (c) life underwriting risk;

- (d) health underwriting risk;
 - (e) non-life underwriting risk (applicable only where an insurer is also authorised to carry out classes 3 to 9 insurance business); and
 - (f) intangible asset risk.
- (3) An insurer's BSCR is determined as follows—

$$BSCR = \sqrt{\sum_{r,c} Corr_{r,c} \cdot SCR_r \cdot SCR_c} + SCR_{intangibles}$$

where—

- (a) $Corr_{r,c}$ are the entries of the correlation matrix $Corr$;
- (b) SCR_r and SCR_c are the capital requirements for the individual SCR risks according to the rows and columns of the correlation matrix $Corr$;
- (c) $SCR_{intangibles}$ is the capital requirement for intangible asset risk;
- (d) $Corr$ is defined as—

<i>Corr</i>	Market	Default	Life	Health	Non-life
Market	1	0.25	0.25	0.25	0.25
Default	0.25	1	0.25	0.25	0.5
Life	0.25	0.25	1	0.25	0
Health	0.25	0.25	0.25	1	0
Non-life	0.25	0.5	0	0	1

- (4) For the purpose of regulations 51, 66, 67, 68, and 70, an insurer must determine whether the simplified calculation is proportionate using the assessment under regulation 8.
- (5) A simplified calculation must not be considered to be proportionate where the error referred to in paragraph 8(2)(b) leads to a misstatement of an insurer's SCR that could influence the decision-making or the judgement of the user of the information relating to the insurer's SCR, unless the simplified calculation leads to a SCR which exceeds the SCR that results from the standard calculation.
- (6) The capital requirement for non-life underwriting risk in paragraph (2)(e) is determined under the Insurance (Non Long-Term Business Valuation and Solvency) Regulations 2021.

34 Adjustment for the loss-absorbing capacity of technical provisions and deferred taxes

- (1) The adjustment for the loss-absorbing capacity of an insurer's technical provisions and deferred taxes under regulation 28(6)(b) is the sum of the following items—

- (a) the adjustment for the loss-absorbing capacity of technical provisions, Adj_{TP} determined under regulation 35; and
 - (b) the adjustment for the loss-absorbing capacity of deferred taxes determined under regulation 36.
- (2) The adjustment for the loss-absorbing capacity of an insurer's technical provisions and deferred taxes reflects potential compensation from unexpected losses, through a simultaneous decrease in the insurer's technical provisions or deferred taxes or a combination of the two.
 - (3) The adjustment takes account of the risk mitigating effect provided by any relevant future discretionary benefits of insurance contracts meeting the requirements of regulation 21(3)(e), to the extent an insurer can establish that a reduction in those benefits can be used to cover its unexpected losses when they arise.
 - (4) The risk mitigating effect provided by relevant future discretionary benefits of insurance contracts can be determined by comparing the value of future discretionary benefits under each scenario to an insurer's best-estimate of those benefits.
 - (5) The risk mitigating effect provided by future discretionary benefits can be no higher than the sum of an insurer's technical provisions and deferred taxes relating to those future discretionary benefits.

35 Adjustment for the loss absorbing capacity of technical provisions calculation

- (1) The adjustment to an insurer's SCR for the loss-absorbing capacity of technical provisions in regulation 34(1)(a) is equal to the following—

$$Adj_{TP} = -\max(0; \min(BSCR - nBSCR; FDB))$$

where—

- (a) $nBSCR$ denotes the net BSCR; and
 - (b) FDB denotes the best estimate of future discretionary benefits.
- (2) The $nBSCR$ is calculated under regulation 33, with the exception that the requirement in regulation 30(6)(e) is waived, allowing an insurer to change the value of future discretionary benefits included in its technical provisions when applying the scenarios.
 - (3) For the purposes of paragraph (2), an insurer must take into account all legal, regulatory or contractual restrictions in the distribution of future discretionary benefits.
 - (4) For each specific risk scenario, r , if the capital requirement, SCR_r and net capital requirement, $nSCR_r$ are derived from different stresses within the scenario, then SCR_r must be calculated using the same underlying stresses as $nSCR_r$.

36 Adjustment for the loss absorbing capacity of deferred taxes

- (1) The adjustment to an insurer's SCR for the loss-absorbing capacity of deferred taxes referred to in regulation 34(1)(b) is equal to the change in the value of an insurer's deferred taxes resulting from an instantaneous loss of an amount equal to the following—
 - (a) the insurer's BSCR determined under regulation 33;
 - (b) the adjustment for the loss-absorbing capacity of technical provisions determined under regulation 35; and
 - (c) the capital requirement for operational risk determined under regulation 37.
- (2) For the purpose of paragraph (1), and subject to paragraphs (3) to (6), deferred taxes must be valued under regulation 13(15).
- (3) Where the loss referred to in paragraph (1) would result in an increase in an insurer's deferred tax assets, the insurer must not utilise this increase for the purpose of this adjustment unless it can demonstrate that future profits will be available in accordance regulation 13(17), taking into account the magnitude of the loss referred to in paragraph (1) and its impact on the insurer's current and future financial situation.
- (4) For the purpose of paragraph (1), a decrease in the insurer's deferred tax liabilities or an increase in its deferred tax assets must result in a negative adjustment for the loss-absorbing capacity of its deferred taxes.
- (5) If the calculation of the adjustment under paragraph (1) results in a positive change of an insurer's deferred taxes, the adjustment is nil.
- (6) If it is necessary to allocate the loss referred to in paragraph (1) to its causes in order to calculate the adjustment for the loss-absorbing capacity of an insurer's deferred taxes, the insurer must allocate the loss to the risks that are captured by the BSCR in regulation 33(2). The allocation must be consistent with the contribution of the specific risk to the BSCR.

37 Operational risk capital requirement

- (1) In this Regulation—

“operational risk” in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to the loss arising from inadequate or failed internal processes, from personnel or systems or from external events.
- (2) Under regulation 28(6)(c) the operational risk capital requirement of the SCR consists of two elements—

$$SCR_{op_UL} \text{ and } SCR_{op_nonUL}$$

where—

- (a) SCR_{op_UL} is the operational risk capital requirement in respect of an insurer's insurance obligations with unit-linked and index-linked benefits —

$$SCR_{op_UL} = EXP_{UL}$$

where

EXP_{UL} is the value of expenses incurred by the insurer for insurance obligations with unit-linked and index-linked benefits in the twelve months before to the valuation date, excluding acquisition expenses and renewal commission; and

- (b) SCR_{op_nonUL} is the operational risk capital requirement for the insurer's other insurance obligations not included in SCR_{op_UL} —

$$SCR_{op_nonUL} = \max(Op_{premiums}, Op_{provisions})$$

where—

- (i) $Op_{premiums} = 0.04 \cdot Earn_{nonUL} + \max(0, 0.04 \cdot (Earn_{nonUL} - 1.2 \cdot pEarn_{nonUL}))$
- (ii) $Earn_{nonUL}$ is the premium earned by the insurer in the 12 month period preceding the valuation date, for insurance obligations not included in SCR_{op_UL} , with no deduction for reinsurance premiums;
- (iii) $pEarn_{nonUL}$ is the premium earned by the insurer in the 12 month period that commenced 24 months before the valuation date for insurance obligations not included in SCR_{op_UL} , with no deduction for reinsurance premiums;
- (iv) $Op_{provisions} = 0.0045 \cdot \max(0, TP_{nonUL})$; and
- (v) TP_{nonUL} is the insurer's technical provisions for insurance obligations not included in SCR_{op_UL} .
- (3) For the purpose of paragraph (2)(b)(v), technical provisions must not include the risk margin and must be calculated without deduction of recoverables from reinsurance contracts and special purpose vehicles.

38 Intangible asset capital requirement

Under regulation 33(2)(f) the intangible asset risk capital requirement of the BSCR is —

$$SCR_{intangibles} = 0.8 \cdot V_{intangibles}$$

where—

$V_{intangibles}$ denotes the amount of intangible assets as recognised and valued under regulation 13(14)(b).

39 Market risk capital requirement

- (1) In these Regulations—
- “**market risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in the level or volatility of market prices of financial instruments;
- (2) Under regulation 33(2) an insurer’s market risk capital requirement is derived from the sub-risk capital requirements —
- interest rate risk;
 - equity risk;
 - property risk;
 - spread risk;
 - currency risk; and
 - market risk concentration.
- (3) The capital requirement for market risk is —

$$SCR_{market} = \sqrt{\sum_{r,c} MarketCorr_{r,c} \cdot Market_r \cdot Market_c}$$

where—

- $Market_r$ and $Market_c$ are the capital requirements for the individual market shock scenarios according to the rows and columns of the correlation matrix $MarketCorr$;
- $MarketCorr_{r,c}$ are the entries of the correlation matrix $MarketCorr$ —

MarketCorr	Interest	Equity	Property	Spread	Currency	Conc.
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

- The parameter A is equal to 0 if the capital requirement for interest rate risk is derived from regulation 42(2)(a).
- In all other cases, the parameter A is equal to 0.5.
- If an insurer has a participation in a related entity, determined under regulations 10(1)(a) and 10(1)(b), the market risk capital requirement of the participation must be determined under regulation 41.

40 Look-through approach

- (1) An insurer must assess the economic substance of the market risk exposure inherent in all of its investments, including collective investment vehicles and other investments packaged as funds, 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 also applies to—
 - (a) indirect exposures to market risk other than collective investment vehicles and investments packaged as funds;
 - (b) both actively managed funds and passively managed funds equally;
 - (c) indirect exposures to underwriting risk; and
 - (d) indirect exposures to counterparty risk.
- (3) The look-through approach does not apply to investments of an insurer in related entities, which must instead be valued under regulation 13(19).
- (4) If 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.
- (5) If external asset management firms delay publicising the composition of an investment to which the look-through approach applies, an insurer must ensure that it is able to access the information required so that it can identify the nature of all relevant underlying assets.
- (6) Taking due account of the principles of proportionality in regulation 8, 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.
- (7) For the purposes of paragraph (6), homogeneous data groupings may be used, provided they are applied in a prudent and proportionate manner.

- (8) If an insurer cannot apply the approaches in paragraphs (1) and (6), the collective investment entity or fund must be treated as equity type 2 in the equity risk capital requirement calculation in regulation 45.

41 Treatment of participations in the BSCR

When determining the relevant market capital requirements for the equity and subordinated liability components of a participation of the insurer in a related entity under regulation 39, an insurer must include—

- (a) subordinated liability holdings of a related entity in the interest rate and spread risk capital requirement calculations;
- (b) equity holdings in the related entity, such as ordinary or preference share capital in the equity risk capital requirement calculation; and
- (c) any other exposures as appropriate in the other market risk capital requirements.

42 Interest rate risk capital requirement

- (1) In this regulation—
- “**Interest rate risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in term structure of interest rates.
- (2) Under regulation 39, an insurer’s interest rate risk capital requirement is equal to the larger of—
- (a) the sum, over all currencies, of the capital requirement for the risk of an increase in the term structure of interest rates for a given currency, as calculated under regulation 43; or
 - (b) the sum, over all currencies, of the capital requirement for the risk of a decrease in the term structure of interest rates for a given currency, as calculated under regulation 44.

43 Increase in the term structure of interest rates

- (1) Under regulation 42(2)(a) the capital requirement for the risk of an increase in the term structure of interest rates for a given currency is equal to the loss in an insurer’s basic own-funds that would result from an instantaneous increase in basic risk-free interest rates for that currency at different maturities in accordance with the following table—

Maturity t (years)	Relative change $S^{up}(t)$
1	70%
2	70%
3	64%
4	59%
5	55%
6	52%
7	49%
8	47%
9	44%
10	42%
11	39%
12	37%
13	35%
14	34%
15	33%
16	31%
17	30%
18	29%
19	27%
20	26%
90	20%

- (2) $S^{up}(t)$ is the relative change stress factor to be applied to the term structure of interest rates, for each maturity t specified in the table above.
- (3) The stressed interest rate for a maturity t is the basic risk-free interest rate for that maturity multiplied by $(1 + S^{up}(t))$.
- (4) If the basic risk free interest rate is negative, the stressed basic interest rate is—

$$r(t) + |r(t)| \cdot S^{up}(t)$$

where $r(t)$ is the basic risk-free interest rate for maturity t .

- (5) For maturities that are—
- not specified in the table in paragraph (1) and are not subject to paragraphs (b) and (c), $S^{up}(t)$ must be determined using linear interpolation;
 - shorter than 1 year, $S^{up}(t)$ is 70%; and
 - longer than 90 years, $S^{up}(t)$ is 20%.
- (6) In any case, the increase of basic-risk-free interest rates at a maturity must be at least one percentage point.
- (7) The impact of the increase in the term structure of basic risk-free interest rates on the value of participations of an insurer in financial and credit

institutions, determined under regulations 10(1)(a) and 10(1)(b), must be considered only on the value of the participations that are not deducted from the insurer's basic own-funds.

- (8) Further to paragraph (7), the part deducted from an insurer's basic own-funds must be considered only to the extent that such impact increases the insurer's basic own-funds.

44 Decrease in the term structure of interest rates

- (1) Under regulation 42(2)(b), the capital requirement for the risk of a decrease in the term structure of interest rates for a given currency is equal to the loss in an insurer's basic own-funds that would result from an instantaneous decrease in basic risk-free interest rates for that currency at different maturities in accordance with the following table –

Maturity t (years)	Relative change $S^{down}(t)$
1	-75%
2	-65%
3	-56%
4	-50%
5	-46%
6	-42%
7	-39%
8	-36%
9	-33%
10	-31%
11	-30%
12	-29%
13	-28%
14	-28%
15	-27%
16	-28%
17	-28%
18	-28%
19	-29%
20	-29%
90	-20%

- (2) $S^{down}(t)$ is the relative change stress factor to be applied to the term structure of interest rates, for each maturity t specified in the table above.
- (3) The stressed interest rate for a maturity t specified in the table above is the basic risk-free interest rate for that maturity multiplied by $(1 + S^{down}(t))$.
- (4) If the basic risk free interest rate is negative, the stressed basic interest rate is equal to the basic risk free interest rate.

- (5) For maturities that are—
 - (a) not specified in the table in paragraph (1) and not subject to paragraphs (b) and (c), the value of the increase must be determined by linear interpolation;
 - (b) shorter than 1 year, $S^{down}(t)$ is 75%; and
 - (c) longer than 90 years, $S^{down}(t)$ is 20%.
- (6) The impact on the value of participations of an insurer in financial and credit institutions, determined under regulations 10(1)(a) and 10(1)(b), of the decrease in the term structure of basic risk-free interest rates must be considered only on the value of the participations that are not deducted from the insurer's basic own-funds.
- (7) Further to paragraph (6), the part deducted from an insurer's basic own-funds must be considered only to the extent that such impact increases the insurer's basic own-funds.

45 Equity risk capital requirement

- (1) In this regulation—

“**equity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in the level or volatility of the market price of equities.

“**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 40(8), unless that asset is included in the—
 - (i) interest rate risk capital requirement defined in regulation 42;
 - (ii) property risk capital requirement defined in regulation 46; or
 - (iii) spread risk capital requirement defined in regulation 49.
- (2) Under regulation 39 an insurer's equity risk capital requirement is derived from the capital requirement for type 1 equities and the capital requirement for type 2 equities.

(3) The capital requirement for equity risk is equal to the following—

$$Market_{equity} = \sqrt{\sum_{r,c} EqCorr_{r,c} \cdot Market_{equity,r} \cdot Market_{equity,c}}$$

where—

- (a) $Market_{equity,r}$, $Market_{equity,c}$ are the capital requirements for the individual equity risk types, according to the rows and columns of the correlation matrix $EqCorr$; and
- (b) $EqCorr_{r,c}$ are the entries of the correlation matrix $EqCorr$ —

EqCorr	Type 1	Type 2
Type 1	1	0.75
Type 2	0.75	1

(4) In paragraph (3)(a) the capital requirement for type 1 and type 2 equities is—

$$Market_{equity,i} = \max(Equity_i^{VolUp}, Equity_i^{VolDown})$$

where—

- (a) i is 1 for Type 1 equities and 2 for Type 2 equities;
- (b)

$$Equity_i^{VolUp} = \sqrt{\sum_{r,c} EqVolUpCorr_{r,c} \cdot EquityShock_i \cdot VolUp_i}$$

where—

- (i) $EqVolUpCorr_{r,c}$ are the entries of the correlation matrix $EqVolUpCorr$ —

EqVolUpCorr	EquityShock_i	VolUp_i
EquityShock_i	1	0.75
VolUp_i	0.75	1

- (ii) $VolUp_i$ is the loss in the insurer’s basic own-funds that would result from an increase of 50% in the best estimate volatility assumption used by the insurer for equity type i ; and
- (iii) $EquityShock_i$ is the loss of the insurer’ basic own-funds that would result from an instantaneous permanent decrease in the value of all of its type i equity investments by a shock factor specific to equity type i —



	Type 1	Type 2
<i>EquityShock_i</i>	39%	49%

(c)

$$Equity_i^{VolDown} = \sqrt{\sum_{r,c} EqVolDownCorr_{r,c} \cdot EquityShock_i \cdot VolDown_i}$$

where—

- (i) *EqVolDownCorr_{r,c}* are the entries of the correlation matrix *EqVolDownCorr*—

<i>EqVolDownCorr</i>	<i>EquityShock_i</i>	<i>VolDown</i>
<i>EquityShock_i</i>	1	0
<i>VolDown_i</i>	0	1

- (ii) *VolDown_i* is the loss in the insurer’s basic own-funds that would result from a decrease of 15% in the best estimate volatility assumption used by the insurer for equities of type *i*; and
- (iii) *EquityShock_i* is as defined in paragraph (b)(iii).

46 Property risk capital requirement

- (1) In this regulation—

“**property risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in the level of market price of property.

- (2) Under regulation 39 an insurer’s property risk capital requirement is equal to the insurer’s loss in basic own-funds resulting from an instantaneous decrease of 25% in the value of immovable property.

47 Currency risk capital requirement

- (1) In this regulation—

“**currency risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in the level of currency exchange rates.

- (2) In this regulation and regulation 48 —

“**foreign currency**” means a currency other than the local currency;

“**foreign currency group**” means a group of foreign currencies;

“**local currency**” means the pound sterling, or the Manx pound as defined in the Currency Act 1992; and

“**reporting currency**” means the currency used for the preparation of the insurer’s audited financial statements.

- (3) For this regulation, an investment of an insurer in—
- (a) a type 1 or 2 equity which is listed on multiple stock exchanges operating with different currencies is sensitive to the currency of the equity’s main listing;
 - (b) a type 2 equity which is not listed is sensitive to the currency of the country in which the issuer of the equity has its main operations; and
 - (c) immovable property is sensitive to the currency of the country in which the property is located.
- (4) An insurer must assign its foreign currency exposures to the foreign currency groups below—

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	Bahraini Dinar		
Czech Koruna	UAE Dirham		
Hungarian Forint	Qatari Riyal		
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					
Argentine Peso					

- (5) Under regulation 39 an insurer’s currency risk capital requirement is —

$$Market_{fx} = \sqrt{\sum_{r,c} CurrencyCorr_{r,c} \cdot Market_{fx,r} \cdot Market_{fx,c}}$$

where—

- (a) $Market_{fx,r}$, $Market_{fx,c}$ are the currency risk capital requirements for each foreign currency group, as calculated in paragraph (7), according to the rows and columns of the correlation matrix $CurrencyCorr$; and
- (b) $CurrencyCorr_{r,c}$ are the entries of the correlation matrix $CurrencyCorr$ —

<i>CurrencyCorr</i>	1	2	3	4	5	6	7	8	9	10
<i>CurrGroup 1</i>	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
<i>CurrGroup 2</i>	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
<i>CurrGroup 3</i>	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5
<i>CurrGroup 4</i>	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5
<i>CurrGroup 5</i>	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5
<i>CurrGroup 6</i>	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5
<i>CurrGroup 7</i>	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5
<i>CurrGroup 8</i>	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5
<i>CurrGroup 9</i>	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5
<i>CurrGroup 10</i>	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1

- (6) If an insurer is exposed to currency risk in relation to one or more of the currencies within a foreign currency group, it must calculate its capital requirement for currency risk for that foreign currency group under paragraph (7).
- (7) The capital requirement for currency risk of a foreign currency group, is equal to the larger of the following scenarios—
- (a) the capital requirement for the risk of an increase in value of the foreign currency group against the base currency; and
- (b) the capital requirement for the risk of a decrease in value of the foreign currency group against the base currency.
- (8) Under paragraph (7)(a), the capital requirement for the risk of an increase in value of a foreign currency group against the base currency is equal to an insurer’s loss in basic own-funds resulting from an instantaneous increase of 25% in the value of the foreign currency group against the base currency.
- (9) Under paragraph (7)(b), the capital requirement for the risk of a decrease in value of a foreign currency group against the base currency is equal to an insurer’s loss in basic own-funds resulting from an instantaneous

decrease of 25% in the value of the foreign currency group against the base currency.

- (10) For the purposes of paragraph (7), the base currency is the local currency, unless an insurer can meet the requirements of paragraph (11).
- (11) If an insurer has a material exposure to a foreign currency group, which for the purposes of paragraph (12) must be referred to as “foreign currency group C” (for example where the insurer’s reporting currency is different to the local currency), and the conditions in paragraph (12) are met, for the purpose of the calculation in paragraph (7) the insurer may substitute the local currency exposure for the foreign currency group C exposure, meaning foreign currency group C then becomes the base currency in the calculation.
- (12) The conditions referred to in paragraph (11) are—
 - (a) in respect of the insurer’s overall cash inflows, more than 50% of the present value of future cash inflows are in foreign currency group C;
 - (b) in respect of the cash flows of foreign currency group C, 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 respect of the cash flows of foreign currency group C, 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 paragraph (7), applied to foreign currency group C against the local currency.
- (13) 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.

48 Currency risk capital requirement optional simplification

- (1) An insurer has the option to replace the capital requirement calculation for currency risk set out in regulation 47(6) to 47(13) with the approach set out in paragraphs (2) to (5) of this regulation.
- (2) If an insurer is exposed to currency risk in relation to one or more foreign currencies, it must calculate its capital requirement for currency risk as the sum of the capital requirements for each foreign currency exposure, determined under paragraph (3).
- (3) The capital requirement for currency risk of a foreign currency exposure is equal to the larger of the following scenarios—

- (a) the capital requirement for the risk of an increase in value of the foreign currency against the insurer's reporting currency; and
 - (b) the capital requirement for the risk of a decrease in value of the foreign currency against the insurer's reporting currency.
- (4) Under paragraph (3)(a), the capital requirement for the risk of an increase in value of a foreign currency against an insurer's reporting currency is equal to the insurer's loss in basic own-funds resulting from an instantaneous increase of 25% in the value of the foreign currency against the reporting currency.
- (5) Under paragraph (3)(b), the capital requirement for the risk of a decrease in value of a foreign currency against an insurer's reporting currency is equal to the insurer's loss in basic own-funds resulting from an instantaneous decrease of 25% in the value of the foreign currency against the reporting currency.
- (6) For the purposes of paragraph 47(7), the reporting currency must be used in paragraph (3), unless an insurer can meet the requirements of regulation 47(11) in which case it can substitute the reporting currency for foreign currency group C.

49 Spread risk capital requirement

- (1) In this regulation—
- “**spread risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in the level of credit spreads over the risk-free interest rate term structure.
- (2) Under regulation 39 an insurer's spread risk capital requirement is—
- $$Market_{sp} = Market_{sp}^{bonds} + Market_{sp}^{securitisation} + Market_{sp}^{cd}$$
- where—
- (a) $Market_{sp}^{bonds}$ is the capital requirement for spread risk of bonds and loans as defined in regulation 50;
 - (b) $Market_{sp}^{securitisation}$ is the capital requirement for spread risk on securitisation positions as defined in regulation 53; and
 - (c) $Market_{sp}^{cd}$ is the capital requirement for spread risk on credit derivatives as defined in regulation 54.

50 Spread risk on bonds and loans

- (1) Under regulation 49(2)(a), the spread risk on bonds and loans capital requirement, $Market_{sp}^{bonds}$, is equal to an insurer's loss in basic own-funds resulting from an instantaneous relative decrease of $stress_i$ in the value of each bond or loan i , other than mortgage loans meeting the requirements

of regulation 62, including bank deposits other than cash at bank referred to in regulation 61.

- (2) An insurer must determine the modified duration of the bond or loan i denominated in years (dur_i).
- (3) dur_i must never be lower than 1.
- (4) 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.
- (5) Bonds or loans which are not listed as a specific exposure in regulation 52 and for which a credit assessment by a nominated ECAI is available must be assigned a risk factor $stress_i$ depending on the credit quality step of the counterparty and the modified duration dur_i of the bond or loan i according to the following table—

Dur_i	Credit quality step					
	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_i ≤ 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_i ≤ 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_i ≤ 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	$12.0\% + 0.5\% \cdot (dur_i - 20)$	$13.4\% + 0.5\% \cdot (dur_i - 20)$	$15.5\% + 0.5\% \cdot (dur_i - 20)$	$30.0\% + 0.5\% \cdot (dur_i - 20)$	$46.6\% + 0.5\% \cdot (dur_i - 20)$	$63.5\% + 0.5\% \cdot (dur_i - 20)$

- (6) Bonds and loans which are not listed as a specific exposure in regulation 52, for which a credit assessment by a nominated ECAI is not available and for which debtors have not posted collateral are assigned a risk factor $stress_i$ depending on the duration dur_i of the bond or loan i according to the following table—

Dur_i	$Stress_i$
Up to 5	$3.0\% \cdot dur_i$
More than 5 and up to 10	$15.0\% + 1.7\% \cdot (dur_i - 5)$
More than 10 and up to 20	$23.5\% + 1.2\% \cdot (dur_i - 10)$
More than 20	$\text{Min}[35.5\% + 0.5\% \cdot (dur_i - 20); 1]$

- (7) Bonds and loans which are not listed as a specific exposure in regulation 52, for which a credit assessment by a nominated ECAI is not available

and for which debtors have posted collateral are assigned a risk factor $stress_i$ according to the following—

- (a) if the risk-adjusted value of collateral is higher than or equal to the value of the bond or loan i , $stress_i$ is equal to half of the risk factor that would be determined under paragraph (6);
 - (b) if the risk-adjusted value of collateral is lower than the value of the bond or loan i , and if the risk factor determined under paragraph (6) would result in a value of the bond or loan i that is lower than the risk-adjusted value of the collateral, $stress_i$ is equal to the average of the following—
 - (i) the risk factor determined under paragraph (6); and
 - (ii) the difference between the value of the bond or loan i and the risk-adjusted value of the collateral, divided by the value of the bond or loan i ; and
 - (c) if the risk-adjusted value of collateral is lower than the value of the bond or loan i , and where the risk factor determined under with paragraph (6) would result in a value of the bond or loan i that is higher than or equal to the risk-adjusted value of the collateral, $stress_i$ is determined under paragraph (6).
- (8) The risk-adjusted value of the collateral is calculated in accordance with regulations 69 and 70.

51 Simplified calculation for spread risk on bonds and loans

- (1) Where regulation 33(4) is complied with, and upon prior approval from the Authority, an insurer may calculate the capital requirement for spread risk referred to in regulation 50 of this Regulation as follows:

$$Market_{sp}^{bonds} = MV^{bonds} \cdot \left[\sum_i \%MV_i^{bonds} \cdot stress_i + \%MV_{no\ rating}^{bonds} \cdot \min(1; dur_{no\ rating} \cdot 0.03) \right] + \Delta Liab_{ul}$$

where—

- (a) MV^{bonds} is the total market value of the assets subject to capital requirements for spread risk on bonds and loans;
- (b) $\%MV_i^{bonds}$ is the proportion of the portfolio of the assets subject to a capital requirement for spread risk on bonds and loans with credit quality step i , where a credit assessment by a nominated ECAI is available for those assets;
- (c) $stress_i$ is a function of the credit quality step i and of the modified duration denominated in years of the assets subject to a capital

requirement for spread risk on bonds and loans with credit quality step i , set out in paragraph (2);

- (d) $\%MV_{no\ rating}^{bonds}$ is the proportion of bond and loans portfolio for which no credit quality step is available;
- (e) dur_i and $dur_{no\ rating}$ is the modified duration denominated in years of the assets subject to a capital requirement for spread risk on bonds and loans where no credit assessment by a nominated ECAI is available; and
- (f) $\Delta Liab_{ul}$ denotes the increase in the technical provisions less risk margin for policies where the policyholders bear the investment risk with embedded options and guarantees that would result from an instantaneous decrease in the value of the assets subject to the capital requirement for spread risk on bonds of –

$$MV^{bonds} \cdot \left[\sum_i \%MV_i^{bonds} \cdot stress_i + \%MV_{no\ rating}^{bonds} \cdot \min(1; dur_{no\ rating} \cdot 0.03) \right]$$

- (2) For the purpose of paragraph (1)(c), $stress_i$ for each credit quality step i , must be equal to $dur_i \cdot b_i$ where dur_i is the modified duration denominated in years of the assets subject to a capital requirement for spread risk on bonds and loans with credit quality step i , and b_i is determined in accordance with the following table –

Credit quality step	0	1	2	3	4	5, 6
b_i	0.9%	1.1%	1.4%	2.5%	4.5%	7.5%

- (3) dur_i referred to in paragraph (1)(e) and paragraph (2) must not be lower than 1 year.

52 Treatment of specific exposures for spread risk on bonds and loans

- (1) Schedule 2 has effect and sets out the approved entities list.
- (2) An insurer's exposures in the form of covered bonds which have been assigned to credit quality step 0 or 1 are assigned a risk factor $stress_i$ according to the following table –

Credit Step/ Dur_i	0	1
Up to 5	$0.7\% \cdot dur_i$	$0.9\% \cdot dur_i$
More than 5	$\text{Min}(1; 3.5\% + 0.5\% \cdot (dur_i - 5))$	$\text{Min}(1; 4.5\% + 0.5\% \cdot (dur_i - 5))$

- (3) Exposures in the form of bonds and loans issued by an entity included in the Approved Entities list in Schedule 2 are assigned a risk factor $stress_i$ of 0%.
- (4) Exposures in the form of bonds and loans issued by central governments and central banks not included in the Approved Entities list in Schedule 2, denominated and funded in the domestic currency of that central

government and central bank, and for which a credit assessment by a nominated ECAI is available is assigned a risk factor $stress_i$ depending on the credit quality step and the duration of the exposure according to the following table—

Credit quality step											
		0 and 1		2		3		4		5 and 6	
Dur_i	$Stress_i$	a_i	b_i	a_i	b_i	a_i	b_i	a_i	b_i	a_i	b_i
≤ 5	$b_i \cdot dur_i$	-	0%	-	1.1%	-	1.4%	-	2.5%	-	4.5%
$5 < dur_i \leq 10$	$a_i + b_i \cdot (dur_i - 5)$	0%	0%	5.5%	0.6%	7.0%	0.7%	12.5%	1.5%	22.5%	2.5%
$10 < dur_i \leq 15$	$a_i + b_i \cdot (dur_i - 10)$	0%	0%	8.4%	0.5%	10.5%	0.5%	20.0%	1.0%	35.0%	1.8%
$15 < dur_i \leq 20$	$a_i + b_i \cdot (dur_i - 15)$	0%	0%	10.9%	0.5%	13.0%	0.5%	25.0%	1.0%	44.0%	0.5%
> 20	$Min[a_i + b_i \cdot (dur_i - 20, 1)]$	0%	0%	13.4%	0.5%	15.5%	0.5%	30.0%	0.5%	46.5%	0.5%

- (5) Exposures to bonds or loans issued by an insurer for which a credit assessment by a nominated ECAI is not available and if the insurer meets the following requirements—
- the insurer meets its MCR or an equivalent approach in the jurisdiction of an approved supervisor;
 - the insurer's solvency ratio is determined according to the requirements set out in these Regulations; and
 - the insurer's solvency ratio is determined consistently to the scenario under consideration,

are assigned a risk factor $stress_i$ depending on the credit quality step and the duration of the exposure using the mapping between solvency ratios and credit quality steps according to the following table—

Solvency ratio	196%	175%	122%	95%	75%	75%
Credit quality step	1	2	3	4	5	6

- (6) If the solvency ratio of an insurer falls in between the solvency ratios set out in the table in paragraph (5), the value of $stress_i$ is linearly interpolated from the closest values of $stress_i$ corresponding to the closest solvency ratios set out in paragraph (5).
- (7) If the solvency ratio is lower than 75%, $stress_i$ is equal to the factor corresponding to the credit quality steps 5 and 6.
- (8) If the solvency ratio is higher than 196%, $stress_i$ is the same as the factor corresponding to the credit quality step 1.
- (9) Exposures to bonds or loans issued by insurers which do not meet their MCR under these Regulations or an equivalent approach in the

jurisdiction of an approved supervisor is assigned a risk factor $stress_i$ according to the following table—

Duration (years)	$Stress_i$
Up to 5	$7.5\% \cdot dur_i$
More than 5 and up to 10	$37.5\% + 4.2\% \cdot (dur_i - 5)$
More than 10 and up to 15	$58.5\% + 0.5\% \cdot (dur_i - 10)$
More than 15 and up to 20	$61.0\% + 0.5\% \cdot (dur_i - 15)$
More than 20	$\text{Min}[63.5\% + 0.5\% \cdot (dur_i - 20); 1]$

53 Spread risk on securitisation positions

(1) In this regulation —

“**originator**” in relation to a securitisation means an entity which—

- (a) itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised; or
- (b) purchases a third party’s exposure for its own account then securitises it;

“**resecuritisation position**” is a securitisation where the risk associated with the underlying pool of exposures is tranching, and at least one of the underlying exposures is a securitisation position;

“**securitisation special purpose entity**” or “**SSPE**” is a corporation, trust or other entity, other than an institution, organised for carrying out securitisations or resecuritisations, where —

- (c) the activities of which are limited to those appropriate to accomplishing that objective;
- (d) the structure of which is intended to isolate the obligations of the SSPE from those of the originator institution; and
- (e) in which the holders of the beneficial interests have the right to pledge or exchange those interest without restrictions;

“**sponsor**” in relation to a securitisation means an institution other than an originator institution that establishes and manages the securitisation scheme that purchases exposures from third-party entities;

“**synthetic securitisation**” is a securitisation where the transfer of risk involved is achieved by the use of credit derivatives or guarantees, and the exposures being securitised remain exposures of the originator;

“**type 1 securitisation position**” is a securitisation position meeting the requirements of paragraph (2);

“**type 2 securitisation position**” is a securitisation position meeting the requirements of paragraph (3).

- (2) Type 1 securitisation positions are securitisation positions that meet all of the following criteria—
- (a) the position has been assigned to credit quality step 0, 1, 2 or 3;
 - (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; for these purposes (a tranche is deemed the most senior where, after the delivery of an enforcement notice and if applicable an acceleration notice, the tranche is not subordinated to other tranches of the same securitisation transaction or scheme in respect of receiving principal and interest payments, without taking into account amounts due under interest rate or currency derivative contracts, fees or other similar payments);
 - (d) the underlying exposures have been acquired by the SSPE in a manner that is enforceable against any third party and are beyond the reach of the seller (originator, sponsor or original lender) and its creditors including in the event of the seller's insolvency;
 - (e) the transfer of the underlying exposures to the SSPE must not be subject to material claw back provisions in the jurisdiction where the seller (originator, sponsor or original lender) is incorporated; this includes but is not limited to provisions under which the sale of the underlying exposures can be invalidated by the liquidator of the seller (originator, sponsor or original lender) solely on the basis that it was concluded within a certain period before the declaration of the seller's insolvency or provisions where the SSPE can prevent such invalidation only if it can prove that it was not aware of the insolvency of the seller at the time of sale;
 - (f) the underlying exposures have their administration governed by a servicing agreement which includes servicing continuity provisions to ensure, at a minimum, that a default or insolvency of the servicer does not result in a termination of servicing;
 - (g) the documentation governing the securitisation includes continuity provisions to ensure, at a minimum, the replacement of derivative counterparties and of liquidity providers upon their default or insolvency, if applicable;
 - (h) 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 with a the credit quality step 2 or above;
- (ii) loans to small and medium-sized enterprises;
- (iii) auto loans and leases for the financing of—
 - (A) motor vehicles – all power driven vehicles which are moved by their own means, having at least 4 wheels, being complete, completed or incomplete, with a maximum design speed exceeding 25km/h;
 - (B) trailers – all non-self-propelled vehicles on wheels which are designed and constructed to be towed by a motor vehicle;
 - (C) agricultural or forestry tractors – all tractors, trailers or interchangeable towed machinery, whether being complete, completed or incomplete, which is intended to be used in agriculture or forestry;
 - (D) motorcycles or motor tricycles – two-wheeled vehicles without a sidecar or with a sidecar or vehicles with 3 symmetrically arranged wheels respectively, fitted with an engine having a cylinder capacity of more than 50 cm³ if of the interval combustion type and/or having a maximum design speed of more than 45 km/h; or
 - (E) tracked vehicles;
- (iv) leased property;
- (v) consumer loans; or
- (vi) credit card receivables;
- (i) the pool of underlying assets may only include derivatives if these are used strictly for hedging currency or interest rate risk;
- (j) the position is not in a resecuritisation or a synthetic securitisation;
- (k) the underlying exposures do not include transferable financial instruments or derivatives, except financial instruments issued by the SSPE itself or other parties within the securitisation structure and derivatives used to hedge currency risk or interest rate risk;
- (l) at the time of issuance of the securitisation or when incorporated in the pool of underlying exposures at any time after issuance, the underlying exposures do not include exposures to credit-impaired obligors (or if applicable, credit-impaired guarantors), if a credit-impaired obligor (or credit-impaired guarantor) is a borrower (or guarantor) who—

- (i) has declared bankruptcy, agreed with his creditors to a debt dismissal or reschedule or had a court grant his creditors a right of enforcement or material damages as a result of a missed payment within 3 years prior to the date of origination;
 - (ii) is on an official register of persons with adverse credit history; or
 - (iii) has a credit assessment by an ECAI or has a credit score indicating a significant risk that contractually agreed payments will not be made compared to the average obligor for this type of loan in the relevant jurisdiction;
- (m) at the time of issuance of the securitisation or when incorporated in the pool of underlying exposures at any time after issuance, the underlying mortgages and loans do not include any mortgages or loans in default;
- (n) 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;
- (o) 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 in the SSPE on each payment date;
- (p) 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 originator or the servicer;
- (q) at the time of issuance of the securitisation, the borrowers (or, if applicable, the guarantors) have made at least one payment, except if the securitisation is backed by credit facilities referred to in paragraphs (h)(v) and (h)(vi);
- (r) in the case of securitisations where the underlying exposures are residential loans referred to in paragraph (h)(i), the pool of loans

does not include any loan that was marketed and underwritten on the premise that the loan applicant or, if applicable, intermediaries were made aware that the information provided might not be verified by the lender;

- (s) in the case of securitisations backed by residential mortgages, the assessment of the borrower's creditworthiness meets the requirements set out below –
- (i) before concluding a credit agreement, 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;
 - (ii) the procedures and information on which the assessment is based are established, documented and maintained;
 - (iii) the assessment of creditworthiness must not rely predominantly on the value of the residential immovable property exceeding the amount of the credit or the assumption that the residential immovable property will increase in value unless the purpose of the credit agreement is to construct or renovate the residential immovable property;
 - (iv) if a creditor concludes a credit agreement with a borrower the creditor must not subsequently cancel or alter the credit agreement to the detriment of the borrower on the grounds that the assessment of creditworthiness was incorrectly conducted (but this must not apply if it is demonstrated that the borrower knowingly withheld or falsified the information);
 - (v) the creditor only makes the credit available to the borrower if the result of the creditworthiness assessment indicated that the obligations resulting from the credit agreement are likely to be met in the manner required under that agreement;
 - (vi) if a database is to be consulted, the creditor informs the borrower in advance;
 - (vii) if the credit application is rejected the creditor informs the borrower without delay of the rejection and, if applicable, that the decision is based on automated processing of data (if the rejection is based on the result of the database consultation, the creditor informs the borrower of the result of that consultation and of the particulars of the database consulted);

- (viii) the borrower's creditworthiness is re-assessed on the basis of updated information before any significant increase in the total amount of credit is granted after the conclusion of the credit agreement unless that additional credit was envisaged and included in the original creditworthiness assessment;
 - (t) if the issuer, originator or sponsor of the securitisation is established in the Isle of Man, United Kingdom or European Union, it discloses to relevant stakeholders information on—
 - (i) the credit quality and performance of the underlying exposures;
 - (ii) the structure of the transaction;
 - (iii) the cash flows and any collateral supporting the exposures; and
 - (iv) all other information that is necessary;for those stakeholders, if appropriate, to conduct comprehensive and well-informed stress tests; and
 - (u) if the issuer, originator and sponsors are established outside the Isle of Man, United Kingdom or European Union, comprehensive loan-level data in compliance with standards generally accepted by market participants is made available to relevant stakeholders at issuance and on a regular basis.
- (3) Type 2 securitisation positions are all securitisation positions that do not qualify as type 1 securitisation positions.
- (4) Securitisations that were issued before the entry into force of this regulation qualify as type 1 securitisation positions if they meet the requirements set out in paragraphs (2)(a), (2)(c), (2)(d), (2)(h), (2)(j) and (2)(k).
- (5) Under regulation 49(2)(b) an insurer's spread risk on securitisation positions capital requirement, $Market_{sp}^{securitisation}$ is the sum of—
- (a) the capital requirement for type 1 securitisation positions calculated under paragraph (6);
 - (b) the capital requirement for type 2 securitisation positions calculated under paragraph (9); and
 - (c) the capital requirement for resecuritisation positions calculated under paragraph (11).
- (6) Under paragraph (5)(a), an insurer's capital requirement for spread risk on type 1 securitisation positions is equal to the insurer's loss in basic own-funds resulting from an instantaneous permanent decrease in the value of each type 1 securitisation position i held by the insurer, due to the application of the risk factor $stress_i$.

- (7) The risk factor $stress_i$, for type 1 securitisation positions which do not meet the requirements of paragraph (8) is –

$$Stress_i = \text{Min}(b_i \cdot dur_i; 1)$$

where –

- (a) dur_i denotes the modified duration of securitisation position i denominated in years; and
- (b) b_i must be assigned depending on the credit quality step of securitisation position i according to the following table –

Credit Quality Step	b_i
0	2.1%
1	3.0%
2	3.0%
3	3.0%

- (8) Type 1 securitisation positions which are fully, unconditionally and irrevocably guaranteed by the Bank of England, European Investment Fund or the European Investment Bank, and the guarantee meets the requirements set out in regulation 105, must be assigned a risk factor $stress_i$ of 0%.
- (9) Under paragraph (5)(b) an insurer's capital requirement for spread risk on type 2 securitisation position is equal to the insurer's loss in basic own-funds resulting from an instantaneous permanent decrease in the value of each type 2 securitisation position i held by the insurer, due to the application of the risk factor, $stress_i$.
- (10) The risk factor $stress_i$ for type 2 securitisation positions is –

$$Stress_i = \text{Min}(b_i \cdot dur_i; 1)$$

where –

- (a) dur_i denotes the modified duration of securitisation position i denominated in years; and
- (b) b_i must be assigned depending on the credit quality step of securitisation position i according to the following table –

Credit Quality Step	b_i
0	12.5%
1	13.4%
2	16.6%
3	19.7%
4	82.0%
5,6	100.0%

- (11) Under paragraph (5)(c), an insurer’s capital requirement for spread risk on resecuritisation positions is equal to the insurer’s loss in basic own-funds resulting from an instantaneous permanent decrease in the value of each resecuritisation position i , due to the application of the risk factor, $stress_i$.
- (12) The risk factor, $stress_i$, for resecuritisation positions is—

$$Stress_i = \text{Min}(b_i \cdot dur_i; 1)$$

where—

- (a) dur_i denotes the modified duration of resecuritisation position i denominated in years; and
- (b) b_i must be assigned depending on the credit quality step of resecuritisation position i according to the following table—

Credit Quality Step	b_i
0	33%
1	40%
2	51%
3	91%
4	100%
5,6	100%

- (13) The modified duration dur_i must not be less than 1 year.

54 Spread risk on credit derivatives

- (1) Under regulation 49(2)(c) an insurer’s capital requirement for spread risk on credit derivatives (other than those referred to in paragraphs (4) and (5)), $Market_{sp}^{cd}$ is equal to the higher of the following capital requirements—
- (a) the insurer’s loss in basic own-funds resulting from an instantaneous increase in absolute terms of the credit spread of the instruments underlying the credit derivatives under paragraphs (2) and (3); and
- (b) the loss in the insurer’s basic own-funds that would result from an instantaneous relative decrease of the credit spread of the instruments underlying the credit derivatives by 75%.
- (2) For the purposes of paragraph (1)(a), the instantaneous increase of the credit spread of the instruments underlying the credit derivatives for which a credit assessment by a nominated ECAI is available is calculated according to the following table—

Credit quality step	Instantaneous increase in spread
0	+130 basis points
1	+150 basis points
2	+260 basis points
3	+450 basis points
4	+840 basis points
5	+1620 basis points
6	+1620 basis points

- (3) For the purposes of paragraph (1)(a), the instantaneous increase of the credit spread of the instruments underlying the credit derivatives for which a credit assessment by a nominated ECAI is not available is 5 basis points.
- (4) 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 in any circumstances.
- (5) The capital requirement for spread risk on credit derivatives if the underlying financial instrument is a bond or a loan to any exposure listed in Schedule 2 is nil.

55 Single name counterparty exposure

- (1) When determining a single name exposure of an insurer in Regulation 56 —
 - (a) exposures of the insurer to counterparties which belong to a corporate group are treated as a single name exposure; and
 - (b) exposures of the insurer in respect of immovable properties which are located in the same building are treated as a single name exposure.
- (2) An insurer's exposure at default to a counterparty is the sum of its exposures to that counterparty.
- (3) An insurer's exposure at default to a single name exposure is the sum of the exposures at default to all counterparties that belong to the single name exposure.
- (4) The weighted average credit quality step on a single name exposure of an insurer is equal to the rounded-up average of the credit quality steps of its exposures to the counterparties that belong to the single name exposure, weighted by the value of each exposure.

56 Market risk concentration capital requirement

(1) In this regulation—

“**market risk concentration**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to changes in the level of market prices due to a concentration of exposures to a single counterparty.

(2) Under regulation 39 an insurer’s market risk concentration capital requirement is calculated on the basis of single name exposures and is equal to the following—

$$Market_{conc} = \sqrt{\sum_i (Conc_i^2)}$$

where—

- (a) the sum covers all single name exposures i ; and
 - (b) $Conc_i$ denotes the capital requirement for market risk concentration on a single name exposure i .
- (3) For each single name exposure i , the capital requirement for market risk concentration $Conc_i$ is equal to an insurer’s loss in basic own-funds resulting from an instantaneous decrease in the value of the assets corresponding to the single name exposure i equal to the following—

$$XS_i \cdot g_i$$

where—

- (a) XS_i is the excess exposure calculated under regulation 57; and
- (b) g_i is the risk factor for market risk concentration calculated under regulation 59.

57 Excess exposure

(1) In this regulation, ‘**ancillary services company**’ means a non-regulated company the principal activity of which consists of owning or managing property, managing data-processing services, health and care services or any other similar activity which is ancillary to the principal activity of one or more insurers.

(2) Under regulation 56(3)(a) the excess exposure on a single name exposure i is equal to the following—

$$XS_i = \max(0; E_i - CT_i \times Assets_{xl})$$

where—

- (a) E_i denotes an insurer’s exposure at default to single name exposure i that is included in $Assets_{xl}$;
- (b) $Assets_{xl}$ is defined in paragraph (3);

- (c) CT_i denotes the relative excess exposure threshold under regulation 58.
- (3) $Assets_{xl}$ is equal to the value of all assets held by an insurer considered in the equity, spread and property risk capital requirements of the market risk capital requirement, excluding the following—
- (a) assets held in respect of life insurance contracts if the investment risk is fully borne by the policyholders;
 - (b) exposures to a counterparty which belongs to the same corporate group as the insurer, provided that all of the following conditions are met—
 - (i) the counterparty is either—
 - (A) an insurer;
 - (B) an insurance holding company;
 - (C) a mixed financial holding company; or
 - (D) an ancillary services company;
 - (ii) the counterparty is subject to the same (or equivalent) risk evaluation, measurement and control procedures as the insurer;
 - (iii) the counterparty is established in the Island, the United Kingdom or the European Union; and
 - (iv) 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;
 - (c) deferred tax assets;
 - (d) intangible assets; and
 - (e) assets included in the counterparty default risk capital requirement.
- (4) The exposure at default on a single name exposure i , is reduced by the amount of the exposure at default to counterparties belonging to that single name exposure for which the risk factor, assigned in accordance with regulation 59, for market risk concentration is 0%.

58 Relative excess exposure thresholds

Under regulation 57(2)(c), each single name exposure i must be assigned, in accordance with the following table, a relative excess exposure threshold depending on the weighted average credit quality step of the single name exposure i , calculated under regulation 55(4).

Credit quality step	Excess exposure threshold (CT_i)
0	3.0%
1	3.0%
2	3.0%
3	1.5%
4	1.5%
5	1.5%
6 or unrated	1.5%

59 Risk factor for market risk concentration

- (1) Under regulation 56(3)(b) each single name exposure i must be assigned a risk factor g_i for market risk concentration depending on the weighted average credit quality step of the single name exposure i determined under regulation 55(4), in accordance with the following table—

CQS	0	1	2	3	4	5	6
Risk factor g_i	12%	12%	21%	27%	73%	73%	73%

- (2) If a single name exposure of an insurer does not have a credit assessment by a nominated ECAI, and that single name exposure is an insurer which is supervised by an approved supervisor, and which meets its MCR, that single name exposure must be assigned a risk factor g_i for market risk concentration depending on that insurer's solvency ratio in accordance with the following table—

Solvency Ratio	>196%	175%	122%	100%	≤95%
Risk factor g_i	12%	21%	27%	64.5%	73%

- (3) For the purpose of the table in paragraph (2)—
- if the solvency ratio falls in between the solvency ratios set out in the table, the value of g_i must be linearly interpolated from the closest values of g_i corresponding to the closest solvency ratios set out in the table;
 - if the solvency ratio is lower than 95%, the risk factor g_i is equal to 73%; and
 - if the solvency ratio is higher than 196%, the risk factor g_i is equal to 12%.
- (4) If a single name exposure of an insurer is an insurer which does not meet its MCR, or is not supervised by an approved supervisor, it must be assigned a risk factor g_i for market risk concentration equal to 73%.
- (5) If a single name exposure of an insurer does not have a credit assessment by a nominated ECAI, and that single name exposure is a credit institution

or a financial institution then that exposure must be assigned a risk factor g_i of 64.5%.

- (6) Single name exposures of an insurer, other than those identified in paragraphs (1) to (5) must be assigned a risk factor g_i for market risk concentration of 73%.

60 Treatment of specific exposures in market risk concentration

- (1) An insurer's exposures in the form of covered bonds must be assigned a relative excess exposure threshold CT_i of 15% when the following requirements are met—
 - (a) the covered bond has a credit quality step of 0 or 1; and
 - (b) the covered bond must be issued by a credit institution which has its registered office in the Isle of Man, the United Kingdom or the European Union and is subject by law to special public supervision designed to protect bond-holders. In particular, sums deriving from the issue of these bonds must be invested in conformity with the law in assets which, during the whole period of validity of the bonds, are capable of covering claims attaching to the bonds and which, in the event of failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.
- (2) Exposures in the form of covered bonds must be considered as single name exposures, regardless of other net exposures at default to the same counterparties.
- (3) Other net exposures at default to the same counterparties as the counterparties of exposures in the form of covered bonds must be considered as separate single name counterparties.
- (4) An insurer's exposure to a single immovable property must be assigned a relative excess exposure threshold CT_i of 10% and a risk factor g_i for market risk concentration of 12%.
- (5) An insurer's exposures to a counterparty included in the Approved Entities list in Schedule 2 must be assigned a risk factor g_i for market risk concentration of 0%.
- (6) Exposures to central governments and central banks not included in the Approved Entities list in Schedule 2 must be assigned a risk factor g_i for market risk concentration depending on their weighted average credit quality steps, in accordance with the following table—

CQS	0	1	2	3	4	5	6
g_i	0%	0%	12%	21%	27%	73%	73%

- (7) Exposures in the form of bank deposits must be assigned a risk factor g_i for market risk concentration of 0%, provided they meet all of the following requirements—
- (a) the full value of the exposure is covered by a government guarantee scheme in the Island, the United Kingdom, or the European Union;
 - (b) the guarantee covers the insurer without restriction; and
 - (c) there is no double counting of that guarantee in the calculation of the insurer’s SCR.

61 Counterparty default risk capital requirement

- (1) In this regulation—
- “**counterparty default risk**” in relation to an insurer is the sensitivity of any or all of its assets, liabilities and financial instruments to the default or deterioration in the credit standing of counterparties and debtors of the insurer in the 12 months following the valuation date;
- “**type 1 exposures**” has the meaning given in paragraph (6); and
- “**type 2 exposures**” has the meaning given in paragraph (7).
- (2) Exposures of an insurer to the following must be included in the calculation of the counterparty default risk capital requirement —
- (a) risk-mitigating contracts, such as reinsurance arrangements, securitisations and derivatives;
 - (b) receivables from intermediaries;
 - (c) any other credit exposures that are not covered in the spread risk capital requirement; and
 - (d) collateral or other security held by or for the account of the insurer.
- (3) For each counterparty an insurer is exposed to, the counterparty default risk capital requirement takes account of the overall counterparty risk exposure of the insurer concerned to that counterparty, irrespective of the legal form of its contractual obligations to that insurer.
- (4) The capital requirement for counterparty default risk is calculated on the basis of single name exposures under regulation 55.
- (5) Exposures of an insurer are allocated to type 1 and type 2 exposures under paragraphs (6) and (7).
- (6) Type 1 exposures of an insurer include—
- (a) risk mitigation contracts including reinsurance arrangements, special purpose vehicles, insurance securitisations and derivatives;

- (b) cash at bank;
 - (c) deposits with ceding companies, if the number of single name exposures does not exceed 15;
 - (d) commitments received by the insurer that have been called up but are unpaid, if the number of single name exposures does not exceed 15, 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
 - (e) 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.
- (7) Type 2 exposures of an insurer include exposures that are not covered in the spread risk capital requirement and that are not type 1 exposures in paragraph (6) including the following—
- (a) receivables from intermediaries;
 - (b) policyholder debtors;
 - (c) mortgage loans that meet the requirements in regulation 62;
 - (d) deposits with ceding insurers, if the number of single name exposures exceeds 15; and
 - (e) commitments received by an insurer that have been called up but are unpaid, if the number of single name exposures exceeds 15.
- (8) An insurer may, at its discretion, consider all exposures referred to in paragraphs (7)(d) and (7)(e) as type 1 exposures, regardless of the number of single name exposures.
- (9) If a letter of credit, a guarantee or an equivalent risk mitigation technique has been provided to fully secure an exposure of an insurer and this risk mitigation technique complies with the requirements of regulations 101 to

105, then the provider of that letter of credit, guarantee or equivalent risk mitigation technique may be considered as the counterparty on the secured exposure for the purposes of assessing the number of single name exposures.

- (10) The following credit risk exposures of an insurer must not be covered in the counterparty default risk capital requirement—
- (a) the credit risk transferred by a credit derivative;
 - (b) the credit risk on debt issuance by special purpose vehicles reinsuring the insurer or otherwise having an arrangement with the insurer which exposes the insurer to credit risk;
 - (c) the underwriting risk of credit and suretyship insurance or reinsurance on contracts written by the insurer; and
 - (d) the credit risk of the insurer on mortgage loans that do not meet the requirements in regulation 62.
- (11) Investment guarantees on insurance contracts provided to policyholders by a third party and for which an insurer would be liable should the third party default must be treated as derivatives in the counterparty default risk capital requirement.

62 Specific treatment of mortgage loans

- (1) In this regulation—
- “mortgage loans”** are retail loans secured by mortgages on residential property.
- (2) Mortgage loans are treated as type 2 exposures in the counterparty default risk capital requirement calculation provided the requirements in paragraphs below are met—
- (a) the exposure is either to a natural person or persons or to a small or medium sized enterprise;
 - (b) the exposure is one of a significant number of exposures with similar characteristics such that the risks associated with that lending are substantially reduced;
 - (c) the total amount owed to an insurer and, if relevant, to all participations, including any exposure in default, by the counterparty or other connected third party, must not, to the knowledge of the insurer, exceed £1 million and the insurer must take reasonable steps to acquire this knowledge;
 - (d) the residential property is or will be occupied or let by the owner;
 - (e) the value of the property does not materially depend upon the credit quality of the borrower;

- (f) the risk of the borrower does not materially depend upon the performance of the underlying property, but on the underlying capacity of the borrower to repay the debt from other sources, and as a consequence, the repayment of the loan does not materially depend on any cash flow generated by the underlying property serving as collateral;
 - (g) for those other sources referred to in paragraph (f), an insurer must determine maximum loan-to-income ratio as part of its lending policy and obtain suitable evidence of the relevant income when granting the loan; and
 - (h) all of the following requirements on legal certainty are met—
 - (i) a mortgage or charge is enforceable in all jurisdictions that are relevant at the time of the conclusion of the credit agreement and is properly filed on a timely basis;
 - (ii) all legal requirements for establishing the pledge have been fulfilled; and
 - (iii) the protection agreement and the legal process underpinning it enable an insurer to realise the value of the protection within a reasonable timeframe.
- (3) All of the following requirements on the monitoring of property values and on property valuation must be met—
- (a) the insurer monitors the value of the property at a minimum once every 3 years or more frequently if the market is subject to significant changes in conditions; and
 - (b) the property valuation is reviewed when information available to the insurer indicates that the value of the property may have declined materially relative to general market prices and that review is external and independent and carried out by a valuer who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.
- (4) For the purposes of paragraph (3), an insurer may use statistical methods to monitor the value of the property and to identify property that needs revaluation.
- (5) An insurer must clearly document the types of residential property it accepts as collateral and its lending policies in this regard.
- (6) An insurer must require the independent valuer of the market value of the property to document that market value in a transparent and clear manner.
- (7) An insurer must have in place procedures to monitor that the property taken as credit protection is adequately insured against the risk of damage.

- (8) An insurer must report all of the following data on losses stemming from mortgage loans to the Authority—
- (a) losses stemming from loans that have been classified as type 2 exposures according to regulation 61(7) in a given year; and
 - (b) overall losses in a given year.

63 Counterparty default risk capital requirement calculation

- (1) Under regulation 33(2)(b) an insurer's counterparty default risk capital requirement is equal to the following—

$$SCR_{default} = \sqrt{SCR_{default,1}^2 + 1.5 \cdot SCR_{default,1} \cdot SCR_{default,2} + SCR_{default,2}^2}$$

where—

- (a) $SCR_{default,1}$ denotes the capital requirement for counterparty default risk on type 1 exposures calculated under paragraph (2); and
 - (b) $SCR_{default,2}$ denotes the capital requirement for counterparty default risk on type 2 exposures calculated under paragraph (3).
- (2) Under paragraph (1)(a), an insurer's capital requirement for counterparty default risk on type 1 exposures is determined as follows —

- (a) if the standard deviation, σ , calculated under paragraph (d), of the loss distribution of type 1 exposures is lower than or equal to 7% of the insurer's total loss-given-default on all type 1 exposures, the capital requirement for counterparty default risk on type 1 exposures is—

$$SCR_{default,1} = 3 \cdot \sigma$$

- (b) if the standard deviation, σ , calculated under paragraph (d), of the loss distribution of type 1 exposures is higher than 7% of the insurer's total loss-given-default on all type 1 exposures and lower or equal to 20% of the total loss-given-default on all type 1 exposures, the capital requirement for counterparty default risk on type 1 exposures is—

$$SCR_{default,1} = 5 \cdot \sigma$$

- (c) if the standard deviation, σ , calculated under paragraph (d), of the loss distribution of type 1 exposures is higher than 20% of the insurer's total loss-given-default on all type 1 exposures, the capital requirement for counterparty default risk on type 1 exposures is equal to the insurer's total loss-given-default on all type 1 exposures;
- (d) the standard deviation, σ , of the loss distribution of type 1 exposures is equal to the following—

$$\sigma = \sqrt{V}$$

where V denotes the variance of the loss distribution of type 1 exposures;

- (e) in paragraph (d) the variance of the loss distribution of type 1 exposures, V , is equal to the sum of V_{inter} as calculated in paragraph (f) and V_{intra} as calculated in paragraph (g);
- (f) in paragraph (e) V_{inter} is equal to the following—

$$V_{inter} = \sum_{(j,k)} \frac{PD_k \cdot (1 - PD_k) \cdot PD_j \cdot (1 - PD_j)}{1.25 \cdot (PD_k + PD_j) - (PD_k \cdot PD_j)} \cdot TLGD_j \cdot TLGD_k$$

where—

- (i) the sum covers all possible combinations (j,k) of different probabilities of default on single name exposures; and
- (ii) $TLGD_j$ and $TLGD_k$ denote the sum of the insurer's loss-given-default on type 1 exposures, determined under regulation 64, from counterparties bearing a probability of default PD_j and PD_k respectively determined under regulation 72;
- (g) in paragraph (e), V_{intra} is equal to the following—

$$V_{intra} = \sum_j \frac{1.5 \cdot PD_j \cdot (1 - PD_j)}{2.5 - PD_j} \cdot \sum_{PD_j} LGD_i^2$$

where—

- (i) the first sum covers all different probabilities of default on single name exposures;
- (ii) the second sum covers all single name exposures that have a probability of default equal to PD_j determined under regulation 72; and
- (iii) LGD_i denotes the insurer's loss-given-default on the single name exposure i determined under regulation 64.
- (3) Under paragraph (1)(b), an insurer's capital requirement for counterparty default risk on type 2 exposures is equal to the insurer's loss in basic own-funds resulting from an instantaneous decrease in value of type 2 exposures by the following amount—

$$0.9 \cdot LGD_{receivables>3\ months} + 0.15 \cdot \sum_i LGD_i$$

where—

- (a) $LGD_{receivables>3\ months}$ denotes the insurer's total loss-given-default on exposures in regulation 61(7)(a), receivables from intermediaries, that have been due for more than 3 months;

- (b) the sum is taken on all type 2 exposures other than receivables from intermediaries that have been due for more than 3 months, that were included in (a); and
- (c) LGD_i denotes the insurer's loss-given-default on the type 2 exposure i determined under regulation 64.

64 Loss-given-default

- (1) An insurer's loss-given-default on a single name exposure is—
 - (a) equal to the sum of the insurer's loss-given-default for each exposure to counterparties belonging to the single name exposure, if the loss given default for an exposure to a counterparty is determined under paragraphs (2) and (3); and
 - (b) net of the liabilities towards counterparties belonging to the single name exposure provided that those liabilities and exposures are set-off in the case of default of the counterparties and provided that regulation 101 is complied with in relation to that right of set-off. However, no offsetting is allowed for if the liabilities are expected to be met before the credit exposure is cleared.

- (2) An insurer's loss-given-default on a reinsurance arrangement or insurance securitisation is —

$$LGD_i = \max(0; 50\% \cdot (Recoverables_i + 50\% \cdot RM_{re,i}) - F \cdot Collateral_i)$$

where—

- (a) $Recoverables_i$ denotes the insurer's best estimate of amounts recoverable from the reinsurance arrangement i or insurance securitisation and the corresponding debtors;
- (b) $RM_{re,i}$ is the risk mitigating effect on underwriting risk of the reinsurance arrangement or insurance securitisation, i calculated under regulation 65;
- (c) $Collateral_i$ is the risk-adjusted value of collateral in relation to the reinsurance arrangement or insurance securitisation, i calculated under regulation 69; and
- (d) F is a factor to take into account the economic effect of the collateral arrangement in relation to the reinsurance arrangement or insurance securitisation in case of a credit event related to the counterparty, i . 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 F factor is 100%, or else it is 50%.

- (3) For reinsurance arrangements where 60% or more of that counterparty's assets are subject to collateral arrangements, the insurer's loss-given-default is—

$$LGD_i = \max(0; 90\% \cdot (Recoverables_i + 50\% \cdot RM_{re,i}) - F' \cdot Collateral_i)$$

- (4) An insurer's loss-given-default on a derivative is —

$$LGD_i = \max(0; 90\% \cdot (Derivative_i + RM_{fin,i}) - F' \cdot Collateral_i)$$

where—

- (a) *Derivative_i* denotes the value of the derivative;
 - (b) *RM_{fin,i}* denotes the risk mitigating effect on market risk of the derivative calculated under regulation 65;
 - (c) *Collateral_i* denotes the risk-adjusted value of collateral in relation to the derivative calculated under regulation 69; and
 - (d) *F'* is a factor to take into account the economic effect of the collateral arrangement in relation to the derivative in the case of a credit event related to the counterparty *i*. 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, *F'* is 100%, otherwise *F'* is 90%.
- (5) An insurer's loss-given-default on a mortgage loan is —

$$LGD_i = \max(0; Loan_i - 80\% \cdot Mortgage_i)$$

where—

- (a) *Loan_i* denotes the value of the mortgage loan *i*; and
 - (b) *Mortgage_i* is the risk-adjusted value of the mortgage *i* calculated under regulation 71.
- (6) An insurer's loss-given-default on a legally binding commitment is equal to the difference between its nominal value and its value in the insurer's regulatory balance sheet.
- (7) An insurer's loss-given-default—
- (a) on cash at bank;
 - (b) of a deposit with a ceding insurer;
 - (c) of an item listed in regulation 61(6)(d);
 - (d) of a receivable from an intermediary or policyholder debtor; and
 - (e) any other exposure not listed elsewhere in this regulation,
- is equal to the value of the exposure.

65 Risk-mitigating effect on underwriting risk and market risk

Under regulations 64(2)(b) and 64(4)(b), the risk-mitigating effect of a reinsurance arrangement, securitisation or derivative on an insurer's underwriting risks and market risks, must be determined as the difference between the following capital requirements—

- (a) the insurer's hypothetical capital requirement for underwriting risk or market risk that would apply if the reinsurance arrangement, securitisation or derivative did not exist; and
- (b) the insurer's capital requirement for underwriting risk or market risk determined under regulation 33.

66 Simplified calculation of the risk mitigating effect on underwriting risk and market risk

Where regulation 33(4) is complied with, an insurer may calculate the risk-mitigating effect on underwriting and market risk of a reinsurance arrangement, securitisation or derivative referred to in regulation 65 as the difference between the following capital requirements—

- (a) the sum of the hypothetical capital requirement for the sub-modules of the underwriting and market risk modules of the insurer affected by the risk-mitigating technique, as if the reinsurance arrangement, securitisation or derivative did not exist;
- (b) the sum of the capital requirements for the sub-modules of the underwriting and market risk modules of the insurer affected by the risk-mitigating technique.

67 Simplified calculation of the risk mitigating effect for reinsurance arrangements or securitisations

(1) Where regulation 33(4) is complied with, and upon prior approval from the Authority, an insurer may calculate the risk-mitigating effect on underwriting risk of a reinsurance arrangement or securitisation referred to in regulation 65 as follows—

$$RM_{re,all} \cdot \frac{Recoverables_i}{Recoverables_{all}}$$

where—

- (a) $RM_{re,all}$ is the risk mitigating effect on underwriting risk of the reinsurance arrangements and securitisations for all counterparties calculated under paragraph (2);
- (b) $Recoverables_i$ is the best estimate of amounts recoverable from the reinsurance arrangement or securitisation and the corresponding debtors for counterparty i ; and

- (c) $Recoverables_{all}$ is the best estimate of amounts recoverable from the reinsurance arrangements and securitisations and the corresponding debtors for all counterparties.
- (2) The risk mitigating effect on underwriting risk of the reinsurance arrangements and securitisations for all counterparties referred to in paragraph (1) is the difference between the following capital requirements—
- (a) the hypothetical capital requirement for underwriting risk of the insurer as if none of the reinsurance arrangements and securitisations exist;
- (b) the capital requirement for underwriting risk of the insurer.

68 Simplified calculation of the risk mitigating effect for proportional reinsurance arrangements

- (1) Where regulation 33(4) is complied with, and upon prior approval from the Authority, an insurer may calculate the risk-mitigating effect on underwriting risk j of a proportional reinsurance arrangement for a counterparty i referred to in regulation 65 as follows—

$$\frac{Recoverables_i}{BE - Recoverables_{all}} \cdot SCR_j$$

where—

- (a) BE is the best estimate of obligations gross of the amounts recoverable;
- (b) $Recoverables_i$ is the best estimate of amounts recoverable from the proportional reinsurance arrangement and the corresponding debtors for counterparty i ;
- (c) $Recoverables_{all}$ is the best estimate of amounts recoverable from the proportional reinsurance arrangements and the corresponding debtors for all counterparties; and
- (d) SCR_j is the capital requirement for underwriting risk j of the insurer.

69 Risk adjusted value of collateral

- (1) Under regulation 64(2)(c) the risk-adjusted value of collateral provided by way of security, must be equal to the difference between the value of the assets held as collateral, and the adjustment for market risk determined under paragraph (5), provided both of the following requirements are fulfilled—
- (a) an insurer has, or is a beneficiary under a trust where the trustee 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 relating to the counterparty; and

- (b) the insurer has, or is a beneficiary under a trust where the trustee 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 relating to the custodian or other third party holding the collateral on behalf of the counterparty.
- (2) If the requirement in paragraph (1)(a) is met, the criteria set out in regulation 104 are met and the requirement in paragraph (1)(b) is not met, the risk-adjusted value of a collateral provided by way of security, must be equal to 90% of the difference between the value of the assets held as collateral and the adjustment for market risk.
 - (3) If either the requirement in paragraph (1)(a) is not met or the requirements in regulation 104 are not met, the risk-adjusted value of collateral provided by way of security must be zero.
 - (4) Under regulation 64(2)(c), the risk-adjusted value of a collateral of which full ownership is transferred, must be equal to the difference between the value of the assets held as collateral and the adjustment for market risk provided the requirements in paragraph (5) are fulfilled.
 - (5) The adjustment for market risk must be the difference between the following capital requirements—
 - (a) an insurer’s hypothetical capital requirement for market risk that would apply if the assets held as collateral were not included in the calculation; and
 - (b) the insurer’s hypothetical capital requirement for market risk that would apply if the assets held as collateral were included in the calculation.
 - (6) The currency risk of the assets held as collateral is calculated by comparing the currency of the assets held as collateral against the currency of the corresponding exposure.

70 Simplified calculation of the risk-adjusted value of collateral to take into account the economic effect of the collateral

- (1) Where regulation 33(4) is complied with, and upon prior approval from the Authority, and where the counterparty requirement and the third party requirement referred to in regulation 69(1) are both met, an insurer may, for the purposes of regulation 69, calculate the risk-adjusted value of a collateral provided by way of security as referred to in regulation 64(2)(c), as —

$$\text{Collateral} = 0.85 \cdot \text{MarketValue}_{\text{Collateral}}$$

- (2) Where regulation 33(4) and regulation 104 are complied with, and where the counterparty requirement referred to in regulation 69(1)) is met and

the third party requirement referred to in regulation 69(1) is not met, an insurer may, for the purposes of regulation 69, calculate the risk-adjusted value of a collateral provided by way of security as referred to in regulation 64(2)(c), as—

$$\text{Collateral} = 0.75 \cdot \text{MarketValue}_{\text{Collateral}}$$

71 Risk adjusted value of mortgage

- (1) Under regulation 64(5), the risk-adjusted value of mortgage must be equal to the difference between the value of the residential property held as mortgage, determined under paragraphs (2) and (3), and the adjustment for market risk determined under paragraph (4).
- (2) The value of the residential property held as mortgage must be the market value reduced as appropriate to reflect the results of the monitoring required under regulation 62(3) and to take account of any prior claims on the property.
- (3) The external, independent valuation of the property must be the same or less than the market value calculated under regulation 13.
- (4) The adjustment for market risk referred to in paragraph (1) is the difference between the following capital requirements—
 - (a) an insurer's hypothetical capital requirement for market risk that would apply if the residential property held as mortgage were not included in the calculation; and
 - (b) the insurer's hypothetical capital requirement for market risk that would apply if the residential property held as mortgage were included in the calculation.
- (5) The currency risk of the residential property held as mortgage is calculated by comparing the currency of the residential property against the currency of the corresponding loan.

72 Probability of default

- (1) Under regulation 64, the probability of default on a single name exposure is equal to the average of the probabilities of default on each of the exposures to counterparties that belong to the single name exposure, weighted by an insurer's loss-given-default in respect of those exposures.
- (2) Single name exposures i , for which a credit assessment by a nominated ECAI is available, must be assigned a probability of default PD_i under the following table—

Credit quality step	0	1	2	3	4	5	6
PD_i	0.002%	0.01%	0.05%	0.24%	1.20%	4.2%	4.2%

- (3) Single name exposures, i , to an insurer supervised by an approved supervisor for which a credit assessment by a nominated ECAI is not available but where that insurer meets its MCR, must be assigned a probability of default PD_i depending on the insurer's solvency ratio, under the following table—

Solvency ratio	$\geq 196\%$	$\geq 175\%$	$\geq 150\%$	$\geq 125\%$	$\geq 122\%$	$\geq 100\%$	$\geq 95\%$	$\geq 75\%$	$< 75\%$
PD_i	0.01%	0.05%	0.1%	0.2%	0.24%	0.5%	1.2%	4.2%	4.2%

- (4) Exposures of an insurer to another insurer that does not meet its MCR or equivalent must be assigned a probability of default of 4.2%.
- (5) Exposures of an insurer to a bank, incorporated in the Isle of Man and licensed under the Financial Services Act 2008 to conduct deposit taking activity, for which a credit assessment by a nominated ECAI is not available, must be assigned a probability of default of 0.5%.
- (6) The probability of default on single name exposures other than those identified in paragraphs (1) to (5) must be assigned a probability of default of 4.2%.
- (7) 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 regulations 101 to 105, 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 single name exposure.

73 Life underwriting risk capital requirement

- (1) In this regulation—
- “**life underwriting risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from life insurance obligations, in relation to the perils covered and the processes used in the conduct of business.
- (2) Under regulation 33(2)(c), an insurer's life underwriting risk capital requirement is derived from the following life underwriting sub-risk capital requirements —
- mortality risk;
 - longevity risk;
 - disability and morbidity risk;

- (d) lapse risk;
 - (e) expense risk;
 - (f) revision risk; and
 - (g) life catastrophe risk.
- (3) The capital requirement for life underwriting risk is –

$$SCR_{life} = \sqrt{\sum_{r,c} LifeCorr_{r,c} \cdot Life_r \cdot Life_c}$$

where—

- (a) $Life_r$ and $Life_c$ are the capital requirements for the individual life shock scenarios according to the rows and columns of the correlation matrix $LifeCorr$; and
- (b) $LifeCorr_{r,c}$ are the entries of the correlation matrix $LifeCorr$ —

<i>LifeCorr</i>	Mortality	Longevity	Disability	Lapse	Expenses	Revision	CAT
Mortality	1	-0.25	0.25	0	0.25	0	0.25
Longevity	-0.25	1	0	0.25	0.25	0.25	0
Disability	0.25	0	1	0	0.5	0	0.25
Lapse	0	0.25	0	1	0.5	0	0.25
Expenses	0.25	0.25	0.5	0.5	1	0.5	0.25
Revision	0	0.25	0	0	0.5	1	0
CAT	0.25	0	0.25	0.25	0.25	0	1

74 Mortality risk capital requirement

- (1) In this regulation—
- “**mortality risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level, trend, or volatility of mortality rates.
- (2) Under regulation 73(2)(a) an insurer’s mortality risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous permanent increase of 15% in the mortality rates used by the insurer for the calculation of its technical provisions.
- (3) The resulting stressed mortality rates determined under paragraph (2) must not exceed a value of 1.
- (4) The increase in mortality rates must only apply to those insurance contracts for which an increase in mortality rates leads to an increase in technical provisions without the risk margin.
- (5) An insurer may use the following assumptions to identify insurance contracts for which an increase in mortality rates leads to an increase in technical provisions without the risk margin –

- (a) multiple insurance contracts in respect of the same insured person may be treated as if they were one insurance contract; and
 - (b) if the calculation of technical provisions is based on groups of contracts the identification of the contracts for which technical provisions increase under an increase of mortality rates may also be based on those groups of contracts instead of single contracts, provided that it yields a result that is not materially different.
- (6) With regard to reinsurance obligations, the identification of the contracts for which technical provisions increase under an increase in mortality rates must apply to the underlying insurance contracts only and is carried out under paragraphs (4) and (5).

75 Longevity risk capital requirement

- (1) In this regulation—
- “**longevity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level, trend, or volatility of mortality rates.
- (2) Under regulation 73(2)(b), an insurer’s longevity risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous permanent decrease of 20% in the mortality rates used by the insurer for the calculation of its technical provisions.
- (3) The decrease in mortality rates must only apply to those insurance contracts for which a decrease in mortality rates leads to an increase in technical provisions without the risk margin.
- (4) An insurer may use the following assumptions to identify insurance contracts for which a decrease in mortality rates leads to an increase in technical provisions without the risk margin —
- (a) multiple insurance contracts in respect of the same insured person may be treated as if they were one insurance contract; and
 - (b) if the calculation of technical provisions is based on groups of contracts, the identification of the contracts for which technical provisions increase under an decrease of mortality rates may also be based on those groups of contracts instead of single contracts, provided that it yields a result that is not materially different.
- (5) With regard to reinsurance obligations, the identification of the contracts for which technical provisions increase under an decrease in mortality rates must apply to the underlying insurance contracts only and is carried out under paragraphs (3) and (4).

76 Disability and morbidity capital requirement

- (1) In this regulation—
- “**Disability and morbidity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level of disability, sickness and morbidity rates.
- (2) Under regulation 73(2)(c), an insurer’s disability and morbidity risk capital requirement is the insurer’s loss in basic own-funds resulting from the combination of the following changes—
- (a) an increase of 35% in the disability and morbidity rates that are used by the insurer in the calculation of its technical provisions to reflect the disability and morbidity experience in the 12 months following the valuation date;
 - (b) an increase of 25% in the disability and morbidity rates that are used by the insurer in the calculation of its technical provisions to reflect the disability and morbidity experience for all months after the 12 months following the valuation date; and
 - (c) a decrease of 20% in the disability and morbidity recovery rates used by the insurer in the calculation of its technical provisions in respect of the 12 months following the valuation date and for all years thereafter.
- (3) The increase or decrease in disability and morbidity inception rates must be applied to all inception rates used by an insurer in the calculation of its technical provisions, irrespective of the time-period that the rates refer to.
- (4) The resulting stressed mortality rates determined under paragraph (2) must not exceed a value of 1.
- (5) The decrease to recovery rates must not be applied to recovery rates with a value of 1, if this merely reflects the fact that the benefit payments end after a contractually fixed period.

77 Lapse risk capital requirement

- (1) In this regulation—
- “**lapse risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the expected exercise rates of policyholder options;
- “**discontinuance**” means the exercising by the policyholder of the relevant policyholder options; and
- “**policyholder options**” are as set out in paragraphs (2) and (3).
- (2) Policyholder options include the following—

- (a) all legal or contractual policyholder rights to fully or partly terminate, surrender, restrict or suspend insurance cover or permit the policyholder to lapse; and
 - (b) all legal and contractual policyholder rights to fully or partially establish renew, increase, extend or resume the insurance and reinsurance cover.
- (3) In relation to reinsurance contracts the relevant options are the following—
 - (a) the rights referred to in paragraph (2) of the policyholders of the reinsurance contracts;
 - (b) the rights referred to in paragraph (2) of the policyholders of the insurance contracts underlying the reinsurance contracts; and
 - (c) if the reinsurance contracts cover insurance contracts that will be written in the future, the right of the potential policyholders not to conclude those insurance contracts.
- (4) Under regulation 73(2)(d), an insurer's lapse risk capital requirement is the largest of the following capital requirements—
 - (a) the capital requirement for the risk of a permanent increase in lapse rates determined under paragraph (5);
 - (b) the capital requirement for the risk of a permanent decrease in lapse rates determined under paragraph (7); or
 - (c) the capital requirement for mass lapse risk determined under paragraph (10).
- (5) Under paragraph (4)(a) the capital requirement for the risk of a permanent increase in lapse rates is an insurer's loss in basic own-funds resulting from an instantaneous permanent increase of 50% in the exercise rates of the relevant policyholder options.
- (6) Under paragraph (5), in any event, the increased option exercise rates must not exceed 100% and the increase in option exercise rates must only apply to those relevant options for which the exercise of the option would result in an increase of an insurer's technical provisions without the risk margin.
- (7) Under paragraph (4)(b), an insurer's capital requirement for the risk of a permanent decrease in lapse rates is the insurer's loss in basic own-funds resulting from an instantaneous permanent decrease of 50% in the exercise rates of the relevant policyholder options.
- (8) Under paragraph (7), in any event, the decrease in option exercise rates must not exceed 20% and the decrease in option exercise rates must only apply to those relevant options for which the exercise of the option would result in an increase of the insurer's technical provisions without the risk margin.

- (9) For the purposes of paragraph (2)(b), the change in the option exercise rate referred to in paragraphs (5) and (7) is applied to the rate reflecting that the relevant option is not exercised.
- (10) In paragraph (4)(c), an insurer's capital requirement for mass lapse risk is the insurer's loss in basic own-funds resulting from a combination of the following instantaneous events—
 - (a) the discontinuance of 40% of the insurance contracts for which discontinuance would result in an increase of technical provisions without the risk margin; and
 - (b) if reinsurance contracts cover insurance contracts that will be written in the future, the decrease of 40% of the number of those future insurance contracts used in the calculation of technical provisions.
- (11) Under paragraph (10), for the purposes of determining the loss in basic own-funds of an insurer under the events referred to in paragraphs (10)(a) and (10)(b), the insurer must base the calculation on the type of discontinuance that most negatively affects the basic own-funds of the insurer on a per contract basis.
- (12) An insurer's capital requirement for mass lapse risk under paragraph (10) must reflect the adjustments after the mass lapse event that the insurer would have to make to the expense component of the cash-flow projection in the calculation of the best estimate.

78 Expense risk capital requirement

- (1) In this regulation—

“**expense risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level or trend of the expenses incurred in servicing insurance contracts.
- (2) The expenses incurred in servicing insurance costs must include overhead expenses and must exclude investment management expenses.
- (3) Under regulation 73(2)(e), an insurer's expense risk capital requirement is the insurer's loss in basic own-funds resulting from the combination of the following instantaneous permanent changes—
 - (a) an increase of 10% in the amount of expenses taken into account in the calculation of the insurer's technical provisions; and
 - (b) an increase of in the expense inflation rate used by the insurer in the calculation of its technical provisions by an absolute value of 1%.

- (4) With regard to reinsurance obligations, an insurer must apply the changes referred to in paragraph (3) to its own expenses and, if relevant, to the expenses of the cedant.

79 Revision risk capital requirement

- (1) In this regulation—
“**revision risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from fluctuations in the level or trend of the revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured.
- (2) Under regulation 73(2)(f), an insurer’s revision risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous permanent increase of 3% in the amount of annuity benefits only on annuity insurance obligations if the benefits payable under the underlying insurance contracts could increase as a result of changes in the legal environment or in the state of health of the person insured.

80 Life catastrophe risk capital requirement

- (1) In this regulation—
“**life catastrophe risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from the significant uncertainty of pricing and provisioning assumptions related to extreme or irregular events.
- (2) Under regulation 73(2)(g), an insurer’s life catastrophe risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous absolute addition of 0.15% to the mortality rates that are used by the insurer in the calculation of its technical provisions to reflect the mortality experience in the 12 months following the valuation date.
- (3) The life catastrophe risk shock scenario must be calculated allowing for insurance obligations that are contingent on mortality, i.e. if an increase in mortality rates can lead to either an increase or a decrease in technical provisions without the risk margin, and hence must take into account the assumptions in regulations 74(5) and 74(6).

81 Health underwriting risk capital requirement

- (1) In this regulation—
“**health underwriting risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from health insurance obligations, whether it is pursued on a similar technical basis to that of life insurance or not,

following from both the perils covered and the processes used in the conduct of business.

- (2) Under regulation 33(2)(d), an insurer's health underwriting risk capital requirement is derived from the following capital requirements for health underwriting sub-risks—
- (a) NSLT health underwriting risks;
 - (b) SLT health underwriting risks; and
 - (c) health catastrophe risk.
- (3) An insurer's capital requirement for health underwriting risk is —

$$SCR_{Health} = \sqrt{\sum_{r,c} HCorr_{r,c} \cdot SCR_r \cdot SCR_c}$$

where—

- (a) the sum covers all possible combinations (r,c) of the capital requirements set out in paragraph (4);
 - (b) SCR_r and SCR_c denote the capital requirements for risk capital requirement r and c respectively; and
- (4) $HCorr_{r,c}$ are the entries of the correlation matrix $HCorr$ —

<i>HCorr</i>	SLT	NSLT	Catastrophe
SLT	1	0.5	0.25
NSLT	0.5	1	0.25
Catastrophe	0.25	0.25	1

- (5) An insurer must apply—
- (a) the NSLT health underwriting risk capital requirement to the health insurance and reinsurance obligations included in the NSLT segments below —

Segment	Explanation
A: Medical expense insurance and proportional reinsurance	An obligation of the insurer that covers the provision of financial compensation arising from illness, accident, disability or infirmity, where the underlying business is pursued on a NSLT basis, other than obligations included in segment C.
B: Income protection insurance and proportional reinsurance	An obligation of the insurer that covers the provision of financial compensation arising from illness, accident, disability or infirmity, where the underlying business is pursued on a NSLT basis, other than obligations included in segments A and C.
C: Workers' compensation insurance and proportional reinsurance	An obligation of the insurer that covers the provision of financial compensation arising from illness, accident, disability or infirmity and that arises only from to accidents at work, industrial injury and occupational disease where the underlying business is pursued on a NSLT basis.
D. Non-proportional health reinsurance	Non-proportional reinsurance obligations of the insurer relating to insurance obligations included in segments A, B, and C.

- (b) the SLT health underwriting risk capital requirement to health insurance and reinsurance obligations other than those in paragraph (a); and
- (c) the health catastrophe risk capital requirement to all health insurance and reinsurance obligations.

82 SLT health underwriting risk capital requirement

- (1) Under regulation 81(2)(b), an insurer's SLT health underwriting risk capital requirement of the health underwriting capital requirement must consist of all of the following capital requirements—
 - (a) SLT health mortality risk determined under regulation 83;
 - (b) SLT health longevity determined under regulation 84;
 - (c) SLT health disability-morbidity under regulation 85;
 - (d) SLT health expense risk under regulation 88;
 - (e) SLT health revision risk determined under regulation 89; and
 - (f) SLT health lapse risk determined under regulation 90.
- (2) The capital requirement for SLT health underwriting risk is —

$$SCR_{SLTHealth} = \sqrt{\sum_{r,c} HealthCorr_{r,c}^{SLT} \cdot Health_r^{SLT} \cdot Health_c^{SLT}}$$

where—

- (a) the sum denotes all possible combinations (r,c) of the capital requirements set out in paragraph (1);
- (b) $Health_r^{SLT}$ and $Health_c^{SLT}$ are the capital requirements for the individual health SLT shock scenarios according to the rows and columns of the correlation matrix $HealthCorr^{SLT}$; and
- (c) $HealthCorr_{r,c}^{SLT}$ are the entries of the correlation matrix $HealthCorr^{SLT}$ —

$HealthCorr^{SLT}$	Mortality	Longevity	Disability	Lapse	Expenses	Revision
Mortality	1	-0.25	0.25	0	0.25	0
Longevity	-0.25	1	0	0.25	0.25	0.25
Disability	0.25	0	1	0	0.5	0
Lapse	0	0.25	0	1	0.5	0
Expenses	0.25	0.25	0.5	0.5	1	0.5
Revision	0	0.25	0	0	0.5	1

83 SLT health mortality risk capital requirement

- (1) In this regulation—

“**SLT health mortality risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level, trend, or volatility of mortality rates.
- (2) Under regulation 82(1)(a), an insurer’s SLT health mortality risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous permanent increase of 15% in the mortality rates used by the insurer for the calculation of its technical provisions.
- (3) The resulting stressed mortality rates determined under paragraph (2) must not exceed a value of 1.
- (4) The increase in mortality rates must only apply to an insurer’s insurance contracts for which an increase in mortality rates leads to an increase in technical provisions without the risk margin.
- (5) Further to paragraph (4), the identification of insurance contracts for which an increase in mortality rates leads to an increase in technical provisions without the risk margin must be based on the assumptions in regulations 74(5) and 74(6).

84 SLT health longevity risk capital requirement

- (1) In this regulation—

“**SLT health longevity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level, trend, or volatility of mortality rates.
- (2) Under regulation 82(1)(b), an insurer’s SLT health longevity risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous permanent decrease of 20% in the mortality rates used by the insurer for the calculation of its technical provisions.
- (3) The resulting stressed mortality rates determined under paragraph (2) must not exceed a value of 1.
- (4) The decrease in mortality rates must only apply to those insurance contracts for which a decrease in mortality rates leads to an increase in technical provisions without the risk margin.
- (5) Assumptions in relation to the identification of insurance contracts for which a decrease in mortality rates leads to an increase in technical provisions without the risk margin must be based on the assumptions in regulations 75(4) and 75(5).

85 SLT health disability and morbidity risk capital requirement

- (1) In this regulation—

“**SLT health disability and morbidity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level of medical expenses and income protection disability-morbidity risk.
- (2) Under regulation 82(1)(c), an insurer’s SLT health disability-morbidity risk capital requirement of is the sum of —
 - (a) the insurer’s capital requirement for SLT health medical expense disability-morbidity risk, determined under regulation 86; and
 - (b) the insurer’s capital requirement for SLT health income protection disability-morbidity risk, determined under regulation 87.
- (3) An insurer must apply—
 - (a) the scenarios underlying the calculation of the capital requirement for SLT health medical expense disability-morbidity risk only to SLT health medical expense insurance obligations; and
 - (b) the scenarios underlying the calculation of the capital requirement for SLT health income protection disability-morbidity risk only to SLT health income protection insurance obligations.

86 SLT health medical expense disability and morbidity risk capital requirement

- (1) In this regulation—
- “**SLT health medical expense disability and morbidity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level or trend of the medical expenses incurred in servicing SLT health medical expense disability-morbidity insurance contracts.
- (2) Under regulation 85(2)(a), an insurer’s SLT health expense disability-morbidity risk capital requirement is the larger of —
- (a) the insurer’s capital requirement for the increase of medical payments determined under paragraph (3); and
 - (b) the insurer’s capital requirement for the decrease of medical payments determined under paragraph (4).
- (3) Under paragraph (2)(a) an insurer’s capital requirement for the increase of medical payments is the insurer’s loss in basic own-funds resulting from the following combination of instantaneous permanent changes —
- (a) an increase of 5% in the amount of medical payments taken into account in the calculation of the insurer’s technical provisions; and
 - (b) an increase in the inflation rate of medical payments (expressed as a percentage), used by the insurer for the calculation of its technical provisions, by an absolute value of 1%.
- (4) Under paragraph (2)(b), an insurer’s capital requirement for the decrease of medical payments is the insurer’s loss in basic own-funds resulting from the following combination of instantaneous permanent changes —
- (a) a decrease of 5% in the amount of medical payments taken into account in the calculation of the insurer’s technical provisions; and
 - (b) a decrease in the inflation rate of medical payments (expressed as a percentage), used by the insurer for the calculation of its technical provisions, by an absolute value of 1%.

87 SLT health income protection disability-morbidity risk capital requirement

- (1) In this regulation—
- “**SLT health income protection disability-morbidity risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level of disability, sickness and morbidity rates.
- (2) Under regulation 85(2)(b), an insurer’s SLT health income protection disability-morbidity risk capital requirement is the insurer’s loss in basic

own-funds resulting from the following combination of instantaneous permanent changes—

- (a) an increase of 35% in the disability and morbidity rates that are used by the insurer in the calculation of its technical provisions to reflect the disability and morbidity in the 12 months following the valuation date;
 - (b) an increase of 25% in the disability and morbidity rates that are used by the insurer in the calculation of its technical provisions to reflect the disability and morbidity in the years after the 12 months following the valuation date;
 - (c) if the disability and morbidity recovery rates used by the insurer in the calculation of its technical provisions are lower than 50%, a decrease of 20% in those rates; and
 - (d) if the disability and morbidity persistency rates used by the insurer in the calculation of its technical provisions are equal or lower than 50%, an increase of 20% in those rates.
- (3) The resulting stressed disability and morbidity rates determined under paragraph (2) must not exceed a value of 1.

88 SLT health expense risk capital requirement

- (1) In this regulation—
- “**SLT health expense risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the level or trend of the expenses incurred in servicing SLT health insurance contracts.
- (2) Under regulation 82(1)(d), an insurer’s SLT health expense risk capital requirement is the insurer’s loss in basic own-funds resulting from the following combination of instantaneous permanent changes—
- (a) an increase of 10% in the amount of expenses taken into account in the calculation of the insurer’s technical provisions; and
 - (b) an increase to the expense inflation rate (expressed as a percentage), used by the insurer for the calculation of its technical provisions, by an absolute value of 1%.
- (3) With regard to reinsurance obligations, an insurer must apply those changes to its own expenses and, if relevant, to the expenses of the ceding insurer.

89 SLT health revision risk capital requirement

- (1) In this regulation—

“**SLT health revision risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from fluctuations in the level or trend of the revision rates applied to annuities, due to changes in the legal environment or in the state of health of the person insured.

- (2) Under regulation 82(1)(e), an insurer’s SLT health revision risk capital requirement is the insurer’s loss in basic own-funds resulting from an instantaneous permanent increase of 4% in the amount of annuity benefits, only on SLT health annuity insurance obligations if the benefits payable under the underlying insurance contracts could increase as a result of changes in inflation, the legal environment or the state of health of the person insured.

90 SLT health lapse risk capital requirement

- (1) In this regulation—

“**SLT health lapse risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from changes in the expected exercise rates of policyholder options in respect of SLT health products;
- (2) In this regulation, “policyholder options” are as set out in regulation 77(2) and “discontinuance” has the same meaning as regulation 77(1).
- (3) Under regulation 82(1)(f), an insurer’s SLT health lapse risk capital requirement is the largest of —
 - (a) the risk of a permanent increase in SLT health lapse rates determined under paragraph (4);
 - (b) the risk of a permanent decrease in SLT health lapse rates determined under paragraph (6); or
 - (c) SLT health mass lapse risk determined under paragraph (8).
- (4) Under paragraph (3)(a) an insurer’s capital requirement for the risk of a permanent increase in SLT health lapse rates is the insurer’s loss in basic own-funds resulting from an instantaneous permanent increase of 50% in the exercise rates of the relevant policyholder options.
- (5) Under paragraph (4), in any event, the increased option exercise rates must not exceed 100% and the increase in option exercise rates must only apply to those relevant options for which the exercise would result in an increase of the insurer’s technical provisions without the risk margin.
- (6) Under paragraph (3)(b), an insurer’s capital requirement for the risk of a permanent decrease in SLT health lapse rates is the insurer’s loss in basic own-funds resulting from an instantaneous permanent decrease of 50% in the option exercise rates of the relevant policyholder options.

- (7) Under paragraph (6), in any event, the decrease in option exercise rates must not exceed 20% and the decrease in option exercise rates must only apply to those relevant options for which the exercise would result in a decrease of the insurer's technical provisions without the risk margin.
- (8) Under paragraph (3)(c), an insurer's capital requirement for SLT health mass lapse risk is the insurer's loss in basic own-funds resulting from a combination of the following instantaneous events —
 - (a) the discontinuance of 40% of the insurer's insurance contracts for which discontinuance would result in an increase of technical provisions without the risk margin; and
 - (b) if the reinsurance contract covers insurance or reinsurance contracts that will be written in the future, the decrease of 40% of the number of those future insurance or reinsurance contracts used in the calculation of the technical provisions.
- (9) The events referred to in paragraph (8)(a) must apply uniformly to all insurance contracts concerned.
- (10) In relation to reinsurance contracts the event referred to in paragraph (8)(a) must apply to the underlying insurance contracts.
- (11) For the purposes of determining an insurer's loss in basic own-funds under the event referred to in paragraph (8)(a), the insurer must base the calculation on the type of discontinuance that most negatively affects the basic own-funds of the insurer on a per contract basis.

91 NSLT health underwriting risk capital requirement

- (1) Under regulation 81(2)(a), an insurer's NSLT health underwriting risk capital requirement must consist of all of the following capital requirements—
 - (a) NSLT health premium and reserve risk, determined under regulation 92; and
 - (b) NSLT health lapse risk, determined under regulation 95.
- (2) An insurer's capital requirement for NSLT health underwriting risk is—

$$SCR_{NSLTHealth} = \sqrt{(Health_{pr}^{NonSLT})^2 + (Health_{lapse}^{NonSLT})^2}$$

where—

- (a) $Health_{pr}^{NonSLT}$ denotes the capital requirement for NSLT health premium and reserve risk; and
- (b) $Health_{lapse}^{NonSLT}$ denotes the capital requirement for NSLT health lapse risk.

92 NSLT health premium and reserve risk capital requirement

Under regulation 91(1)(a), an insurer's capital requirement for NSLT health premium and reserve risk is —

$$Health_{pr}^{NonSLT} = \theta \cdot \sigma_{NonSLT} \cdot V_{NonSLT}$$

where—

- (a) θ is equal to 3;
- (b) V is the volume measure for NSLT health insurance obligations determined under regulation 93; and
- (c) σ is the combined standard deviation for NSLT health premium and reserve risk determined under regulation 94.

93 Volume measure for NSLT health premium and reserve risk

- (1) In this regulation, “earned premiums” means the premiums relating to the risk covered by the insurer during the relevant time period.
- (2) Under regulation 92(b), the volume measure for NSLT health premium and reserve risk is equal to the sum of the volume measures for premium and reserve risk of an insurer's NSLT segments set out in regulation 81(5)(a).
- (3) For all NSLT segments, the volume measure of a particular segment s is—

$$V_s = V_{(prem,s)} + V_{(res,s)}$$

where—

- (a) $V_{(prem,s)}$ denotes the volume measure for premium risk of segment s determined under paragraph (4); and
- (b) $V_{(res,s)}$ denotes the volume measure for reserve risk of segment s determined under paragraph (8).
- (4) For all of an insurer's NSLT segments, the volume measure for premium risk of a particular segment s is —

$$V_{(prem,s)} = \max(P_s; P_{(last,s)}) + FP_{(existing,s)} + FP_{(future,s)}$$

where—

- (a) P_s denotes an estimate of the premiums to be earned by the insurer in the segment s in the 12 months after the valuation date;
- (b) $P_{(last,s)}$ denotes the premiums earned by the insurer in the segment s in the 12 months before the valuation date;
- (c) $FP_{(existing,s)}$ denotes the expected present value of any remaining premiums to be earned by the insurer in the segment s on existing contracts that aren't already included in sub-paragraph (a); and
- (d) $FP_{(future,s)}$ denotes 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 in the segment s , excluding the premiums to be earned during the 12 months after the initial recognition date; or
 - (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 in the segment s after the 12 months following the valuation date.²
- (5) For all its NSLT segments an insurer may, as an alternative to the calculation set out in paragraph (4), choose to calculate the volume measure for premium risk of a particular segment s in accordance with the following formula—

$$V_{(prem,s)} = P_s + FP_{(existing,s)} + FP_{(future,s)}$$

provided that all of the following conditions are met—

- (a) the management of the insurer has decided that the insurer's earned premiums in the segment s during the 12 months following the valuation date will not exceed P_s ;
 - (b) the insurer has established effective control mechanisms to ensure that the limits on earned premiums referred to in paragraph (a) will be met; and
 - (c) the insurer has informed the Authority about the decision referred to in paragraph (a) and the reasons for it.
- (6) For the purposes of paragraph (5), the terms P_s , $FP_{(existing,s)}$ and $FP_{(future,s)}$ are denoted under paragraphs (4)(a) to (4)(d).
- (7) For the purposes of the calculations set out in paragraphs (4) and (5), an insurer must use net premiums, after deduction of commission and premiums for reinsurance contracts, unless the premium for a reinsurance contract meets one of the following conditions—
 - (a) the reinsurance premium cannot be taken into account in the calculation of amounts recoverable from reinsurance contracts and special purpose vehicles in regulation 22; or
 - (b) the reinsurance contract for which the premium is payable does not meet the requirements of a risk mitigation technique.
- (8) For all of an insurer's NSLT segments, the volume measure for reserve risk of a particular segment is equal to the insurer's best estimate for the provision for claims outstanding for the segment, after deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles.
- (9) The volume measure referred to in paragraph (8) must not be a negative amount.

- (10) Finite reinsurance, or similar arrangements for which the lack of effective risk transfer is comparable to that of finite reinsurance, must not be taken into account for the purposes of determining the volume measures for NSLT health premium and reserve risk.

94 Standard deviation for NSLT health premium and reserve risk

- (1) Under regulation 92(c), the standard deviation for NSLT health premium and reserve risk is –

$$\sigma_{NSLT} = \frac{1}{V_{NSLT}} \sqrt{\sum_{r,c} CorrS_{r,c} \cdot \sigma_r \cdot V_r \cdot \sigma_c \cdot V_c}$$

where –

- (a) V_{NSLT} is the sum of the volume measure V_s over all segments, s , determined for each segment under regulation 93(3);
- (b) the sum includes all possible combinations of risk group (r,c) in the form (segment, s);
- (c) V_r and V_c are the volume measures for premium and reserve risk of segments r and c respectively determined under regulations 93(4), 93(5) and 93(8);
- (d) σ_r and σ_c are the standard deviations for non-life premium and reserve risk of segments s and t respectively determined under paragraph (2); and
- (e) $CorrS_{r,c}$ are the entries of the correlation matrix $CorrS$ –
- (i) A = NSLT health medical expense insurance and proportional reinsurance;
- (ii) B = NSLT health income protection insurance and proportional reinsurance;
- (iii) C = NSLT health workers' compensation insurance and proportional reinsurance;
- (iv) D = NSLT health non-proportional health reinsurance;

<i>CorrS</i>	A	B	C	D
A	1	0.5	0.5	0.5
B	0.5	1	0.5	0.5
C	0.5	0.5	1	0.5
D	0.5	0.5	0.5	1

- (2) The standard deviation for NSLT health premium and reserve risk of a particular segment s is –

$$\sigma_s = \frac{\sqrt{(\sigma_{(prem,s)} \cdot V_{(prem,s)})^2 + (\sigma_{(prem,s)} \cdot V_{(res,s)} \cdot V_{(prem,s)} \cdot \sigma_{(res,s)}) + (\sigma_{(res,s)} \cdot V_{(res,s)})^2}}{V_{(prem,s)} + V_{(res,s)}}$$

where—

- (a) $\sigma_{(prem,s)}$ denotes the standard deviation for NSLT health premium risk of segment *s* determined under paragraph (3);
 - (b) $\sigma_{(res,s)}$ denotes the standard deviation for NSLT health reserve risk of segment *s* determined under paragraph (6);
 - (c) $V_{(prem,s)}$ denotes the volume measure for premium risk of segment *s* determined under regulation 93(4) to 93(7); and
 - (d) $V_{(res,s)}$ denotes the volume measure for reserve risk of segment *s* determined under regulation 93(8).
- (3) For all of an insurer’s NSLT segments, the standard deviation for NSLT health premium risk of a particular segment is the product of the standard deviation for NSLT health gross premium risk of the segment determined under paragraph (5) and the adjustment factor for non-proportional reinsurance determined under paragraph (4).
 - (4) For all segments the adjustment factor referred to in paragraph (3) for non-proportional reinsurance is equal to 100%.
 - (5) The standard deviation for NSLT health gross premium risk for each segment is —

Segment, <i>s</i>	Standard deviation for premium risk (gross of reinsurance)
A	5.0%
B	8.5%
C	8.0%
D	17.0%

- (6) The standard deviation for NSLT health reserve risk net of reinsurance for each segment is —

Segment, <i>s</i>	Standard deviation for reserve risk (net of reinsurance)
A	5%
B	14%
C	11%
D	20%

95 NSLT health lapse risk capital requirement

- (1) Under regulation 91(1)(b), an insurer’s capital requirement for NSLT health lapse risk, is the insurer’s loss in basic own-funds following an

instantaneous permanent decrease in the profit anticipated from future insurance contracts .

- (2) The decrease to be applied is 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.

96 Health catastrophe risk capital requirement

- (1) In this regulation—

“**health catastrophe risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial instruments (as applicable) to risks arising from the significant uncertainty of pricing and provisioning assumptions related to outbreaks of major epidemics, as well as the unusual accumulation of risks under such extreme circumstances.
- (2) Under regulation 81(2)(c), an insurer's health catastrophe risk capital requirement is —

$$SCR_{CATHealth} = \sqrt{Health_{massaccident}^2 + Health_{concentration}^2 + Health_{pandemic}^2}$$

where—

- (a) $Health_{massaccident}$ denotes the insurer's capital requirement for health catastrophe mass accident risk, determined under regulation 97;
 - (b) $Health_{concentration}$ denotes the insurer's capital requirement for health catastrophe accident concentration risk, determined under regulation 98; and
 - (c) $Health_{pandemic}$ denotes the insurer's capital requirement for health catastrophe pandemic risk, determined under regulation 99.
- (3) An insurer must apply—
 - (a) the mass accident risk capital requirement to health insurance obligations other than workers' compensation insurance obligations (as set out in regulation 81(5)(a));
 - (b) the accident concentration risk capital requirement to workers' compensation insurance obligations and to group income protection insurance obligations (as set out in regulation 81(5)(a)); and
 - (c) the pandemic risk capital requirement to health insurance obligations other than workers' compensation insurance obligations (as set out in regulation 81(5)(a)).

97 Health catastrophe mass accident risk capital requirement

- (1) Under regulation 96(2)(a), an insurer's health catastrophe mass accident risk capital requirement is —

$$Health_{massaccident} = \sqrt{\sum_c Health_{ma,c}^2}$$

where—

- (a) the sum includes all countries that the insurer has insurance obligations in; and
- (b) $Health_{ma,c}$ denotes the insurer's capital requirement for mass accident risk for country c , determined under paragraph (2).
- (2) An insurer's capital requirement for the risk of a catastrophic mass accident in a particular country c is the insurer's loss in basic own-funds resulting from an instantaneous loss of an amount that, before deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles is calculated as follows—

$$L_{ma,c} = r_c \cdot \sum_e x_e \cdot E_{(e,c)}$$

where—

- (a) r_c = ratio of persons affected by the mass accident in country c determined under paragraph (4);
- (b) x_e = ratio of persons that will be affected by event type e as the result of the accident determined under paragraph (5); and
- (c) $E_{(e,c)}$ = sum insured of the insurer for event type e in country c determined under paragraph (3).
- (3) In respect of paragraph (2)(c) for all event types and all countries, the sum insured of an insurer for a particular event type e in a particular country s is —

$$E_{(e,c)} = \sum_i SI_{(e,i)}$$

where—

- (a) the sum includes all insured persons i of the insurer who are insured against event type e and are inhabitants of country c ; and
- (b) $SI_{(e,i)}$ denotes the value of the benefits payable for the insured person i in case of event type e determined under paragraph (6).
- (4) In respect of paragraph (2)(a) the ratios r_c for each country are given below—

Country c	R_c
Austria	0.30%
Belgium	0.25%
Bulgaria	0.30%
Croatia	0.40%
Cyprus	1.30%
Czech Republic	0.10%
Denmark	0.35%
Estonia	0.45%
Finland	0.35%
France	0.05%
Germany	0.05%
Greece	0.30%
Hungary	0.15%
Iceland	2.45%
Ireland	0.95%
Italy	0.05%
Latvia	0.20%
Lithuania	0.20%
Luxembourg	1.05%
Malta	2.15%
Netherlands	0.15%
Norway	0.25%
Poland	0.10%
Portugal	0.30%
Romania	0.15%
Slovakia	0.30%
Slovenia	0.40%
Spain	0.10%
Sweden	0.25%
Switzerland	0.25%
United Kingdom	0.05%
Other Countries	0.45%

- (5) In respect of paragraph (2)(b) the event types e to be considered in the mass accident scenario, and the corresponding ratios x_e are as follows—

Event type e	x_e
Death caused by an accident	10.0%
Permanent disability caused by an accident	1.5%
Disability lasting 10 years, caused by an accident	5.0%
Disability lasting 12 months, caused by an accident	13.5%
Medical treatment caused by an accident	30.0%

- (6) In respect of the benefits as referred to in paragraph (3)(b)—

- (a) the value of the benefit is the sum insured or, if the insurance contract provides for recurring benefit payments, the best estimate of the benefit payments in case of event type e ;
 - (b) if the benefits of an insurance contract depend on the nature or extent of an injury resulting from event e , the calculation of the value of the benefits is based on the maximum benefits obtainable under the contract that are consistent with the event; and
 - (c) for medical expense insurance obligations the value of the benefits is based on an estimate of the average amounts paid in case of event e , assuming the insured person is disabled for the duration specified and taking into account the specific guarantees the obligations include.
- (7) If regulation 8 is complied with, an insurer may calculate the value of the benefit payable to an insured person referred to in paragraph (3) based on homogenous risk groups, provided that the grouping of contracts complies with regulation 19.

98 Health catastrophe accident concentration risk capital requirement

- (1) Under regulation 96(2)(b), an insurer's health catastrophe accident concentration risk capital requirement is—

$$Health_{concentration} = \sqrt{\sum_c Health_{con,c}^2}$$

where—

- (a) the sum includes all countries c where the insurer has insurance obligations; and
 - (b) $Health_{con,c}$ denotes the capital requirement for accident concentration risk for country c determined under paragraph (2).
- (2) For all countries an insurer's capital requirement for health catastrophe accident concentration risk of country c is the insurer's loss in basic own-funds resulting from an instantaneous loss of an amount that, before deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles, is calculated as follows—

$$L_{ma,c} = \sum_e x_e \cdot E_{(e,c)}$$

where—

- (a) x_e = ratio of persons that will be affected by event type e as the result of the accident determined under paragraph (4); and
- (b) $E_{(e,c)}$ = sum insured of the insurer for concentration group C_c for event type e in country c and is defined as—

$$E_{(e,c)} = \sum_i SI_{(e,i)}$$

where—

- (i) C_c denotes the largest accident risk concentration of the insurer in country c ;
 - (ii) $SI_{(e,i)}$ denotes the value of the benefits payable to each insured person i in group C_c in case of event e determined under paragraph (3); and
 - (iii) the sum is over all insured persons i who are insured against event e and are members of the group C_c .
- (3) In respect of the benefits as referred to in paragraph (2)(b)(ii)—
- (a) if the benefits of an insurance contract depend on the nature or extent of the injury resulting from event e , the calculation of the value of the benefits is based on the maximum benefits obtainable under the contract that are consistent with the event; and
 - (b) for medical expense insurance obligations the value of the benefits is based on an estimate of the average amounts paid in case of event e , assuming the insured person is disabled for the duration specified and taking into account the specific guarantees the obligations include.
- (4) The event types e to be considered in the accident concentration scenario, and the corresponding ratios x_e are as follows—

Event type e	x_e
Death caused by an accident	10.0%
Permanent disability caused by an accident	1.5%
Disability lasting 10 years, caused by an accident	5.0%
Disability lasting 12 months, caused by an accident	13.5%
Medical treatment caused by an accident	30.0%

- (5) If regulation 8 is complied with, an insurer may calculate the value of the benefits payable by the insurer for the insured person based on homogenous risk groups, provided that the grouping of contracts complies with the requirements set out in regulation 19.

99 Health catastrophe pandemic risk capital requirement

- (1) In this regulation—
- “**health catastrophe pandemic risk**”, in relation to an insurer, is the sensitivity of the values of any or all of its assets, liabilities and financial

instruments (as applicable) to risks arising from a pandemic resulting in a large number of non-lethal claims.

- (2) Under regulation 96(2)(c), an insurer's health catastrophe pandemic risk capital requirement is the loss in the insurer's basic own-funds resulting from an instantaneous loss of an amount that, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles, is calculated as follows—

$$L_p = 0.000075 \cdot E$$

where E is the insurer's pandemic exposure to income protection contracts determined under paragraph (3).

- (3) The income protection pandemic exposure of an insurer is—

$$E = \sum_i E_i$$

where—

- (a) the sum includes all insured persons i covered by the insurer's income protection insurance obligations other than workers' compensation insurance obligations (as defined in regulation 81(5)(a));
- (b) E_i denotes the value of the benefits payable by the insurer, for the insured person i in case of a permanent work disability caused by an infectious disease, determined under paragraph (c) below; and
- (c) The value of the benefits E_i is—
- (i) the sum insured; or
 - (ii) if the contract provides for recurring benefit payments, the best estimate of the benefit payments, assuming that the insured person is permanently disabled and will not recover.

100 Determining the SCR for ring-fenced funds and marked-to-model portfolios

- (1) If an insurer has a material ring-fenced fund, determined under regulation 118, or a marked-to-model portfolio, the insurer must calculate a notional SCR for each ring-fenced fund, marked-to-model portfolio and the residual.
- (2) An insurer's SCR is the sum of the notional SCRs for each ring-fenced fund, marked-to-model portfolio and the residual.
- (3) If the ring-fenced fund, marked-to-model portfolio or the residual is determined to have a negative notional SCR, the notional SCR must be set to zero before being aggregated with positive notional SCRs in the SCR calculation in paragraph (2).

- (4) Under paragraph (1), if the insurer has determined it has a non-material ring-fenced fund, the assets and liabilities of that ring-fenced arrangement must still be included within the residual of the insurer's portfolio.
- (5) An insurer must determine its notional SCRs before making any adjustment to its basic own-funds required by regulation 114(2), to avoid circularity in the calculation.
- (6) An insurer must calculate its notional SCRs under regulation 28, with the exception that for risk scenarios 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 under that scenario, for each ring-fenced fund, marked-to-model portfolio and the residual.
- (7) Under 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, marked-to-model portfolio and the residual and then considering which stress determines the capital requirement under that scenario.
- (8) The notional SCRs must be calculated net of the mitigating effect of future discretionary benefits under regulation 35.
- (9) If profit participation exists, an insurer's assumptions relating to the variation of future bonus rates must be realistic and have due regard to the impact of the shock at the level of the ring-fenced fund and to any contractual, legal or statutory requirements governing the profit participation mechanism.
- (10) For each ring-fenced fund, marked-to-model portfolio and the residual, the relevant downward adjustment of the notional SCR for the loss-absorbing capacity of technical provisions must not exceed the amount of future discretionary benefits within that fund.

101 Qualitative criteria for risk mitigation techniques

- (1) An insurer must only allow for a risk mitigation technique in its capital requirement calculations if that technique meets the following qualitative criteria —
 - (a) in accordance with paragraph (5), the technique must provide for effective risk transfer to a party other than the insurer and 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, including transfer of risk, 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 a 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; and
 - (g) where the insurer uses insurance risk mitigation, the requirements of regulation 102 are met; and
 - (h) where the insurer uses financial risk mitigation, the requirements of regulations 103, 104 and 105 are met.
- (2) Under paragraph (1)(b) the determination that the contractual arrangement and transfer of risk are legally effective and enforceable in all relevant jurisdictions must, as applicable, take into account the following—
- (a) whether the contractual arrangement is subject to any condition that could undermine the effective transfer of an insurer's risk, the fulfilment of which is outside the direct control of the insurer; and
 - (b) whether there are any connected transactions that could undermine the effective transfer of the insurer's risk.
- (3) Unless paragraph (4) applies, the risk mitigation effect of the risk mitigation technique must remain in force for at least 12 months following the valuation date.
- (4) If the risk mitigation technique will only be in force for a period shorter than 12 months but an insurer intends to replace that risk mitigation technique at the time of its expiry with a similar arrangement, the risk mitigation technique may be fully taken into account in the insurer's capital requirement calculations provided all of the following qualitative criteria are met—

- (a) the insurer has a written and in force governance procedure on the replacement 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 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.

- (5) Under paragraph (1)(a), an insurer must prove the extent of an effective transfer of risk in order to ensure that any reduction in SCR or increase in own-funds resulting from its risk transfer arrangements is commensurate with the change in risk that the insurer is exposed to.
- (6) Further to paragraph (5), an insurer's SCR and own-funds must reflect the economic substance of the risk mitigation arrangement that implement the risk transfer, in particular, when calculating the BSCR under regulation 33, an insurer must only take into account a risk mitigation technique where —

- (a) the reduction in SCR, or increase in own-funds, is commensurate with the extent of risk transfer; and
- (b) there is an appropriate treatment within the SCR of any corresponding risks that are acquired as a consequence of implementing the risk mitigation technique.

102 Insurance risk mitigation

- (1) The counterparty to the reinsurance contract must either—
 - (a) an insurer who meets its SCR under these Regulations or under equivalent provisions in a jurisdiction where the insurer is regulated by an approved supervisor; or
 - (b) an insurer, who doesn't comply with paragraph (a), that has been assigned to credit quality step 0, 1, 2 or 3.
- (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 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 provided in the relevant regulations of its supervisor.
- (3) In the circumstances of paragraph (2), the effect of the risk mitigation technique must be reduced by the percentage by which the counterparty's eligible own-funds falls below its regulatory capital requirements.

103 Financial risk mitigation techniques

- (1) An insurer must be able to value reliably 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 as provided under regulation 13.
- (2) If the risk mitigation technique includes the use of financial instruments, the financial instrument must have a credit quality step of 0, 1, 2 or 3.
- (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 0, 1, 2 or 3.

104 Additional requirements for collateral arrangements

- (1) A collateral arrangement must 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 of 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 57(3)(b) or regulation 60(5) 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.
- (2) 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 0, 1, 2 or 3;
 - (c) the segregated assets are individually identifiable and must 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 (or is a beneficiary under a trust where the trustee 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.
- (3) If the value of the collateral determined under regulation 13 is less than the total risk exposure, the collateral arrangement must only be taken into account as a risk mitigation technique to the extent that the collateral covers that risk exposure.

105 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, 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 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 5: MINIMUM CAPITAL REQUIREMENT

106 Minimum capital requirement

- (1) An insurer must hold, at all times, eligible basic own-fund items of an amount that is equal to or greater than the MCR, as determined under this regulation.
- (2) The MCR for a dormant insurer is the insurer’s SCR.

- (3) The MCR for an insurer who isn't a dormant insurer is —

$$MCR = \max(MCR_{SCR}; FMCR)$$

where—

- (a) MCR_{SCR} is determined under paragraph (4); and
 (b) $FMCR$ is the absolute floor of the MCR and is £3 million.
- (4) MCR_{SCR} is —

$$MCR_{SCR} = \max(0.35 \cdot SCR; 0.25 \cdot SCR_{noMA})$$

where—

- (a) SCR is the insurer's SCR determined under Part 4 of these Regulations; and
 (b) SCR_{noMA} is the insurer's SCR determined under Part 4 of these Regulations, with the exception that the insurer must not allow for any future management actions as defined in regulation 20;
- (5) If the $FMCR$ as defined in paragraph (3)(b) determines an insurer's MCR, the insurer must, as soon as is practicable, notify the Authority that this is the case and provide the Authority with sufficient information to enable the Authority to understand why this is the case.

PART 6: OWN-FUNDS

107 Eligible capital resources

- (1) An insurer's capital resources, or "own-funds" are the excess of its assets over its liabilities, as valued under regulation 13.
- (2) An insurer's own-funds consists of the sum of its basic own-fund items determined under regulation 110 and its ancillary own-fund items determined under regulation 111.

108 Eligibility

- (1) An own-fund item which meets the following conditions is 'eligible'—
- (a) the item must be permanently available, or able to 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 must be available to meet the insurance obligations of the insurer and the repayment of the item must not be made 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.
- (2) An own-fund item is therefore 'ineligible' if it doesn't meet the conditions under paragraph (1).

109 Use of eligible own-fund items to meet capital requirements

- (1) An insurer must determine the quality of its eligible own-fund items under regulations 114, 115 and 116, with Tier 1 being the highest quality and Tier 2 and Tier 3 reducing sequentially in quality.
- (2) At a minimum an insurer must hold eligible own-fund items of sufficient quality as follows—
 - (a) to meet its SCR—
 - (i) 50% or more must be Tier 1 items;
 - (ii) if applicable, the remainder may be either Tier 2 or Tier 3 items, subject to the restriction in sub-paragraph (iii); and
 - (iii) no more than 15% can be Tier 3 items; and
 - (a) to meet its MCR —
 - (i) 80% or more must be Tier 1 items; and
 - (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% of those items can be—
 - (i) items referred to in regulation 114(1)(c);
 - (ii) items referred to in regulation 114(1)(e); or

- (iii) items referred to in regulation 114(1)(c);

110 Basic own-fund items

- (1) An eligible own-fund item of an insurer that meets the requirements below is classed as a basic own-fund item—
- (a) the item is listed in regulations 114, 115 and 116;
 - (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 108;
 - (d) the legal or contractual arrangements governing the item allows for the cancellation of distributions in relation to that item, as required under section 12A of the Act, if—
 - (i) the insurer is not in compliance with its capital requirements; 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-fund items must include amounts in respect of 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.

111 Ancillary own-funds

- (1) The classification of an eligible own-fund item of an insurer as an ancillary own-fund item is subject to the approval of the Authority.
- (2) An ancillary own-fund item of an insurer may comprise the following eligible own-fund items to the extent they are not basic own-fund items as determined under regulation 110—

- (a) unpaid and uncalled ordinary share capital, initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type entities or preference shares;
 - (b) a letter of credit or a guarantee provided to the insurer; or
 - (c) any other legally binding financial commitments provided to the insurer.
- (3) An ancillary own-fund item of an insurer is 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 regulation 114, once it has been called up and paid in, it is classed as Tier 2;
 - (b) otherwise, it is classed as Tier 3.

112 Additional requirements for PCCs

- (1) Where a cell has own-fund items in excess of its SCR or MCR, those own-fund items are not available to meet the SCR or MCR of any other cell or of the core of the PCC.
- (2) Where a core of a PCC has own-fund items in excess of its SCR and MCR, those own-fund items are not available to meet the SCR or MCR of any cell of the PCC unless —
 - (a) secondary liability applies in respect of the cell against the core under section 17 of the Protected Cell Companies Act 2004 (liability of cellular and non-cellular assets);
 - (b) the own-funds of the core in question are not otherwise allocated to another cell of the PCC by way of secondary liability;
 - (c) following any allocation of own-funds of the core by way of secondary liability, the core retains sufficient own-funds to meet its SCR and MCR;
 - (d) the own-funds of the core are of an appropriate quality for the requisite tier of capital required by the cell: and
 - (e) the PCC has effective and demonstrable arrangements in place to determine the order and amount of entitlements of individual cells, and between cells, of the PCC in relation to any secondary liability entitlements the cells may have against the core.

113 Additional requirements for ICCs

- (1) Where an IC has own-fund items in excess of its SCR or MCR, those own-fund items are not available to meet the SCR or MCR of any other IC or of the ICC.
- (2) Where an ICC has own-fund items in excess of its SCR and MCR, those own-fund items are not available to meet the SCR or MCR of any of its ICs.

114 Tier 1 basic own-fund items

- (1) The following basic own-fund items are classed as Tier 1, if they meet all of the features in paragraph (4)—
 - (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 meets the requirements of paragraph (4), subject to the approval of the Authority; and
 - (h) paid-up subordinated liabilities.
- (2) The reconciliation reserve in sub-paragraph (1)(f) is—
 - (a) the insurer's total 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), regulation 115(1)(a) to 115(1)(e), and regulation 116(1)(a) to 116(1)(d); less
 - (e) unless paragraph (3) applies, the amount by which the value of the insurer's restricted own-fund items, determined under regulation 117, exceed the notional SCR of the associated ring-fenced fund or marked-to-model portfolio, determined under regulation 100.
- (3) If a ring-fenced fund is not deemed material under regulation 118, and hence an insurer does not calculate a notional SCR, the item in sub-

paragraph (2)(e) is replaced with the total amount of restricted own-fund items in respect of that ring-fenced fund.

- (4) The required features for an own-fund item to be classed as Tier 1 are—
- (a) the item is either immediately available to meet the insurer's obligations or 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 an item referred to in sub-paragraphs (1)(a), (1)(b), (1)(c), (1)(e), (1)(h), and (1)(g) if applicable—
 - (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 an item referred to in sub-paragraphs (1)(a), (1)(b), and (1)(g), if applicable,—
 - (i) the item ranks after all other claims in the event of winding-up proceedings of the insurer; and
 - (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;
 - (d) for an item referred to in sub-paragraphs (1)(a), (1)(b), and (1)(g) if applicable, in sub-paragraph (b)(ii) full flexibility over the distributions is provided if all of the following conditions are met—
 - (i) there is no obligation for the insurer to make distributions;
 - (ii) non-payment of distributions does not constitute an event of default of the insurer;
 - (iii) the cancellation of distributions imposes no restrictions on the insurer;
 - (iv) 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
- (v) distributions are only paid out of distributable items;
- (e) for an item referred to in sub-paragraphs (1)(c), (1)(e), (1)(h) and (1)(g) if applicable, the item ranks—
- (i) to the same degree as, or ahead of, items in sub-paragraphs (1)(a) and (1)(b);
 - (ii) after Tier 2 and Tier 3 items; and
 - (iii) after the claims of all policyholders and non-subordinated creditors.
- (f) for an item referred to in sub-paragraphs (1)(c), (1)(e), (1)(h), and (1)(g) if applicable, the item possesses one of the three following mechanisms, to be triggered when the insurer is significantly not in compliance with its SCR—
- (i) the nominal or principal amount of the item is written down in such a way that all of the following are reduced—
 - (A) the claim of the holder in the event of winding-up proceedings;
 - (B) the amount required to be paid on repayment or redemption of that item; and
 - (C) any distributions paid on that item.
 - (ii) the item automatically converts into an item listed in sub-paragraphs (1)(a) and (1)(b) and the provisions governing the conversion specify either—
 - (A) the rate of conversion and a limit on the permitted amount of conversion; or
 - (B) a range within which the instruments will convert into an item listed in paragraphs (1)(a) and (1)(b);
or
 - (iii) another mechanism that achieves an equivalent outcome to those in sub-paragraphs (i) and (ii).

- (g) For an item referred to in sub-paragraphs (1)(c), (1)(e), (1)(h), and (1)(g) if applicable—
 - (i) the item does not have a fixed maturity date;
 - (ii) the first contractual opportunity to repay or redeem the item does not occur before 5 years from the date of its issuance;
 - (iii) 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
- (h) for an item referred to in paragraphs (1)(c), (1)(e), (1)(h) and (1)(g) if applicable, in sub-paragraph (b)(ii), full flexibility over the distributions is provided if all of the following conditions are met—
 - (i) 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;
 - (ii) there is no obligation to substitute the distribution by a payment in any other form;
 - (iii) there is no obligation to make distributions in the event of a distribution being made on another own-fund item;
 - (iv) non-payment of distributions does not constitute an event of default of the insurer;
 - (v) the cancellation of distributions imposes no restrictions on the insurer; and
 - (vi) distributions are only paid out of distributable items.

115 Tier 2 basic own-funds

- (1) The following basic 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 meets the requirements of paragraph (2), subject to the approval of the Authority; 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 where the insurer is not in compliance with its SCR or the repayment or redemption of that item would cause such non-compliance; and
 - (f) the item meets the Tier 1 features set out in regulation 114(4), but the limit set in regulation 109(3) for items of its type, is exceeded so it is instead classified as Tier 2 under regulation 109(2)(a)(ii).

116 Tier 3 basic own-funds

- (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 meets the requirements of paragraph (2), subject to the approval of the Authority; 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; and
- (c) the item may include limited incentives to repay or redeem that item.

117 Restricted own-funds

- (1) Restricted own-funds of an insurer have a lack of transferability within an insurer for one or more of the following reasons—
 - (a) the items can only be used to cover losses on a defined portion of the insurer's insurance or reinsurance contracts;
 - (b) the items can only be used to cover losses in respect of certain policyholders of the insurer; or
 - (c) the items can only be used to cover losses arising from particular risks or liabilities of the insurer.
- (2) An insurer must identify the nature of restrictions affecting its own-funds and the liabilities in respect of the contracts, policyholders or risks for which those own-funds can only be used.
- (3) At a minimum, the following must be classified as restricted own-fund items—
 - (a) own-funds within a ring-fenced fund as recognised under regulation 15; and
 - (b) own-funds within a marked-to-model portfolio, as determined under regulation 14.
- (4) Future transfers attributable to shareholders are not classed as restricted own-fund items.

118 Materiality of a ring-fenced fund

- (1) An insurer must consider the materiality of a ring-fenced fund of the insurer by assessing—
 - (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.

PART 7: REVOCATIONS

119 Revocation

- (1) The Insurance (Long-Term Business Valuation and Solvency) Regulations 2018⁴ are revoked.

MADE 2 DECEMBER 2021

⁴ SD 2018/0193

SCHEDULE 1

[Regulation 32]

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 may nominate a different ECAI for each of its asset, liability and counterparty exposures. When nominating an ECAI the following requirements must be met—
 - (a) an insurer must use the same ECAI 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 that would generate the highest solvency capital requirement 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 would generate the lowest solvency capital requirements, and paragraph (e) applies to these two assessments; and
 - (g) both solicited and unsolicited credit assessments from ECAIs must be taken into account.
- (3) Credit assessments from a nominated ECAI for an issuer within a corporate group must not be used as the credit assessment for another issuer within the same corporate group.

SCHEDULE 2

[Regulations 52 and 56]

EXPOSURES TO APPROVED ENTITIES LIST

- (1) Isle of Man Government;
- (2) United Kingdom Government;
- (3) Bank of England;
- (4) European Central Bank;
- (5) the central government or central bank of an EU Member State, denominated and funded in the domestic currency of that Member State;
- (6) 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
- (7) exposures to international organisations including—
 - (a) the European Community;

- (b) the International Monetary Fund; and
 - (c) the Bank for International Settlements ; and
- (8) exposures that are fully, unconditionally and irrevocably guaranteed by the—
- (a) European Investment Bank;
 - (b) European Investment Fund;
 - (c) Isle of Man Government;
 - (d) United Kingdom Government;
 - (e) the Bank of England;
 - (f) European Central Bank; and
 - (g) central government or central bank of an EU Member State, denominated and funded in the domestic currency of that Member State,

if the guarantee meets the requirements set out in regulation 105.

ENDNOTES

Table of Endnote References

¹ The format of this legislation has been changed as provided for under section 75 of, and paragraph 2 of Schedule 1 to, the Legislation Act 2015. The changes have been approved by the Attorney General after consultation with the Clerk of Tynwald as required by section 76 of the Legislation Act 2015.

² Para (4) substituted by SD2023/0176.