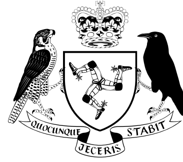

INSURANCE (NON LONG-TERM BUSINESS VALUATION AND SOLVENCY) REGULATIONS 2021

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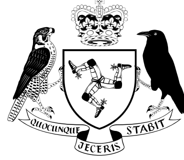

Insurance Act 2008

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

Laid before Tynwald:
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 (Non Long-Term Business Valuation and Solvency) Regulations 2021.

2 Commencement

These Regulations come into operation on 30 June 2022[1].

3 Interpretation

In these Regulations—

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

[1] Under section 50(4) of the Insurance Act 2008, regulations shall be laid before Tynwald as soon as practicable after they are made, and if Tynwald at the sitting at which the regulations are laid, or at the next following sitting, resolves that they shall be annulled, the regulations shall cease to have effect from that time.

"**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 2021[2] with the addition of the Isle of Man Financial Services Authority;

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

"**basic own-fund**" means items satisfying the requirements of regulation 74;

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

"**BSCR**" means basic solvency capital requirement, as determined under regulation 25;

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

"**CGC**" means the Corporate Governance Code of Practice for Insurers 2021[3];

"**class 12 insurance business**" has the same meaning as in the Insurance Regulations 2021;

"**class 12 insurer**" means a class 12 insurer as defined in the Insurance Regulations 2021 to whom, under regulation 4, these Regulations apply;

"**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;

"**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;

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[2] SD 2021/0278

[3] SD 880/10 as amended by SD 886/10, 2015/0317 and SD 2021/0276

"**eligible own-fund**" means an own-fund item which is eligible under regulation 72;

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

"**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

(b) an ICC it may mean the ICC, or an IC.

"**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 sufficiently important to influence the decision-making or judgment of the intended user of the information;

"**MCR**" means minimum capital requirement;

"**non-cellular**", in relation a PCC, means the business of the PCC not attributed to a cell of the PCC;

"**non long-term business**" as defined in the Insurance Regulations 2021;

"**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;

"**own-fund item**" has the meaning given in regulation 71;

"**participation**", in relation to a holding by an insurer in an entity, has the meaning given by regulation 10;

"**PCC**" means a protected cell company;

"**pooling arrangement**" means an arrangement whereby two or more insurers agree to share identified insurance risks in defined proportions;

"**protected cell company**" has the meaning given in the Insurance Regulations 2021;

"**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 tranched, and at least one of the underlying exposures is a securitisation position;

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

"**risk mitigation technique**" is a technique used by an insurer to transfer risk 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**" means solvency capital requirement, which is 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**';

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

"**technical provisions**" has the meaning given in Part 3;

"**type 1 securitisation position**" is a securitisation position meeting the requirements of sub-paragraph 1(1) of Schedule 3, which has effect; and

"**type 2 securitisation position**" is a securitisation position meeting the requirements of sub-paragraph 1(2) of Schedule 3, which has effect.

4 Application

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

(a) classes 3 to 9 and 11; and

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

and therefore apply to an insurer authorised in respect of any such class, or combination of such classes 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 determine its MCR and SCR in accordance with these Regulations, as applicable to its class of authorisation under the Insurance Regulations 2021.

6 Expert judgement

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

(2) An insurer must, taking due account of proportionality under regulation 7, 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 Proportionality

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

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

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

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

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

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

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

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

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

8 Board report

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

(2) Where an insurer is required to have an actuarial function this report (or reports) must be prepared and submitted by the person responsible for that function.

(3) The report(s) must —

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

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

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

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

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

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

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

9 Policyholder behaviour

(1) 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.

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 in accordance with 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 paragraph (1)(a), or could potentially meet those requirements in future if the insurer has the right to increase its shareholdings through the holding of options,

warrants or similar instruments or having any other contractual rights to the same or similar effect;

(b) 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.

11 Recognition of ring-fenced funds

(1) An insurer must identify whether it has assets and liabilities that are ring-fenced funds.

(2) Schedule 7 has effect and an insurer must comply with its requirements accordingly.

PART 2: ASSETS AND LIABILITIES OTHER THAN TECHNICAL PROVISIONS

12 Application

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

13 Use of relevant accounting standards

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.

14 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 13;

(b) separately for each asset and liability;

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

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

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

(f) allowing for proportionality.

(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) When using an alternative valuation method 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.

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

(8) If unobservable inputs are used, an insurer must adjust data that is specific to the insurer if reasonable and 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.

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

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

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

(a) goodwill; and

(b) intangible assets other than goodwill, unless the intangible asset can be sold separately and the insurer can demonstrate to its board of directors that there is a value for the same or similar assets that has been derived using the method in paragraph (4).

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

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

(a) the values ascribed to assets and liabilities using the method in 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.

(14) The value specified in paragraph (13)(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.

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

(16) An insurer must calculate the value of a participation as the quoted market price in an active financial market.

(17) If it is not practicable or proportionate for an insurer to comply with paragraph (16), the insurer must use a relevant alternative approach set out in paragraphs (5) to (8) .

PART 3: TECHNICAL PROVISIONS

15 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 16 and 17 to determine which insurance obligations should be included within its technical provisions.

(4) An insurer must calculate its technical provisions as the sum of a best estimate, determined under regulation 18, and a risk margin, determined under regulation 21.

(5) An insurer must segment its technical provisions into the lines of business in Schedule 6, which has effect.

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

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

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

(b) inflation, including expense and claims inflation;

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

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

(e) generally available data on relevant underwriting risks.

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

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

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

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

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

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

(9) For the purpose of paragraph (8)(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.

(10) 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.

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

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

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

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

(d) the validation of its technical provisions under paragraph (10).

16 Recognition and de-recognition of insurance obligations

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

(2) An insurer must cease to recognise an insurance obligation only when it is fully extinguished, discharged or cancelled or has expired.

17 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) Unless paragraph (4) applies, an insurer must cease to recognise an obligation as belonging to a contract when it is fully extinguished, discharged or cancelled, or has fully expired.

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

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

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

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

18 Calculation of the best estimate

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

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

(3) When determining the best estimate under paragraph (2) —

(a) an insurer should consider removing all known prudence from the accounting provisions before they are used to determine the best estimate;

(b) prudence that has not been, or cannot be, explicitly quantified must not be removed from the accounting provisions; and

(c) the method used by the insurer must be fully documented, approved by the Board, and available to the Authority on request.

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

(5) The calculation of the best estimate must—

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

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

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

(d) use realistic assumptions that comply with regulation 15(8);

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

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

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

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

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

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

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

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

(9) The cash flow projection referred to in paragraph (1) must be carried out for each line of business in Schedule 6 and must include all of the following cash flows, as applicable and to the extent that those cash flows relate to the insurer's obligations—

(a) payments to policyholders;

(b) payments of expenses including—

(i) administrative expenses;

(ii) investment management expenses;

(iii) overhead expenses;

(iv) claims management expenses;

(v) acquisition expenses; and

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

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

(d) any other payments of the insurer under a contract.

(10) For insurance contracts which provide after-the-event insurance cover or have similar deferred premium arrangements, premiums that are not yet received in accordance with the contractual terms must be included as a future cash flow receivable under the policy and not as a debtor in the regulatory balance sheet.

(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—

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

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

(iii) the amount of expenses;

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

(v) policyholder behaviour;

(b) dependency between two or more causes of uncertainty; and

(c) dependency between cash flows on circumstances prior to the date of the cash flow.

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

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

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

19 Amounts recoverable from reinsurance contracts and special purpose vehicles

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

(a) special purpose vehicles;

(b) finite reinsurance contracts; and

(c) other reinsurance contracts.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(5) In paragraph (2)(c), unless paragraph (8) 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.

(6) The change in cash flows in paragraph (5) must not take into account the effect of any risk mitigating technique that mitigates the credit risk of the counterparty.

(7) The adjustment to take account of expected losses due to default of a counterparty in paragraph (5) must—

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

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

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

(8) Where the method of calculating the adjustment described in paragraph (5) 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—

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

(b) must calculate the unadjusted net best estimate for each reinsurance contract or special purpose vehicle under each line of business specified in Schedule 6.

20 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, an insurer must use the annual risk-free interest rate; and

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

21 Calculation of the risk margin

(1) The risk margin is an 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.

(2) Unless paragraph (3) applies, an insurer's risk margin is 5% multiplied by the sum over all future years of —

(a) the SCR determined for a particular year using the approach in Schedule 10, which has effect; multiplied by

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

(3) For a class 12 insurer, where the method of calculation in paragraph (2) is not practicable or proportionate, the insurer may instead use one of the following methods to calculate the risk margin—

(a) estimate the risk margin as 5% multiplied by the modified duration of the best estimate, gross of amounts recoverable from reinsurance contracts and special purpose vehicles, for each line of business set out in Schedule 6; or

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

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

(5) The calculation in paragraph (2) must include any capital add-on imposed under regulation 24, unless the capital add-on is a result of the

insurer's systems of governance not adequately addressing its risk profile.

(6) Where an insurer uses the full method of calculation in paragraph (2) to determine its risk margin, it must update the calculation at least once a year.

(7) For quarterly calculations of the risk margin subsequent to a full calculation under paragraph (6), an insurer may derive the risk margin using a proportionate method.

22 Data quality

(1) An insurer must have internal processes and procedures in place to ensure that the data used in the calculation of its technical provisions is complete, accurate and appropriate.

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

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

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

PART 4: SOLVENCY CAPITAL REQUIREMENT

23 Solvency capital requirement

(1) The SCR for a dormant insurer is the amount of regulatory capital necessary to ensure that its assets exceed all of its liabilities, including those relating to the insurer's operational management and regulatory compliance.

(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 90% for a class 12 insurer and 99.5% for an insurer who is not a class 12 insurer, over a one-year period.

(3) An insurer must determine its SCR on the presumption that the insurer will pursue its business as a going concern, using the standard formula approach in paragraph (4).

(4) The standard formula approach used to determine an insurer's SCR is the sum of—

(a) a BSCR as determined in regulation 25;

(b) a capital requirement for operational risk determined in regulation 27; and

(c) a capital add-on as may be specified by the Authority, determined under regulation 24.

24 Capital add-on

(1) Under regulation 23(4)(c) the Authority may, in exceptional circumstances, increase an insurer's SCR by imposing a capital add-on if the Authority has concluded during the supervisory review process that the 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 must be understood in the context of the specific situation of each insurer rather than in relation to the number of capital add-ons imposed in the Island's non-life insurance market.

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

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

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

(7) The methodology used to determine the capital add-on in the circumstance of paragraph (1)(a) must comply with regulation 23(2).

(8) In the circumstance of paragraphs (1)(b) or (1)(c), the methodology used to determine the capital add-on must reflect an assessment of the significance of the deviation regarding the system of governance, and 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 and it may, if the standardised approach does not adequately reflect the very specific risk profile of an insurer, remain over consecutive years.

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

25 Basic solvency capital requirement

(1) The BSCR referred to in regulation 23(4)(a) is the sum of—

(a) the capital requirement for market risk determined under regulation 29;

(b) the capital requirement for counterparty default risk determined under regulation 38;

(c) the capital requirement for underwriting risk determined under regulation 39;

(d) the capital requirement for NSLT health risk determined under regulation 58;

(e) the capital requirement for intangible asset risk determined under regulation 28; and

(f) a diversification adjustment determined in accordance with paragraphs (1) and (2) of Schedule 1, which has effect.

(2) The capital requirements determined under sub-paragraphs (1)(a) to (1)(e) must be positive and the diversification adjustment under sub-paragraph (1)(f) must be negative.

(3) If an insurer transfers its risks using a risk mitigation technique that meets the requirements of regulation 65, and if the arrangement provides the insurer with protection against the risks specified in paragraphs (1)(a) to (1)(e), the insurer may allow for the risk-mitigating effect of the technique when determining its capital requirements, in a manner that, without double-counting, captures the economic effect of the protections provided.

(4) Where an insurer allows for the use of a risk mitigation technique under paragraph (3), it must assess whether the risk exposure corresponds completely to the risks underlying the exposure to determine whether there is any material basis risk.

(5) If an insurer determines that a particular risk mitigation technique exhibits material basis risk, it may still allow for the technique when determining its capital requirements, provided that 25% of the difference between the following is added to the relevant capital requirement—

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

(b) the capital requirement for the relevant risk.

26 Association of credit assessments to credit quality steps

(1) Schedule 8 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 8, and assign it to a credit quality step.

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

(4) The nominated external credit quality assessment must be capped at the Sovereign credit rating of the country of the exposure.

27 Operational risk capital requirement

(1) The capital requirement for operational risk under regulation 23(4)(b) is 0 for a class 12 insurer or, for an insurer who is not a class 12 insurer, the lower of—

(a) the BSCR multiplied by 0.3; and

(b) the higher of—

(i) a capital requirement based on a premium measure determined under paragraph (2); or

(ii) a capital requirement based on a reserve measure determined under paragraph (4).

(2) In paragraph (1)(b)(i) the operational risk capital requirement based on a premium measure is the sum of—

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

(b) the higher of —

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

(ii) 0.

(3) In paragraph (2)(b)(i), the insurer's adjusted earnings are—

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

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

(4) In paragraph (1)(b)(ii), the operational risk capital requirement based on the reserve measure is the insurer's best estimate provision, gross of amounts recoverable from reinsurance contracts and special purpose vehicles, multiplied by 0.03.

28 Intangible asset risk capital requirement

The capital requirement for intangible asset risk is the value of the insurer's intangible assets, determined under regulation 14(11)(b), multiplied by 0.8.

29 Market risk capital requirement

The capital requirement in respect of market risk is the sum of—

(a) the capital requirement for interest rate risk determined under regulation 32;

(b) the capital requirement for equity risk determined under regulation 33;

(c) the capital requirement for property risk determined under regulation 34;

(d) the capital requirement for currency risk determined under regulation 35;

(e) the capital requirement for spread risk determined under regulation 36;

(f) the capital requirement for concentration risk determined under regulation 37; and

(g) a diversification adjustment as determined under paragraphs 1 and 3 of Schedule 1.

30 Look-through approach

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

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

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

(2) The look-through approach does not apply to investments of an insurer in a related entity, which is valued under regulation 14.

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

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

(5) Taking due account of proportionality in regulation 7, the full look-through requirements of paragraph (1) may be waived and instead the market risk capital requirement may be calculated on the basis of the target underlying asset allocation of a collective investment vehicle or fund, provided that—

(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 that target allocation.

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

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

31 Treatment of participations in 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 29, 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.

32 Interest rate risk capital requirement

(1) The capital requirement in respect of interest rate risk under regulation 29(a) is the largest resulting capital requirement derived from—

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

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

(2) The interest rate risk capital factors specifying the increase or decrease to be applied to the spot rates at each duration are set out in paragraph 1 of Schedule 2, which has effect.

33 Equity risk capital requirement

(1) In this regulation –

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

(b) "type 2 equities" comprise —

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

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

(iii) all assets and indirect exposures allocated by the insurer to type 2 equities through use of the approach set out in regulation 30(7), unless that asset is included in the interest rate risk capital requirement, property risk capital requirement or spread risk capital requirement.

(2) The capital requirement in respect of equity risk under regulation 29(b) is the sum of—

(a) the reduction in value of an insurer's basic own-funds following the instantaneous permanent reduction in the value of investments in type 1 equities;

(b) the reduction in value of an insurer's basic own-funds following the instantaneous permanent reduction in the value of investments in type 2 equities; and

(c) a diversification adjustment as determined under paragraphs 1 and 4 of Schedule 1.

(3) The equity risk capital factors specifying the reduction to be applied to each type of equity investment are set out in paragraph 2 of Schedule 2.

34 Property risk capital requirement

(1) The capital requirement for property risk under regulation 29(c) is the reduction in value of an insurer's basic own-funds following an instantaneous permanent reduction in the value of the insurer's exposure to immovable property.

(2) The property risk capital factors specifying the reduction to be applied to the insurer's property exposures are set out in paragraph 3 of Schedule 2.

35 Currency risk capital requirement

(1) In this regulation —

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

(b) "currency groups" means a group of foreign currencies; and

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

(2) Unless paragraph (5) applies, the capital requirement for currency risk under regulation 29(d) is the reduction in basic own-funds following an instantaneous permanent increase in the value of the insurer's exposure to foreign currencies.

(3) For a class 12 insurer the increase must be applied to the insurer's total foreign currency exposure.

(4) For an insurer who is not a class 12 insurer, the insurer may either—

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

(b) segment its currency exposures between the currency groups specified in paragraph 4(1) of Schedule 2 and then apply the increase to each currency group.

(5) Where the method in paragraph (4)(b) is used, the calculation in paragraph (2) is reduced by a diversification adjustment as determined under paragraphs 1 and 5 of Schedule 1.

(6) The currency risk capital factors specifying the reduction to be applied to the insurer's currency exposures are set out in paragraph 4(5) of Schedule 2.

(7) In order to determine the currency exposure in paragraph (2), where an insurer holds equities listed on stock exchanges in different currencies the currency of these equities must be assumed to be that of the main listing.

(8) In order to determine the currency exposure in paragraph (2), where an insurer holds assumed Type 2 equities (i.e. not looked-through assets that have been allocated to type 2 equities) the currency of these Type 2 equities must be assumed to be the insurer's reporting currency.

36 Spread risk capital requirement

(1) The capital requirement for spread risk under regulation 29(e) for a class 12 insurer and an insurer who is not a class 12 insurer but for whom the calculation in paragraph (3) is disproportionate in accordance with regulation 7, is the reduction in basic own-funds following an instantaneous permanent decrease in the value of the insurer's credit-risky assets (i.e. bonds, loans, deposits, securitisation positions, credit derivatives etc.) that are exposed to spread risk, as set out in paragraph (2).

(2) The decrease to be applied to an insurer's exposure to credit risky assets under paragraph (1) is—

(a) for exposures with credit quality steps 0 to 6, the sum over all credit quality steps of the proportion of the insurer's exposure to credit risky assets assigned to that credit quality step, multiplied by the applicable spread risk credit quality step factor specified in paragraph 5(1) of Schedule 2, multiplied by the average modified duration of the credit risky assets assigned to that credit quality step.

(b) for any unrated exposures the proportion of the insurer's exposure to credit risky assets that are unrated; multiplied by the lower of —

(i) the average modified duration of the credit risky assets, multiplied by 0.015 for a class 12 insurer and 0.03 for an insurer who is not a class 12 insurer; and

(ii) 1.

(3) Unless paragraph (1) applies, the capital requirement for spread risk under regulation 29(e) for an insurer who is not a class 12 insurer is—

(a) the capital requirement for spread risk on bonds and loans (including bank deposits that are not cash) as determined under paragraph (4); plus

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

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

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

(5) The reduction to be applied to the insurer's exposure to bonds and loans is determined for each bond or loan exposure as—

(a) for exposures to approved entities in the list in Schedule 4 (which has effect), 0%; or

(b) for other exposures in the form of bonds and loans not in the list in Schedule 4, the applicable spread risk credit quality step factor specified in paragraph 5(2) of Schedule 2.

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

(7) The reduction to be applied to the insurer's exposures to type 1 securitisation positions, type 2 securitisation positions and resecuritisation positions is determined for each type of securitisation position as the lower of —

(a) the applicable spread risk credit quality step factor specified in paragraph 5(3) of Schedule 2, multiplied by the modified duration of the securitisation position; and

(b) 1.

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

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

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

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

(10) The increase to be applied to the credit spreads of the instruments underlying the credit derivatives in paragraph (9)(a) is determined for each exposure using the applicable spread risk credit quality step factor specified under paragraph 5(4) of Schedule 2.

(11) The decrease to be applied to the credit spreads of the instruments underlying the credit derivatives under paragraph (9)(b) is 75%.

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

(13) The capital requirement for spread risk on credit derivatives if the underlying financial instrument is a bond or a loan to any entity listed in Schedule 4, is nil.

37 Market concentration risk capital requirement

(1) The capital requirement in respect of market concentration risk under regulation 29(f) is the sum of —

(a) the reduction in value of an insurer's basic own-funds following an instantaneous permanent decrease in value of the assets corresponding to the insurer's excess exposures to single counterparties; and

(b) a diversification adjustment as determined under paragraphs 1 and 6 of Schedule 1.

(2) In paragraph (1)(a), an insurer's excess exposure to a single counterparty for an exposure that is included within the amount of assets determined in paragraph (5) is —

(a) the market value of the exposure at default to that single counterparty; less

(b) the amount of assets determined in paragraph (5) multiplied by the exposure threshold determined in paragraph (3),

and is subject to a minimum of 0.

(3) The exposure threshold for a single counterparty is determined based on the weighted average credit quality step of the single counterparty, and the exposure threshold table specified in paragraph 6(1) of Schedule 2.

(4) In paragraph (3) the weighted average credit quality step is determined as the rounded-up average of the credit quality steps of the insurer's exposures to the counterparties that belong to the single name exposure, weighted by the value of that exposure.

(5) The amount of assets referred to in paragraph (2) is the assets held by the insurer that are considered in the equity, spread and property risk capital requirement calculations, less the following—

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

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

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

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

(b) deferred tax assets;

(c) intangible assets;

(d) assets in relation to exposures to counterparties on the list in Schedule 4;

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

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

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

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

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

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

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

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

(7) The reduction to be applied to the insurer's single counterparty excess exposures under paragraph (1)(a) is the applicable market concentration risk credit quality step factor specified in paragraph 6(3) of Schedule 2.

(8) If regulation 30(5) is used then for the purpose of this regulation the exposure to single counterparty is replaced by the exposure to homogenous data group under regulation 30(6).

38 Counterparty default risk capital requirement

(1) The capital requirement in respect of counterparty default risk under regulation 25(1)(b) is the sum of—

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

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

(c) a diversification adjustment as determined under paragraphs 1 and 7 of Schedule 1.

(2) The capital requirement for counterparty default risk is calculated on the basis of exposure to single counterparties and in this regulation the following exposures are classed as an exposure to a single counterparty—

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

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

(3) An insurer's type 1 exposures to single counterparties cover default risk other than on receivables and the following types of exposures are classed as type 1 exposures—

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

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

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

(d) cash at bank;

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

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

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

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

(iv) called up but unpaid guarantees;

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

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

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

(g) exposures to entities that are members of the same corporate group as the insurer, other than those included in sub-paragraph (c);

(h) mortgage loans; and

(i) deposits with ceding insurers;

(4) An insurer's type 2 exposures to single counterparties cover default risk on receivables and the following types of exposures are classed as type 2 exposures—

(a) receivables and recoverables (other than those in relation to reinsurance arrangements under paragraph (3)(a));

(b) policyholder debtors;

(c) prepayments and deferred expenses; and

(d) exposures that are neither captured in the spread risk capital requirement under regulation 36 or as a type 1 exposure in paragraph (3).

(5) The loss-given default of an exposure to a single counterparty is the loss of basic own-funds which an insurer would incur if the single counterparty defaulted, and is determined for each type of exposure as follows —

(a) for the following exposures, the loss-given default is equal to the best estimate of that exposure—

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

(ii) cash at bank;

(iii) a deposit with a ceding insurer;

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

(v) receivables from an intermediary, reinsurer (other than reinsurance recoverables) or policyholder debtor;

(vi) exposures to entities that are within the same corporate group of the insurer other than those included in paragraph (3)(c); or

(vii) other type 2 exposures not included above;

(b) for legally binding commitments the loss-given default is the commitment's nominal value less the commitment's value in the insurer's regulatory balance sheet.

(c) for mortgage loans the loss-given default is the best estimate of the mortgage loan less the risk adjusted value of the mortgage loan determined under paragraph (15).

(d) for exposures not covered by sub-paragraphs (a) to (c), the higher of 0 and—

(i) the recovery rate applicable to the type of exposure, specified under paragraph 7 of Schedule 2; multiplied by —

(A) the best estimate of the amounts recoverable from the counterparty or the market value of the derivative as applicable; plus

(B) an estimate of the impact of the risk mitigation arrangement on the underwriting risk or market risk capital requirement as applicable, multiplied by the risk mitigating factor specified under paragraph 7 of Schedule 2; less

(ii) the best estimate of the amount that can be offset in the event of default of that counterparty; multiplied by the economic adjustment factor applicable to the type of exposure, specified under paragraph 7 of Schedule 2.

(6) The estimate of the impact of the risk mitigation arrangement in paragraph 38(5)(d)(i)(B) is the hypothetical capital requirement that would apply if the risk mitigation arrangement did not exist less the capital requirement determined using these regulations.

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

(8) Where an insurer has an exposure for which the underlying risk is subject to a pooling arrangement, the insurer must either —

(a) treat the pool as a single counterparty under paragraph (2); or

(b) obtain the method to determine the loss-given-default from the Authority.

(9) The amount offset in the event of default in paragraph 38(5)(d)(ii), is the best estimate of the liabilities that the insurer can offset in the case of default of that counterparty to the extent that they can be offset or recovered in the event of default, such as—

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

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

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

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

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

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

(a) if the insurer has the unilateral right to liquidate or retain, in a timely manner, the collateral in the event of a default of the counterparty or other third party holding the collateral on behalf of the counterparty, the best estimate of the assets held as collateral less an estimate of the impact of the collateral on the market risk capital requirement determined under paragraph (6);

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

(c) if sub-paragraphs (a) or (b) do not apply, 0.

(13) Where paragraph (12)(a) applies, an insurer may estimate the risk adjusted value of its collateral as the market value of the collateral multiplied by 0.85 as long as this approach is documented in the board report.

(14) Where paragraph (12)(b) applies, an insurer may estimate the risk adjusted value of its collateral as the market value of the collateral multiplied by 0.75 as long as this approach is documented in the board report.

(15) The risk-adjusted value of the mortgage loan under sub-paragraph (9)(b) is the value of the mortgage loan less an estimate of the impact of the mortgage loan on the market risk capital requirement, determined under paragraph (6).

(16) The capital requirement for counterparty default risk on type 1 exposures is the type 1 exposure capital factor as determined under paragraph 7(3) of Schedule 2 multiplied by —

(a) where the standard deviation of the loss distribution of the insurer's type 1 exposures is assigned to band 3 under paragraph 7(3) of Schedule 2, the sum of the loss-given default of each of the insurer's type 1 exposures; or

(b) otherwise, the standard deviation of the loss distribution of the insurer's type 1 exposures.

(17) The standard deviation of the loss distribution of the insurer's type 1 exposures is the sum of—

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

(i) the probability of default factor A for a particular combination; multiplied by

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

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

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

(i) the probability of default factor B; multiplied by

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

(18) The probability of default factors referred to in paragraph (17) are as determined under paragraph 7(4) of Schedule 2.

(19) The capital requirement for counterparty default risk on type 2 exposures is the sum of—

(a) the total loss-given default for receivables and recoverables that have been due for more than 3 months multiplied by 0.45 for a class 12 insurer and 0.9 for an insurer who is not a class 12 insurer; and

(b) the total loss-given default from the insurer's other type 2 exposures multiplied by 0.075 for a class 12 insurer and 0.15 for an insurer who is not a class 12 insurer.

39 Underwriting risk capital requirement

(1) Subject to paragraph (2), the capital requirement for underwriting risk under regulation 25(1)(c) is the sum of—

(a) the capital requirement for premium and reserve risk determined under regulation 40;

(b) the capital requirement for lapse risk determined under regulation 41;

(c) the capital requirement for catastrophe risk determined under regulation 42; and

(d) a diversification adjustment as determined under paragraphs 1 and 8 of Schedule 1.

(2) Where an insurer has an aggregate stop loss risk mitigation arrangement that meets the requirements of regulation 66(4) the capital requirement for underwriting risk in paragraph (1) is limited to the retention limit of the stop loss arrangement less a deduction for any claims covered under the agreement that have been settled.

40 Premium and reserve risk capital requirement

(1) The capital requirement for premium and reserve risk under regulation 39(1)(a) is—

(a) the volume measure determined under paragraph (3); multiplied by

(b) the standard deviation as determined under paragraph (9); multiplied by

(c) the premium and reserve factor as determined under paragraph 8(2) of Schedule 2.

(2) An insurer must allocate its insurance obligations to the segments in the premium and reserve risk segment table in paragraph 8(3) of Schedule 2.

(3) The volume measure in paragraph (1)(a) is the sum over all applicable segments, of the combined volume measure for each segment.

(4) The combined volume measure for a segment is the geographical diversification adjustment as determined under paragraph 8(4) of Schedule 2, multiplied by the sum of—

(a) the premium volume measure for that segment as determined under paragraph (5); and

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

(5) Unless the requirements of paragraph (7) are met, the premium volume measure for a particular segment is the sum of—

(a) the higher of—

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

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

(b) the expected present value of any remaining premiums to be earned by an insurer on existing contracts that aren't already included in sub-paragraph (a)(i); and

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

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

(ii) 30% of the expected present value of any remaining premiums to be earned by an insurer that aren't already included in sub-paragraph (i).

(6) The premiums in paragraph (5) must be net of commission and premiums in respect of reinsurance contracts that meet the requirements of regulation 65.

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

(8) The reserve volume measure for a particular segment is the best estimate of outstanding claim amounts, net of the amount recoverable from risk mitigation contracts that meet the requirements of regulation 65.

(9) The standard deviation in paragraph (1)(b) is the result of the aggregation formula in paragraphs 1 and 9 of Schedule 1, applied to the combined volume measure and the combined standard deviation, for each applicable segment, divided by the volume measure determined under paragraph (3).

(10) The combined standard deviation for a segment is the result of the aggregation formula in paragraphs 1 and 10 of Schedule 1, applied to the premium volume measure, reserve volume measure, premium standard deviation and reserve standard deviation for that segment, divided by the sum of the premium volume measure for that segment and the reserve volume measure for that segment.

(11) The premium standard deviation is the sum of —

(a) the premium risk standard deviation factor determined under paragraph 8(8) of Schedule 2; and

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

(12) The reserve standard deviation is the sum of—

(a) the reserve risk standard deviation factor determined paragraph 8(8) of Schedule 2; and

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

41 Lapse risk capital requirement

(1) The capital requirement for lapse risk under regulation 39(1)(b) is the reduction in value of an insurers basic own-funds following an instantaneous permanent decrease in the profit anticipated from future insurance contracts.

(2) The lapse capital requirement factor determines the decrease to be applied and is 20% for a class 12 insurer and 40% for an insurer who is not a class 12 insurer.

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

42 Catastrophe risk capital requirement

(1) For a class 12 insurer the catastrophe risk capital requirement under regulation 39(1)(c) is nil.

(2) For an insurer who is not a class 12 insurer, the catastrophe risk capital requirement is the sum of—

(a) the capital requirement for natural catastrophe risk as determined under regulation 43;

(b) the capital requirement for non-proportional property reinsurance risk determined under regulation 49;

(c) the capital requirement for man-made catastrophe risk determined under regulation 50;

(d) the capital requirement for other non-life catastrophe risk determined under regulation 57; and

(e) a diversification adjustment determined under paragraphs 1 and 11 in Schedule 1.

43 Natural catastrophe risk capital requirement

(1) The capital requirement for natural catastrophe risk under regulation 42(2)(a) is the sum of—

(a) the capital requirement for windstorm risk determined under regulation 44;

(b) the capital requirement for earthquake risk determined under regulation 45;

(c) the capital requirement for flood risk determined under regulation 46;

(d) the capital requirement for hail risk determined under regulation 47;

(e) the capital requirement for subsidence risk determined under regulation 48; and

(f) a diversification adjustment determined under paragraphs 1 and 12 of Schedule 1.

44 Windstorm risk capital requirement

(1) The capital requirement for windstorm risk under regulation 43(1)(a) applies to—

(a) insurance obligations of lines of business numbered 3 or 15 in Schedule 6 that cover onshore property damage by windstorm; and

(b) insurance obligations of lines of business numbered 4 or 16 in Schedule 6 that cover windstorm risk.

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

(a) 1.75; multiplied by

(i) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (1); multiplied by

(ii) a geographical diversification factor determined under paragraph 8(9) of Schedule 2;

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

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

45 Earthquake risk capital requirement

(1) The capital requirement for earthquake risk under regulation 43(1)(b) applies to—

(a) insurance obligations of lines of business numbered 3 or 15 in Schedule 6 that cover onshore property damage by earthquake; and

(b) insurance obligations of lines of business numbered 4 or 16 in Schedule 6 that cover earthquake risk.

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

(a) 1.2; multiplied by

(i) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date on the contracts in paragraph (1); multiplied by

(ii) a geographical diversification factor determined under paragraph 8(9) of Schedule 2;

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

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

46 Flood risk capital requirement

(1) The capital requirement for flood risk under regulation 43(1)(c) applies to—

(a) insurance obligations of lines of business numbered 2 or 14 in Schedule 6 that cover flood risk;

(b) insurance obligations of lines of business numbered 3 or 15 in Schedule 6 that cover onshore property damage by flood; and

(c) insurance obligations of lines of business numbered 4 or 16 in Schedule 6 that cover flood risk.

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

(a) 1.1 multiplied by —

(i) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (1); multiplied by

(ii) a geographical diversification factor determined under paragraph 8(9) of Schedule 2;

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

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

47 Hail risk capital requirement

(1) The capital requirement for hail risk under regulation 43(1)(d) applies to—

(a) insurance obligations of lines of business numbered 2 or 14 in Schedule 6 that cover hail risk;

(b) insurance obligations of lines of business numbered 3 or 15 in Schedule 6 that cover onshore property damage by hail; and

(c) insurance obligations of lines of business numbered 4 or 16 in Schedule 6 that cover hail risk.

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

(a) 0.3; multiplied by

(i) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (1); multiplied by

(ii) a geographical diversification factor determined under paragraph 8(9) of Schedule 2;

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

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

48 Subsidence risk capital requirement

(1) The capital requirement for subsidence risk under regulation 43(1)(e) applies to obligations of lines of business numbered 4 or 16 in Schedule 6 that cover subsidence risk of residential buildings.

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

(a) 0.0005 multiplied by the gross sum insured by the insurer, on the contracts in paragraph (1);

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

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

49 Non-proportional property reinsurance risk capital requirement

(1) The capital requirement for non-proportional property reinsurance risk under regulation 42(2)(b) applies to non-proportional property reinsurance obligations (line of business numbered 27 in Schedule 6), other than non-proportional reinsurance obligations relating to insurance obligations included in lines of business numbered 6 and 18 in Schedule 6.

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

(a) 2.5; multiplied by

(i) the best estimate of the gross premiums to be earned by an insurer during the 12 months following the valuation date, on the contracts in paragraph (1); multiplied by

(ii) a geographical diversification factor determined under paragraph 8(9) of Schedule 2;

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

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

50 Man-made catastrophe risk capital requirement

(1) The capital requirement for man-made catastrophe risk under regulation 42(2)(c) is the sum of—

(a) the capital requirement for motor vehicle liability risk as determined under regulation 51;

(b) the capital requirement for marine risk as determined under regulation 52;

(c) the capital requirement for aviation risk as determined under regulation 53;

(d) the capital requirement for fire risk as determined under regulation 54;

(e) the capital requirement for liability risk as determined under regulation 55;

(f) a capital requirement for credit and suretyship risk as determined under regulation 56; and

(g) a diversification adjustment as determined under paragraphs 1 and 13 of Schedule 1.

51 Motor vehicle liability risk capital requirement

(1) The capital requirement for motor vehicle liability risk under regulation 50(1)(a) applies to obligations of lines of business numbered 1 and 13 in Schedule 6 that cover motor vehicle liability risk.

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

(3) The amount of the loss under paragraph (2) must be determined gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles, and is the sum of—

(a) 50,000 multiplied by the higher of —

(i) 120; and

(ii) the square root of the sum of—

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

(B) 0.05 multiplied by the number of vehicles insured with a deemed policy limit of £20 million or below; and

(C) 0.95 multiplied by the lower of—

(i) 20,000; and

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

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

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

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

(5) In paragraph (3) the deemed policy limit is the overall limit of the motor vehicle liability insurance policy or, where no such overall limit is specified in the terms and conditions of the policy, the sum of the limits for damage to property and for personal injury and where the policy limit is specified as a maximum per victim, the deemed policy limit shall be based on the assumption of ten victims.

52 Marine risk capital requirement

(1) The capital requirement for marine risk under regulation 50(1)(b) is the sum of—

(a) the capital requirement for marine vessel collision risk determined under paragraph (4);

(b) the capital requirement for marine platform explosion risk determined under paragraph (5); and

(c) a diversification adjustment determined under paragraphs 1 and 14 of Schedule 1.

(2) For the purpose of paragraph 52(1), marine vessel includes any sea worthy vessel (such as a tanker, bulker, container ship, roll on-roll off, cruise ship, or fishing vessel) where the maximum hull value insured is more than £250,000.

(3) The capital requirement for marine vessel collision risk applies to insurance obligations of lines of business numbered 3, 15 or 26 in Schedule 6 that cover vessel collision.

(4) The capital requirement for marine vessel collision risk is the reduction in value of an insurer's basic own-funds following an instantaneous permanent loss in relation to the insurance contract, where the amount of the loss is the sum of—

(a) the maximum across all insured vessels of the sum of—

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

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

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

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

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

(5) The capital requirement for marine platform explosion risk applies to insurance obligations of lines of business numbered 3, 15 or 26 in Schedule 6 that cover platform explosions.

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

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

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

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

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

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

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

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

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

53 Aviation risk capital requirement

(1) The capital requirement for aviation risk under regulation 50(1)(c) applies to insurance obligations of lines of business numbered 3, 15 and 26 in Schedule 6 that relate to aviation hull or aviation liability risk.

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

(a) the maximum across all insured aircrafts of the sum of—

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

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

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

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

54 Fire risk capital requirement

(1) The capital requirement for fire risk under regulation 50(1)(d) applies to insurance obligations of lines of business numbered 4 and 16 in Schedule 6 that cover damage to a building due to fire or explosion, including as a result of terrorist attacks.

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

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

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

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

(3) For the purpose of paragraph (2)(a) fire concentration risk relates to a set of buildings where all buildings are partly or fully located within a radius of 200 meters.

55 Liability risk capital requirement

(1) The capital requirement for liability risk under regulation 50(1)(e) applies to insurance obligations that fall within the liability risk groups in paragraph 8(10) of Schedule 2.

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

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

(i) 1 multiplied by —

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

(B) the liability risk factor for that liability group as determined under paragraph 8(11) of Schedule 2;

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

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

(b) a diversification adjustment determined under paragraphs 1 and 15 of Schedule 1.

56 Credit and suretyship risk capital requirement

(1) The capital requirement for credit and suretyship risk under regulation 50(1)(f) applies to insurance obligations of lines of business numbered 6 and 18 in Schedule 6 that cover default risk.

(2) The capital requirement for credit and suretyship risk is the sum of—

(a) the capital requirement for risk of a large credit default determined under paragraph (3);

(b) the capital requirement for recession risk determined under paragraph (5); and

(c) a diversification adjustment determined under paragraphs 1 and 16 of Schedule 1.

(3) The capital requirement for the risk of a large credit default under paragraph (2)(a) is the reduction in value of an insurer's basic own-funds following an instantaneous permanent loss in relation to the insurance contract resulting from the default of the two largest exposures under the contract, where the amount of the loss is the sum of—

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

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

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

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

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

(5) The capital requirement for recession risk under paragraph (2)(b) is the reduction in value of an insurer's basic own-funds following an instantaneous permanent loss in relation to the insurance contract, where the amount of the loss is the sum of—

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

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

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

57 Other non-life catastrophe risk capital requirement

(1) The capital requirement for other non-life catastrophe risk under regulation 42(2)(d) applies to insurance obligations that fall within the

other non-life catastrophe risk groups as determined under paragraph 8(12) of Schedule 2.

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

(a) for each risk group under paragraph 8(12) of Schedule 2, the sum of—

(i) 1, multiplied by—

(A) the estimate of the gross premiums to be earned by the insurer during the 12 months after the valuation date in relation to insurance obligations for that risk group; multiplied by

(B) the other non-life catastrophe risk factor for that risk group as determined under paragraph 8(14) of Schedule 2;

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

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

(b) a diversification adjustment determined under paragraphs 1 and 17 of Schedule 1.

58 NSLT health risk capital requirement

(1) The capital requirement for NSLT health risk under regulation 25(1)(d) is the lower of—

(a) the sum of—

(i) the capital requirement for NSLT health premium and reserve risk as determined under regulation 59;

(ii) the capital requirement for NSLT health lapse risk as determined under regulation 60;

(iii) the capital requirement for NSLT health catastrophe risk as determined under regulation 61;

(iv) a diversification adjustment as determined under paragraphs 1 and 18 in Schedule 1; and

(b) the insurer's retention limit on an aggregate stop loss risk mitigation arrangement less a deduction for any claims covered under the arrangement that have been settled.

(2) In paragraph (1)(b), a stop loss risk mitigation arrangement must meet the requirements of regulation 66(4) in order for it to be taken into account.

59 NSLT health premium and reserve risk capital requirement

(1) The capital requirement for NSLT health premium and reserve risk under regulation 58(1)(a)(i) is—

(a) the volume measure determined under paragraph (3); multiplied by

(b) the standard deviation determined under paragraph (10); multiplied by

(c) the NSLT health premium and reserve factor determined under paragraph 9 of Schedule 2.

(2) An insurer must allocate its business to the segments in the NSLT health premium and reserve risk segment table under paragraph 9(2) of Schedule 2.

(3) The volume measure under paragraph (1)(a) is the sum over all segments of the combined volume measure for each segment.

(4) The combined volume measure for a particular segment is the applicable geographical diversification adjustment determined under paragraph 9(3) of Schedule 2 multiplied by the sum of—

(a) the premium volume measure for that segment determined under paragraph (5); and

(b) the reserve volume measure for that segment determined under paragraph (8).

(5) Unless paragraph (6) applies, the premium volume measure for a particular segment is the sum of—

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

(b) the expected present value of any remaining premiums to be earned by an insurer on existing contracts that aren't already included in sub-paragraph (a); and

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

(i) for contracts whose initial term is one year or less, the expected present value of premiums to be earned by an

insurer, excluding the premiums to be earned during the 12 months after the initial recognition date; 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, after the 12 months following the valuation date.

(6) Where the management of the insurer has established effective control mechanisms to ensure that the actual earned premiums for each segment during the 12 months after the valuation date will not exceed the expected present value of those premiums, the insurer may replace the calculation in paragraph (5)(a) with the expected present value of premiums to be earned by an insurer in the 12 months after the valuation date.

(7) The premiums used to determine the premium volume measure in paragraphs (5) and (6) must be net, after deduction of commission and premiums for reinsurance contracts that meet the requirements of regulation 65.

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

(9) Claim amounts must be net of the amount recoverable from risk mitigation arrangements that meet the requirements of regulation 65.

(10) The standard deviation under paragraph (1)(a) is the result of the aggregation formula in paragraphs 1 and 19 of Schedule 1, applied to the combined volume measure and the combined standard deviation, for all segments applicable to the insurer, divided by the volume measure determined under paragraph (3).

(11) The combined standard deviation for a segment is the result of the aggregation formula in paragraphs 1 and 10 of Schedule 1, applied to the premium volume measure, reserve volume measure, premium standard deviation and reserve standard deviation for that segment, divided by the sum of the premium volume measure for that segment and the reserve volume measure for that segment.

(12) The premium standard deviation is the sum of—

(a) the health premium risk standard deviation factor under paragraph 9(7) of Schedule 2; and

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

(13) The reserve standard deviation is the sum of—

(a) the health reserve risk standard deviation factor under paragraph 9(7) of Schedule 2; and

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

60 NSLT health lapse risk capital requirement

(1) The capital requirement for NSLT health lapse risk under regulation 58(1)(a)(ii) is the reduction in value of an insurer's basic own-funds following an instantaneous permanent decrease in the profit anticipated from future insurance contracts.

(2) The NSLT health lapse capital requirement factor determines the decrease to be applied and is 20% for a class 12 insurer and 40% for an insurer who is not a class 12 insurer.

(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.

61 NSLT health catastrophe risk capital requirement

(1) For a class 12 insurer, the NSLT health catastrophe risk capital requirement under regulation 58(1)(a)(iii) is nil.

(2) For an insurer who is not a class 12 insurer, the NSLT health catastrophe risk capital requirement is the sum of—

(a) the capital requirement for mass accident risk determined under regulation 62;

(b) the capital requirement for accident concentration risk determined under regulation 63;

(c) the capital requirement for pandemic risk determined under regulation 64; and

(d) a diversification adjustment determined under paragraphs 1 and 20 of Schedule 1.

62 Mass accident risk capital requirement

(1) The capital requirement for mass accident risk under regulation 61(2)(a) applies to health insurance obligations other than workers' compensation insurance and reinsurance obligations.

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

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

(i) the country ratio factor as determined under paragraph 9(8) of Schedule 2; multiplied by the sum over all event types of—

(A) the event type ratio factor as determined under paragraph 9(9) of Schedule 2; multiplied by

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

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

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

(b) a diversification adjustment determined under paragraphs 1 and 21 of Schedule 1.

(3) When determining the sum insured under paragraph (2)—

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

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

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

63 Accident concentration risk capital requirement

(1) The capital requirement for accident concentration risk under regulation 61(2)(b) applies to workers' compensation insurance obligations and to group income protection insurance obligations.

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

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

(i) the sum over all event types of—

(A) the event type ratio factor as determined under paragraph 9(9) of Schedule 2; multiplied by

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

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

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

(b) a diversification adjustment determined under paragraphs 1 and 21 of Schedule 1.

(3) The largest accident risk concentration in a country under paragraph (2) is the largest number of persons for which all of the following conditions are met:

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

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

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

(4) When determining the sum insured under paragraph (2) the following must be allowed for—

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

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

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

64 Pandemic risk capital requirement

(1) The capital requirement for pandemic risk under regulation 61(2)(c) applies to health insurance obligations, other than workers' compensation insurance obligations.

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

(a) 0.000075 multiplied by the total sum insured payable across all insured lives, in the event the insured suffers a permanent work disability caused by an infectious disease;

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

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

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

65 Qualitative criteria for risk mitigation techniques

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

(a) in accordance with paragraph (4), 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 is legally effective and enforceable in all relevant jurisdictions;

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

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

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

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

(g) where the insurer uses insurance risk mitigation, the requirements of regulation 66 are met; and

(h) where the insurer uses financial risk mitigation, the requirements of regulations 67, 68 and 69 are met.

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

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

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

(b) the replacement of the risk mitigation technique does 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, the conditions are clearly documented in the written policy referred to in sub-paragraph (a);

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

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

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

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

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

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

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

(4) 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.

(5) Further to paragraph (4), 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 25, 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.

66 Insurance risk mitigation

(1) The counterparty to the reinsurance contract must be 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 sub-paragraph (a), but 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 still be partially recognised by an insurer, provided that the insurer can demonstrate to its board of directors—

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

(b) the counterparty can restore compliance within the timeframe provided in the relevant regulations of its supervisor.

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

(4) For an aggregate stop loss arrangement to be considered a recognisable risk mitigation arrangement of an insurer –

(a) the contract must provide for complete compensation for the aggregated exposures of the insurer that are being ceded (in excess of any retention level that may be specified in the contract), that relate to all of its insurance exposures from all of its lines of business during a specified time period; and

(b) approval must be received from the Authority in accordance with paragraph's (6) and (7).

(5) In sub-paragraph (4)(a), complete compensation is provided where the ceded amount is either –

(a) without limit (such that it covers all of the insurer's potential aggregate losses in excess of the specified retention level of the insurer);

(b) at least equal to the insurer's total aggregate contractual limits of liability, or

(c) at least equal to the insurer's expected total aggregate losses.

(6) The Authority's approval where complete compensation is provided under sub-paragraph's (5)(a) and (5)(b) is subject to the insurer providing sufficient contractual evidence.

(7) The Authority's approval where complete compensation is provided under (5)(c) is subject to the insurer providing actuarially supported evidence which satisfies the Authority that any limit placed on the compensation due under the contract is sufficiently in excess of the insurer's reasonable expectation of the aggregate losses it might face across all of its lines of business during that time period.

67 Financial risk mitigation

(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 14.

(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.

68 Additional requirements for collateral arrangements

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

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

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

(2) A collateral arrangement can only be recognised as a risk mitigation technique if—

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

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

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

(ii) the collateral is guaranteed by a counterparty, other than a counterparty referred to in either regulation 37(5)(a) or 37(5)(d), 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 the collateral arrangement and the value of the collateral; and

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

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

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

(b) the segregated assets are held by a deposit-taking institution that has a credit quality step of 0, 1, 2 or 3;

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

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

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

69 Additional requirements for guarantees

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

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

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

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

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

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

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

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

(d) on the default, insolvency or bankruptcy, or other credit event of the original obligor, the insurer has the right to pursue, in a timely manner, the guarantor for any monies due under the claim that is

covered by the guarantee and the payment by the guarantor must not be subject to the insurer first having to pursue the original obligor;

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

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

PART 5: MINIMUM CAPITAL REQUIREMENT

70 Minimum capital requirement

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

(2) The MCR for a dormant insurer is the insurer's SCR.

(3) The MCR for a class 12 insurer is the higher of —

(a) the insurer's SCR multiplied by 0.75; and

(b) the minimum MCR, which is —

(i) where the insurer is a cell of a PCC, 0; or

(ii) where the insurer is not a cell of a PCC, £100,000.

(4) The MCR for an insurer who is not a class 12 insurer is the higher of—

(a) the insurer's SCR multiplied by 0.35; and

(b) the minimum MCR, which is £500,000.

(5) The minimum MCR in paragraph (4)(b) is subject to any reduction determined by the Authority under Regulation 23 of the Insurance Regulations 2021.

PART 6: OWN-FUNDS

71 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 14.

(2) An insurer's own-funds consists of the sum of its basic own-fund items determined under regulation 74 and its ancillary own-fund items determined under regulation 75.

72 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).

73 Use of eligible own-funds to meet capital requirements

(1) An insurer must determine the quality of its eligible own-fund items using Schedule 9, 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 must 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

(b) 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—

(a) items referred to in paragraph 1(1)(c) of Schedule 9;

(b) items referred to in paragraph 1(1)(e) of Schedule 9; or

(c) items referred to in paragraph 1(1)(h) of Schedule 9.

74 Basic own-funds 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 paragraphs 1(1), 2(1) or 3(1) of Schedule 9;

(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 72;

(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 relating to expected profits in future premiums relating to existing contracts that are expected to be received in the future, where the insurer has anticipated these premiums in the calculation of its technical provisions.

75 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 74—

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

(b) a letter of credit or a guarantee provided to the insurer;

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

(d) 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 Schedule 9, once it has been called up and paid in, it is classed as Tier 2;

(b) otherwise, it is classed as Tier 3.

76 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 in accordance with 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-fund items 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.

77 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.

MADE 2 DECEMBER 2021

B.ROTH

Chief Executive, Isle of Man Financial Services Authority

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SCHEDULE 1

[Regulations 25, 29, 33, 35, 37 to 40, 42, 43, 50, 52, and 55 to 63]

DIVERSIFICATION ADJUSTMENT AND CORRELATION MATRICES

1 Diversification adjustment

The diversification adjustment for use in the standard formula approach is—

$$Diversification\ adjustment = diversified\ amount - undiversified\ amount$$

where—

(a) the undiversified amount is the result of the standard formula calculation before the diversification adjustment is applied;

(b) the diversified amount is determined using the aggregation formula—

$$Aggregation\ Formula = \sqrt{\sum_{x,y} Corr_{x,y} \cdot C_x \cdot C_y}$$

where—

(i) $\sum x, y$ is the sum over all combinations of variables;

(ii) $Corr_{x,y}$ is the correlation between variables x and y and where there are multiple variables, x and y make up the rows and columns of a correlation matrix;

(iii) C_x, C_y is the value corresponding to variable x and variable y;

(c) $Corr_{x,y} = 1$ is equivalent to full correlation and leads to no diversification benefit; and

(d) $Corr_{x,y} = 0$ is equivalent to no correlation and leads to full diversification benefit.

(e) The diversification adjustment must be negative.

2 Correlation Matrix: SCR Standard Formula Approach

$Corr_{x,y}$ for use in the diversification adjustment in regulation 25(1)(f) is, for a class 12 insurer—

	Market	**Default**	**Health**	**Non-Life**
Market	1	0	0	0
Default	0	1	0	0.25
Health	0	0	1	0
Non-Life	0	0.25	0	1

Or else, for an insurer who is not a class 12 insurer—

	Market	**Default**	**Health**	**Non-Life**
Market	1	0.25	0.25	0.25
Default	0.25	1	0.25	0.5
Health	0.25	0.25	1	0
Non-Life	0.25	0.5	0	1

3 Correlation Matrix: Market Risk Capital Requirement

(1) $Corr_{x,y}$ for use in the diversification adjustment in regulation 29(g) is, for a class 12 insurer—

	Interest	**Equity**	**Property**	**Spread**	**Currency**	**Concentration**
Interest	1	A	A	A	0	0
Equity	A	1	0.5	0.5	0	0
Property	A	0.5	1	0.25	0	0
Spread	A	0.5	0.25	1	0	0
Currency	0	0	0	0	1	0
Concentration	0	0	0	0	0	1

Or else, for an insurer who is not a class 12 insurer—

	Interest	**Equity**	**Property**	**Spread**	**Currency**	**Concentration**
Interest	1	A	A	A	0.25	0
Equity	A	1	0.75	0.75	0.25	0
Property	A	0.75	1	0.5	0.25	0
Spread	A	0.75	0.5	1	0.25	0
Currency	0.25	0.25	0.25	0.25	1	0
Concentration	0	0	0	0	0	1

(2) Unless sub-paragraph (3) applies factor A is 0.25 for a class 12 insurer and 0.5 for an insurer who is not a class 12 insurer.

(3) When the capital requirement for interest rate risk determined in regulation 32, is derived from the capital requirement for the risk of an increase in the interest rate term structure, factor A is 0.

4 Correlation Matrix: Equity Risk

$Corr_{x,y}$ for use in regulation 33(2)(c) is, for a class 12 insurer—

	Type 1	**Type 2**
Type 1	1	0.5
Type 2	0.5	1

Or else, for an insurer who is not a class 12 insurer—

	Type 1	**Type 2**
Type 1	1	0.75
Type 2	0.75	1

5 Correlation Matrix: Currency Risk

$Corr_{x,y}$ for use in regulation 35(4)(a) is—

Group	1	2	3	4	5	6	7	8	9	10
1	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
2	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
3	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5	0.5
4	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5	0.5
5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5	0.5
6	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5	0.5
7	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5	0.5
8	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5	0.5
9	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.5
10	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1

6 Correlation Matrix: Market Concentration Risk

$Corr_{x,y}$ for use in regulation 37(1)(b) is—

	Concentration A	Concentration B
Concentration A	1	0
Concentration B	0	1

7 Correlation Matrix: Counterparty Default Risk

$Corr_{x,y}$ for use in regulation 38(1)(c) is, for a class 12 insurer—

	Type 1	Type 2
Type 1	1	0.5
Type 2	0.5	1

Or else, for an insurer who is not a class 12 insurer—

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

8 Correlation Matrix: Underwriting Risk

$Corr_{x,y}$ for use in regulation 39(1)(d) is, for a class 12 insurer—

	Premium and Reserve	**Lapse**
Premium and Reserve	1	0
Lapse	0	1

Or else, for an insurer who is not a class 12 insurer—

	Premium and Reserve	**Lapse**	**Catastrophe**
Premium and Reserve	1	0	0.25
Lapse	0	1	0
Catastrophe	0.25	0	1

9 Correlation Matrix: Premium and Reserve Risk – Standard Deviation

For use in regulation 40(9) $Corr_{x,y}$ is for a class 12 insurer—

	Segment											
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**25**	**26**	**27**
1	1	0.25	0.25	0	0.25	0	0.25	0	0.25	0	0	0
2	0.25	1	0	0	0	0	0.25	0.25	0.25	0	0	0
3	0.25	0	1	0	0	0	0	0.25	0.25	0	0.25	0
4	0.25	0	0	1	0	0	0	0.25	0.25	0	0.25	0.25
5	0.25	0	0	0	1	0.25	0.25	0	0.25	0.25	0	0
6	0	0	0	0	0.25	1	0.25	0	0.25	0.25	0	0
7	0.25	0.25	0	0	0.25	0.25	1	0	0.25	0.25	0	0
8	0	0.25	0.25	0.25	0	0	0	1	0.25	0	0	0.25
9	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	1	0	0.25	0
25	0	0	0	0	0.25	0.25	0.25	0	0	1	0	0
26	0	0	0.25	0.25	0	0	0	0	0.25	0	1	0
27	0	0	0	0.25	0	0	0	0.25	0	0	0	1

Or else, for an insurer who is not a class 12 insurer—

Segment												
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**25**	**26**	**27**
1	1	0.5	0.5	0.25	0.5	0.25	0.5	0.25	0.5	0.25	0.25	0.25
2	0.5	1	0.25	0.25	0.25	0.25	0.5	0.5	0.5	0.25	0.25	0.25
3	0.5	0.25	1	0.25	0.25	0.25	0.25	0.5	0.5	0.25	0.5	0.25
4	0.25	0.25	0.25	1	0.25	0.25	0.25	0.5	0.5	0.25	0.5	0.5
5	0.5	0.25	0.25	0.25	1	0.5	0.5	0.25	0.5	0.5	0.25	0.25
6	0.25	0.25	0.25	0.25	0.5	1	0.5	0.25	0.5	0.5	0.25	0.25
7	0.5	0.5	0.25	0.25	0.5	0.5	1	0.25	0.5	0.5	0.25	0.25
8	0.25	0.5	0.5	0.5	0.25	0.25	0.25	1	0.5	0.25	0.25	0.5
9	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	1	0.25	0.5	0.25
25	0.25	0.25	0.25	0.25	0.5	0.5	0.5	0.25	0.25	1	0.25	0.25
26	0.25	0.25	0.5	0.5	0.25	0.25	0.25	0.25	0.5	0.25	1	0.25
27	0.25	0.25	0.25	0.5	0.25	0.25	0.25	0.5	0.25	0.25	0.25	1

10 Correlation Matrix: Combined Standard Deviation

For use in regulation 40(10) and regulation 59(11), $Corr_{x,y}$ is, for a class 12 insurer—

	Premium risk	**Reserve risk**
Premium risk	1	0.25
Reserve risk	0.25	1

Or else, for an insurer who is not a class 12 insurer—

	Premium risk	**Reserve risk**
Premium risk	1	0.5
Reserve risk	0.5	1

11 Correlation Matrix: Catastrophe Risk

For use in regulation 42(2)(e), $Corr_{x,y}$ is—

	Natural Cat	NP Prop Cat	Man-Made Cat	Other Cat
Natural Cat	1	1	0	0
NP Prop Cat	1	1	0	0
Man-Made Cat	0	0	1	0
Other Cat	0	0	0	1

12 Correlation Matrix: Natural Catastrophe Risk

For use in regulation 43(1)(f), $Corr_{x,y}$ is—

	Windstorm	Earthquake	Flood	Hail	Subsidence
Windstorm	1	0	0	0	0
Earthquake	0	1	0	0	0
Flood	0	0	1	0	0
Hail	0	0	0	1	0
Subsidence	0	0	0	0	1

13 Correlation Matrix: Man-Made Catastrophe Risk

For use in regulation 50(1)(g), $Corr_{x,y}$ is—

	Motor	Fire	Marine	Aviation	Liability	Credit
Motor	1	0	0	0	0	0
Fire	0	1	0	0	0	0
Marine	0	0	1	0	0	0
Aviation	0	0	0	1	0	0
Liability	0	0	0	0	1	0
Credit	0	0	0	0	1	1

14 Correlation Matrix: Marine Catastrophe Risk

For use in regulation 52(1)(c), $Corr_{x,y}$ is—

	Vessel	Platform
Vessel	1	0
Platform	0	1

15 Correlation Matrix: Liability Catastrophe Risk

For use in regulation 55(2)(b), $Corr_{x,y}$ is—

Liability Group	1	2	3	4	5
1	1	0	0.5	0.25	0.5
2	0	1	0	0.25	0.5
3	0.5	0	1	0.25	0.5
4	0.25	0.25	0.25	1	0.5
5	0.5	0.5	0.5	0.5	1

Where—

1 = Professional malpractice liability insurance obligations

2 = Employers liability insurance obligations

3 = Directors and officers insurance obligations

4 = Personal liability insurance obligations

5 = Non-proportional liability reinsurance obligations

16 Correlation Matrix: Credit and Suretyship Catastrophe Risk

For use in regulation 56(2)(c), $Corr_{x,y}$ is—

	Default	Recession
Default	1	0
Recession	0	1

17 Correlation Matrix: Other Catastrophe Risk

For use in regulation 57(2)(b), $Corr_{x,y}$ is—

Risk Group	1	2	3	4	5
1	1	1	0	0	0
2	1	1	0	0	0
3	0	0	1	0	0
4	0	0	0	1	0
5	0	0	0	0	1

18 Correlation Matrix: NSLT Health Risk

For use in regulation 58(1)(a)(iv), $Corr_{x,y}$ is for a class 12 insurer —

	Premium and Reserve	Lapse
Premium and Reserve	1	0
Lapse	0	1

Or else, for an insurer who is not a class 12 insurer—

	Premium and Reserve	Lapse	Catastrophe
Premium and Reserve	1	0	0.25
Lapse	0	1	0.25
Catastrophe	0.25	0.25	1

19 Correlation Matrix: NSLT Health Premium and Reserve Risk – Standard Deviation

For use in regulation 59(10), $Corr_{x,y}$ is for a class 12 insurer—

	Medical expense	Income protection	Workers' comp	NP health reins
Medical expense	1	0.25	0.25	0.25
Income protection	0.25	1	0.25	0.25
Workers' comp	0.25	0.25	1	0.25
NP health reins	0.25	0.25	0.25	1

Or else, for an insurer who is not a class 12 insurer—

	Medical expense	Income protection	Workers' comp	NP health reins
Medical expense	1	0.5	0.5	0.5
Income protection	0.5	1	0.5	0.5
Workers' comp	0.5	0.5	1	0.5
NP health reins	0.5	0.5	0.5	1

20 Correlation Matrix: NSLT Health Catastrophe Risk

For use in regulation 61(2)(d), $Corr_{x,y}$ is—

	Mass accident	Concentration	Pandemic
Mass accident	1	0	0
Concentration	0	1	0
Pandemic	0	0	1

21 Correlation Matrix: Mass Accident Risk and Accident Concentration Risk

For use in regulations 62(2)(b) and 63(2)(b), $Corr_{x,y}$ is—

	Country A	Country B
Country A	1	0
Country B	0	1

SCHEDULE 2

[Regulations 32 to 38, 40, 43, 49, 55, 57, 59, 62 and 63]

FACTORS, TABLES AND LISTS

1 Interest Rate Risk Capital Factors

(1) The interest rate risk capital factors for use in regulation 32(2) are, for a class 12 insurer—

Maturity *t* (years)	Increase Factor	Decrease Factor
1	35.0%	-37.5%
2	35.0%	-32.5%
3	32.0%	-28.0%
4	29.5%	-25.0%
5	27.5%	-23.0%
6	26.0%	-21.0%
7	24.5%	-19.5%
8	23.5%	-18.0%
9	22.0%	-16.5%
10	21.0%	-15.5%
11	19.5%	-15.0%
12	18.5%	-14.5%
13	17.5%	-14.0%
14	17.0%	-14.0%
15	16.5%	-13.5%
16	15.5%	-14.0%
17	15.0%	-14.0%
18	14.5%	-14.0%
19	13.5%	-14.5%
20	13.0%	-14.5%
90	10.0%	-10.0%

Or else, for an insurer who is not a class 12 insurer—

Maturity *t* (years)	**Increase Factor**	**Decrease Factor**
1	70%	-75%
2	70%	-65%
3	64%	-56%
4	59%	-50%
5	55%	-46%
6	52%	-42%
7	49%	-39%
8	47%	-36%
9	44%	-33%
10	42%	-31%
11	39%	-30%
12	37%	-29%
13	35%	-28%
14	34%	-28%
15	33%	-27%
16	31%	-28%
17	30%	-28%
18	29%	-28%
19	27%	-29%
20	26%	-29%
90	20%	-20%

(2) For the purposes of sub-paragraph (1) —

(a) for maturities that are shorter than 1 year, the 1 year factor must be used;

(b) for maturities that are longer than 90 years the 90 year factor must be used;

(c) for maturities that are not specified, the factors in the table above must be linearly interpolated.

2 Equity Risk Capital Factors

The equity risk capital factors for use in regulation 33(3) are, for a class 12 insurer —

	Type 1	**Type 2**
Factor	19%	24%

Or else, for an insurer who is not a class 12 insurer—

	Type 1	**Type 2**
Factor	39%	49%

3 Property Risk Capital Factor

The property risk capital factor for use in regulation 34(2) is 12% for a class 12 insurer and 25% for an insurer who is not a class 12 insurer.

4 Currency Risk Capital Factors

(1) The currency groupings for use in regulation 35(4)(b) are—

Foreign Currency Group Table 1			
1	**2**	**3**	**4**
Euro	US Dollar	Singapore Dollar	Australian Dollar
Swiss Franc	Chinese Yuan Renminbi	Indian Rupee	New Zealand Dollar
Swedish Krona	Hong Kong Dollar	Malaysian Ringgit	South African Rand
Norwegian Krone	Taiwan Dollar	Thai Baht	
Danish Krone	Saudi Riyal		
Polish Zloty			
Czech Koruna			
Hungarian Forint			
Bulgarian Lev			
Croatian Kuna			
Romanian Leu			

Foreign Currency Group Table 2					
5	**6**	**7**	**8**	**9**	**10**
Canadian Dollar	Japanese Yen	Russian Ruble	Turkish Lira	South Korean Won	Icelandic Krona
Brazilian Real					
Mexican Peso					
Chilean Peso					
Colombian Peso					

(2) If an insurer has material exposures to one or more currencies other than those specified in the foreign currency group table, it must notify the Authority and obtain the Authority's written approval as to the foreign currency group in which the exposure must be included.

(3) If an insurer has a material exposure to a particular currency group (for example where the insurer's reporting currency is the Euro instead of the Manx pound), and the conditions in sub-paragraph (4) are met, the insurer can exchange its exposure to Manx pounds for the exposure to that currency group in the calculation in regulation 35(4)(b).

(4) The conditions referred to in sub-paragraph (3) are—

(a) in respect of the insurer's overall cash inflows, more than 50% of the present value of future cash inflows are in that currency group;

(b) in respect of the cash flows of the currency group, the present value of future cash inflows of that currency group exceeds the present value of future cash outflows of that currency group; and

(c) the present value of future cash inflows would continue to exceed the present value of future cash outflows following the application of the more adverse of the stresses in the scenario set out in regulation 35(2), applied to currency group against the Manx pound.

(5) The currency risk capital factor to be applied to the insurer's foreign currency exposures in regulation 35(6) is 12% for a class 12 insurer and 25% for an insurer who is not a class 12 insurer.

5 Spread Risk Factors

(1) The spread risk credit quality step factors to be used in regulation 36(2) are, for a class 12 insurer—

Credit quality step	0	1	2	3	4	5	6
Factor	0.4%	0.5%	0.7%	1.2%	2.2%	3.7%	3.7%

Or else, for an insurer who is not a class 12 insurer—

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

(2) The spread risk credit quality step factors to be used for exposures to bonds and loans in regulation 36(5) are—

	Credit quality step					
Dur_i	0	1	2	3	4	5, 6
≤ 5	$0.9\% \cdot dur_i$	$1.1\% \cdot dur_i$	$1.4\% \cdot dur_i$	$2.5\% \cdot dur_i$	$4.5\% \cdot dur_i$	$7.5\% \cdot dur_i$
5 <dur ≤ 10	$4.5\% + 0.5\% \cdot (dur_i - 5)$	$5.5\% + 0.6\% \cdot (dur_i - 5)$	$7.0\% + 0.7\% \cdot (dur_i - 5)$	$12.5\% + 1.5\% \cdot (dur_i - 5)$	$22.5\% + 2.5\% \cdot (dur_i - 5)$	$37.5\% + 4.2\% \cdot (dur_i - 5)$
10 <dur ≤ 15	$7.0\% + 0.5\% \cdot (dur_i - 10)$	$8.5\% + 0.5\% \cdot (dur_i - 10)$	$10.5\% + 0.5\% \cdot (dur_i - 10)$	$20.0\% + 1.0\% \cdot (dur_i - 10)$	$35.0\% + 1.8\% \cdot (dur_i - 10)$	$58.5\% + 0.5\% \cdot (dur_i - 10)$
15 <dur ≤ 20	$9.5\% + 0.5\% \cdot (dur_i - 15)$	$11.0\% + 0.5\% \cdot (dur_i - 15)$	$13.0\% + 0.5\% \cdot (dur_i - 15)$	$25.0\% + 1.0\% \cdot (dur_i - 15)$	$44.0\% + 0.5\% \cdot (dur_i - 15)$	$61.0\% + 0.5\% \cdot (dur_i - 15)$
> 20	$12.0\% + 0.5\% \cdot (dur_i - 20)$	$13.4\% + 0.5\% \cdot (dur_i - 20)$	$15.5\% + 0.5\% \cdot (dur_i - 20)$	$30.0\% + 0.5\% \cdot (dur_i - 20)$	$46.6\% + 0.5\% \cdot (dur_i - 20)$	$63.5\% + 0.5\% \cdot (dur_i - 20)$

Where

(a) dur_i is the modified duration for that exposure;

(b) the modified duration must always be greater than 1.

(c) 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.

(3) The spread risk credit quality step factors to be used for exposures to type 1 securitisation positions, type 2 securitisation positions and resecuritisation positions in regulation 36(7) are—

	Spread Risk Credit Quality Step Factor		
Credit Quality Step	**Type 1 Securitisation Positions**	**Type 2 Securitisation Positions**	**Resecuritisation Positions**
0	2.1%	12.5%	33.0%
1	3.0%	13.4%	40.0%
2	3.0%	16.6%	51.0%
3	3.0%	19.7%	91.0%
4	N/A	82.0%	100.0%
5,6	N/A	100.0%	100.0%

(4) The spread risk credit quality step factors for use in regulation 36(10) are—

Credit quality step	Spread Risk Credit Quality Step Factor
0	+130 basis points
1	+150 basis points
2	+260 basis points
3	+450 basis points
4	+840 basis points
5,6	+1620 basis points
Unrated	+500 basis points

6 Market Concentration Risk Factors

(1) The exposure threshold factors for use in regulation 37(2) are—

Credit Quality Step	Exposure Threshold Factor
0	3.0%
1	3.0%
2	3.0%
3	1.5%
4	1.5%
5	1.5%
6 or unrated	1.5%

(2) For the purposes of sub-paragraph (1), the weighted average credit quality step for the single counterparty must be used which is the rounded-up

average of the credit quality steps of its exposures to counterparties that fall within the single counterparty, weighted by the value of each exposure.

(3) The market concentration risk credit quality factors for use in regulation 37(7) are, for a class 12 insurer—

Credit quality step	0	1	2	3	4	5	6	Un-rated
Factor	6%	6%	10%	13%	36%	36%	36%	36%

Or else, for an insurer who is not a class 12 insurer—

Credit quality step	0	1	2	3	4	5	6	Un-rated
Factor	12%	12%	21%	27%	73%	73%	73%	73%

7 Counterparty Default Risk Factors

(1) The recovery rates and risk mitigation factors for use in regulation 38(5)(d) are—

Type 1 Exposure	Recovery Rate	Risk Mitigation Factor
Reinsurance arrangements and insurance securitisations where < 60% of assets are subject to collateral arrangements	50%	50%
Reinsurance arrangements and insurance securitisations where 60% or more of assets are subject to collateral arrangements	90%	50%
Derivatives	90%	100%

(2) The economic adjustment factor in regulation 38(5)(d), takes into account the economic effect of the risk mitigation arrangement and is determined as follows —

(a) if in the case of the insolvency of the counterparty the determination of the insurer's proportional share of the counterparty's insolvency estate in excess of the collateral does not take into account that the insurer receives collateral, the factor is 100%; or else

(b) if sub-paragraph (a) does not apply the factor is 50% for reinsurance arrangements and 90% for derivatives.

(3) For use in regulation 38(16), the type 1 exposure capital factors are—

	For a class 12 insurer	For an insurer who is not a class 12 insurer
Band 1	1.5	3.0
Band 2	2.5	5.0
Band 3	0.5	1.0

(a) Band 1: the standard deviation is no more than 7% of the insurer's total loss-given default across its counterparties;

(b) Band 2: the standard deviation is more than 7% but no more than 20% of the insurer's total loss-given default across its counterparties;

(c) Band 3: the standard deviation is greater than 20% of the insurer's total loss-given default across its counterparties.

(4) The probability of default factors for use in regulation 38(17) are assigned using the credit quality step of the counterparty using the table below and applying sub-paragraphs (5) to (10) —

CQS/Other	Probability of Default
0	0.002%
1	0.010%
2	0.050%
3	0.240%
4	1.200%
5,6	4.200%
unrated incorporated banks	0.500%

(5) The probability of default factor for unrated incorporated banks must only be used for counterparties that are banks who are incorporated in the Isle of Man and licensed under the Financial Services Act 2008 to conduct deposit taking activity, that do not have an assigned credit quality step.

(6) Where an insurer has a single name counterparty exposure to a reinsurer that is supervised by an approved supervisor, for which a credit assessment by a nominated ECAI is not available, the credit quality step for use in determining the probability of default in paragraph (4) must be assigned using the reinsurer's solvency ratio (determined under the rules of its home jurisdiction) using the table below—

CQS/Other	Solvency Ratio
0	N/A
1	≥196%
2	≥175%
3	≥122%
4	≥95%
5,6	<95%

(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 regulation 65, the provider of that letter of credit, guarantee or equivalent arrangement may be considered as the counterparty on the secured exposure for the purposes of assessing the probability of default of a counterparty.

(8) Where the insurer has made an uncollateralised loan to an undertaking within the same corporate group, where that undertaking has not been assigned a credit rating, but the parent of the group does have a credit rating, the insurer can use the rating of the parent when assessing the probability of default of the counterparty, but only when that undertaking is substantially acting as the treasury function for the group.

(9) For unrated counterparties that are part of the same corporate group as the insurer, where there is a non-public rating available that could be used to assign a credit quality step then the insurer may use that rating, subject to obtaining approval from the Authority.

(10) Where a reinsurance contract has a legally enforceable cut-through liability clause, or similar binding agreement, to a retroceding insurer, the insurer may use the credit quality step of the retroceding insurer when determining the probability of default.

(11) The probability of default factors (referred to as 'PDF' in the table below) for use in regulation 38(17) are —

%	Factor A									Factor B
PDF	**0.00**	**0.01**	**0.05**	**0.10**	**0.20**	**0.24**	**0.50**	**1.20**	**4.20**	
0.002	0.001	0.001	0.002	0.002	0.002	0.002	0.002	0.002	0.002	0.001
0.01	0.001	0.004	0.007	0.007	0.008	0.008	0.008	0.008	0.008	0.006
0.05	0.002	0.007	0.020	0.027	0.032	0.033	0.036	0.038	0.038	0.030

0.24	0.002	0.008	0.033	0.056	0.087	0.096	0.129	0.158	0.174	0.144
0.50	0.002	0.008	0.036	0.066	0.114	0.129	0.198	0.278	0.342	0.715
1.20	0.002	0.008	0.038	0.073	0.135	0.158	0.278	0.471	0.712	2.455
4.20	0.002	0.008	0.038	0.075	0.146	0.174	0.342	0.712	1.568	0.300

8 Underwriting risk factors

(1) In this paragraph, a reference to a numbered line of business means the line of business so numbered in Schedule 6.

(2) The premium and reserve factor for use in regulation 40(1)(c) is 1.3 for a class 12 insurer and 3 for an insurer who is not a class 12 insurer.

(3) The premium and reserve risk segment table for use in regulation 40(2) is—

	Segment
1, 13	Motor vehicle liability insurance and proportional reinsurance
2, 14	Other motor insurance and proportional reinsurance
3, 15	Marine, aviation and transport insurance and proportional reinsurance
4, 16	Fire and other damage to property insurance and proportional reinsurance
5, 17	General liability insurance and proportional reinsurance
6, 18	Credit and suretyship insurance and proportional reinsurance
7, 19	Legal expenses insurance and proportional reinsurance
8, 20	Assistance and its proportional reinsurance
9, 21	Miscellaneous financial loss insurance and proportional reinsurance
25	Non-proportional casualty reinsurance
26	Non-proportional marine, aviation and transport reinsurance
27	Non-proportional property reinsurance

(4) Unless sub-paragraphs (5) or (7) apply, the geographical diversification adjustment in regulation 40(4) is the sum of—

(a) 0.75; and

(b) 0.25 multiplied by the sum across all geographical regions of —

(i) the square of —

(A) the volume measure for premium risk in a geographical region; plus

(B) the volume measure for reserve risk in that geographical region; divided by

(ii) the square of —

(A) the total volume measure for premium risk across all geographical regions; plus

(B) the total volume measure for reserve risk across all geographical regions;

(5) The geographical diversification adjustment for lines of business 6, 25, 26 and 27 is 1.

(6) The geographical regions are specified in Schedule 5.

(7) An insurer may choose not to take the benefit of the geographical diversification adjustment when determining its volume measure, and in this case the geographical diversification adjustment is 1 for all segments.

(8) The premium risk standard deviation factors and reserve risk standard deviation factors in regulations 40(11)(a) and 40(12)(a) for each segment are—

Segment	**Premium risk standard deviation factor** **(gross of reinsurance)**	**Reserve risk standard deviation factor** **(net of reinsurance)**
1, 13	8%	9%
2, 14	8%	8%
3, 15	15%	11%
4, 16	6.4%	10%
5, 17	11.2%	11%
6, 18	12%	19%
7, 19	7%	12%
8, 20	9%	20%
9, 21	13%	20%
25	17%	20%
26	17%	20%
27	17%	20%

(9) The geographical diversification adjustment in regulations 44(2)(a)(ii), 45(2)(a)(ii), 46(2)(a)(ii), 47(2)(a)(ii) and 49(2)(a)(ii) is the sum of —

(a) 0.5; and

(b) 0.5 multiplied by the sum over all geographical regions of —

(i) the square of the volume measure for premium risk in a geographical region; divided by

(ii) the square of the total volume measure for premium risk across all geographical regions,

where the premium measure is defined for each type of risk in regulations 44(2)(a)(i), 45(2)(a)(i), 46(2)(a)(i), 47(2)(a)(i) and 49(2)(a)(i) and the geographical regions are defined in Schedule 5.

(10) The liability risk groups for use in regulation 55 are—

(a) professional malpractice liability insurance obligations which include liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities arising out of professional malpractice in relation to clients and patients, excluding professional malpractice liability insurance and reinsurance for self-employed craftspersons or artisans;

(b) employers liability insurance obligations that include liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities of employers arising out of death, illness, accident, disability or infirmity of an employee in the course of their employment;

(c) directors and officers insurance obligations that include liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities of directors and officers of a company, arising out of the management of that company, or losses of the company itself to the extent it indemnifies its directors and officers in relation to such liabilities;

(d) personal liability insurance obligations that includes liability insurance and proportional reinsurance obligations of lines of business 5 and 17 that cover liabilities of natural persons in their capacity of being private householders excluding—

(i) obligations included in the liability risk groups set out in sub-paragraphs (a) to (c) above;

(ii) personal liability insurance and proportional reinsurance; and

(iii) professional malpractice liability insurance and reinsurance for self-employed craftspersons or artisans; and

(e) non-proportional liability reinsurance obligations in line of business 25 which relate to insurance obligations in lines of business 5 and 17.

(11) The liability risk factors for use in regulation 55(2)(a)(i)(B) are—

Liability group	Factor
[1]	100%
[2]	160%
[3]	160%
[4]	100%
[5]	210%

where

[1]= Professional malpractice liability insurance obligations

[2]= Employers liability insurance obligations

[3]= Directors and officers insurance obligations

[4]= Personal liability insurance obligations

[5]=Non-proportional liability reinsurance obligations

(12) The other non-life catastrophe risk groups for use in regulation 57(1) are—

(a) insurance obligations in lines of business 3 and 15 other than marine and aviation insurance;

(b) non-proportional reinsurance obligations included in line of business 26 other than marine and aviation reinsurance;

(c) insurance obligations included in lines of business 9 and 21 other than extended warranty insurance obligations provided that the portfolio of these obligations is highly diversified and these obligations do not cover the costs of product recalls;

(d) non-proportional reinsurance obligations in line of business 25 other than general liability reinsurance; and

(e) non-proportional reinsurance obligations relating to insurance obligations included in lines of business 6 and 18.

(13) In paragraph 12(c) 'extended warranty insurance obligation' means insurance obligations which cover the cost of repair or replacement in the event of a breakdown of a consumer good used by the individuals in a private capacity and which may also provide additional cover against eventualities such as accidental damage, loss or theft and assistance in setting up, maintaining and operating the good.

(14) The other catastrophe risk factors for use in regulation 57 are—

Other Group	Factor
(a)	100%
(b)	250%
(c)	40%
(d)	250%
(e)	250%

9 NSLT Health Risk Factors

(1) The NSLT health premium and reserve factor in regulation 59(1)(c) is 1.3 for a class 12 insurer and 3 for an insurer who is not a class 12 insurer.

(2) The NSLT Health Premium and Reserve Risk Segment table for use in regulation 59(2) is—

	Segment
10, 22	Medical expense insurance and proportional reinsurance
11, 23	Income protection insurance and proportional reinsurance
12, 24	Workers' compensation insurance and proportional reinsurance
28	Non-proportional health reinsurance

(3) Unless sub-paragraphs (4) or (6) apply, the geographical diversification adjustment in regulation 59(4) is 0.75 plus 0.25 multiplied by the sum across all geographical regions of —

(a) the square of —

(i) the volume measure for premium risk in a geographical region; plus

(ii) the volume measure for reserve risk in that geographical region; divided by

(b) the square of —

(i) the total volume measure for premium risk across all geographical regions; plus

(ii) the total volume measure for reserve risk across all geographical regions.

(4) The geographical diversification adjustment for lines of business numbered 28 in Schedule 6 is 1.

(5) The geographical regions are specified in Schedule 5.

(6) An insurer may choose not to take the benefit of the geographical diversification adjustment when determining their volume measure and in this case the geographical diversification adjustment is 1 for all segments.

(7) The NSLT health premium risk standard deviation factors and health reserve risk standard deviation factors for use in regulations 59(12) and 59(13) for each segment are—

Segment	**Health Premium Risk Standard Deviation Factor (gross of reinsurance)**	**Health Reserve Risk Standard Deviation Factor (net of reinsurance)**
10, 22	5%	5%
11, 23	8.5%	14%
12, 24	8%	11%
28	17%	20%

(8) The country ratio factors for use in in regulation 62(2)(a)(i) are—

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

(9) The event type ratio factors for use in regulations 62(2)(a)(i)(A) and 63(2)(a)(i)(A) are—

Event type	**Factor**
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%

SCHEDULE 3

[Regulation 3]

REQUIREMENTS OF SECURITISATION POSITIONS IN THE SPREAD RISK SCR

1 Type 1 and type 2 securitisation positions

(1) Type 1 securitisation positions are securitisation positions that meet all of the following—

(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;

(d) the underlying exposures have been acquired in a manner that is enforceable against any third party and are beyond the reach of the seller and its creditors including in the event of the seller's insolvency;

(e) the transfer of the underlying exposures must not be subject to material claw back provisions in the jurisdiction where the is incorporated;

(f) the documentation governing the securitisation includes continuity provisions for servicing providers, derivative counterparties or liquidity providers, if applicable;

(g) all the assets underlying the securitisation belong to only one of the following categories—

(i) residential mortgages or fully guaranteed residential loans issued by a counterparty of credit quality step 2 or above, excluding any mortgages or loans in default;

(ii) loans to small and medium-sized enterprises and consumers;

(iii) auto loans and leases for the financing of motor vehicles, trailers, agricultural or forestry tractors, motor cycles or motor tricycles and tracked vehicles;

(iv) leased property; or

(v) credit card receivables;

(h) the underlying exposures do not include transferable financial instruments or derivatives except derivatives used to hedge currency risk or interest rate risk;

(i) the repayment of the securitisation position is not structured to depend predominantly on the sale of assets securing the underlying exposures; however, this must not prevent those exposures from being subsequently rolled over or refinanced;

(j) if the securitisation has been set up without a revolving period or the revolving period has terminated and if an enforcement or an acceleration notice has been delivered, principal receipts from the underlying exposures are passed to the holders of the securitisation positions via sequential amortisation of the securitisation positions and no substantial amount of cash is trapped on each payment date;

(k) if the securitisation has been set up with a revolving period, the transaction documentation provides for appropriate early amortisation events, which must include at a minimum all of the following—

(i) a deterioration in the credit quality of the underlying exposures;

(ii) a failure to generate sufficient new underlying exposures of at least similar credit quality; and

(iii) the occurrence of an insolvency-related event with regard to the insurer or the servicer; and

(l) in the case of securitisations backed by residential mortgages, the creditor makes a thorough assessment of the borrower's creditworthiness, and that assessment has taken appropriate account of factors relevant to verifying the prospect of the borrower to meet their obligations under the credit agreement.

(2) Type 2 securitisation positions are all securitisation positions that do not qualify as type 1 securitisation positions.

SCHEDULE 4

[Regulations 36 and 37]

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.

SCHEDULE 5

[Schedule 2, paragraphs 8 and 9]

GEOGRAPHICAL REGIONS

Region		Territories that the region consists of
1	**Northern Europe**	Denmark (except Greenland), Estonia, Finland, Guernsey, Iceland, Ireland, Isle of Man, Jersey, Latvia, Lithuania, Norway, Sweden, United Kingdom (except Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Falkland Islands, Gibraltar, Montserrat, Pitcairn Islands, Saint Helena, Turks and Caicos Islands)
2	**Western Europe**	Austria, Belgium, France (except French Guiana, French Polynesia, Guadeloupe, Martinique, Mayotte, New Caledonia, Réunion, Saint Barthélemy, Saint Martin, Saint Pierre and Miquelon, Wallis and Futuna), Germany, Liechtenstein, Luxembourg, Monaco, Netherlands (except Aruba, Bonaire, Curaçao, Saba, Saint Eustatius, Saint Maarten), Switzerland
3	**Eastern Europe**	Belarus, Bulgaria, Czech Republic, Hungary, Moldova, Poland, Romania, Russia, Slovakia, Ukraine
4	**Southern Europe**	Albania, Andorra, Bosnia and Herzegovina, Croatia, Cyprus, the former Yugoslav Republic of Macedonia, Gibraltar, Greece, Italy, Malta, Montenegro, Portugal, San Marino, Serbia, Slovenia, Spain, Vatican City State
5	**Central and Western Asia**	Armenia, Azerbaijan, Bahrain, Georgia, Iraq, Israel, Jordan, Kazakhstan, Kuwait, Kyrgyzstan, Lebanon, Oman, Qatar, Saudi Arabia, Syria, Tajikistan, Turkey, Turkmenistan, United Arab Emirates, Uzbekistan, Yemen
6	**Eastern Asia**	China, Japan, Mongolia, North Korea, South Korea, Taiwan
7	**South and South-Eastern Asia**	Afghanistan, Bangladesh, Bhutan, Brunei, Burma/Myanmar, Cambodia, India, Indonesia, Iran, Laos, Malaysia, Maldives, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Thailand, East Timor, Vietnam
8	**Oceania**	American Samoa, Australia, Cook Islands, Fiji, French Polynesia, Guam, Kiribati, Marshall Islands, Micronesia,

		Nauru, New Caledonia, New Zealand, Niue, Northern Mariana Islands, Palau, Papua New Guinea, Pitcairn Islands, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu, Wallis and Futuna
9	**Northern Africa**	Algeria, Benin, Burkina Faso, Cameroon, Cape Verde, Central African Republic, Chad, Côte d'Ivoire, Egypt, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Libya, Mali, Mauritania, Morocco, Niger, Nigeria, Saint Helena, Senegal, Sierra Leone, South Sudan, Sudan, Togo, Tunisia
10	**Southern Africa**	Angola, Botswana, Burundi, Comoros, Democratic Republic of the Congo, Djibouti, Equatorial Guinea, Eritrea, Ethiopia, Gabon, Kenya, Lesotho, Madagascar, Malawi, Mauritius, Mayotte, Mozambique, Namibia, Congo, Réunion, Rwanda, São Tomé and Príncipe, Seychelles, Somalia, South Africa, Swaziland, Uganda, Tanzania, Zambia, Zimbabwe
11	**North America excluding USA**	Bermuda, Canada, Greenland, Saint Pierre and Miquelon
12	**Caribbean and Central America**	Anguilla, Antigua & Barbuda, Aruba, Bahamas, Barbados, Belize, Bonaire, British Virgin Islands, Cayman Islands, Costa Rica, Cuba, Curaçao, Dominica, Dominican Republic, El Salvador, Grenada, Guadeloupe, Guatemala, Haiti, Honduras, Jamaica, Martinique, Mexico, Montserrat, Nicaragua, Panama, Puerto Rico, Saint Barthélemy, Saba, Saint Kitts and Nevis, Saint Lucia, Saint Martin, Saint Vincent and the Grenadines, Sint Eustatius, Sint Maarten, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands
13	**East South America**	Brazil, Falkland Islands, French Guiana, Guyana, Paraguay, Suriname, Uruguay
14	**North, South and West South America**	Argentina, Bolivia, Chile, Colombia, Ecuador, Peru, Venezuela
15	**North-east USA**	Connecticut, Delaware, District of Columbia, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island,Vermont

16	**South-east USA**	Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Puerto Rico, South Carolina, Tennessee, Virginia, West Virginia
17	**Mid-west USA**	Illinois, Indiana, Iowa, Kansas, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, South Dakota, Wisconsin
18	**Western USA**	Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, New Mexico, Oregon, Texas, Utah, Washington, Wyoming
19	**Unallocated Region**	Not directly allocated to any of the regions specified in entries 1 to 18.

SCHEDULE 6

[Regulations 15, 18, and 43 to 56]

LINES OF BUSINESS

Line of Business	Name	Obligations
1	Motor vehicle liability	All liabilities arising out of the use of motor vehicles operating on land including carrier's liability.
2	Other motor insurance	All damage to or loss of land vehicles including railway rolling stock.
3	Marine, aviation and transport	All damage or loss to sea, lake, river and canal vessels, aircraft, and damage to or loss of goods in transit or baggage irrespective of the form of transport. Liabilities arising out of the use of aircraft, ships, vessels or boats on the sea, lakes, rivers or canals including carrier's liability.
4	Fire and other damage to property	All damage to or loss of property other than those included in 2 and 3 due to fire, explosion, natural forces including storm, hail or frost, nuclear energy, land subsidence and events such as theft.
5	General liability	All liabilities other than those in 1 and 3.
6	Credit and suretyship	Insolvency, export credit, instalment credit, mortgages, agricultural credit, direct and indirect suretyship.
7	Legal expense	Legal expenses and cost of litigation.
8	Assistance	Assistance for persons who get into difficulties while travelling, while away from home.
9	Miscellaneous financial loss	Employment risk, insufficiency of income, bad weather, continuing general expenses, unforeseen trading expenses, loss of market value, rent or revenue, benefits, other indirect trading, other financial loss (non-trading) as well as any other risk not covered by 1 to 8 or 10 to 12.
10	NSLT medical expense	Provision of medical treatment or care due to illness, accident, disability or infirmity, other than obligations included in 12.

11	NSLT income protection	Financial compensation arising from illness, accident, disability or infirmity, other than obligations included in 12. These can be short term or long term in nature.
12	NSLT Workers compensation	Provision of medical treatment or care, or financial compensation arising from illness, accident, disability or infirmity as a result of accidents at work, industrial injury and occupational disease.
13-24	Proportional reinsurance obligations which relate to the lines of business 1 to 12 , where line of business 13 is proportional reinsurance obligations which relate to line of business number 1; line of business 14 is proportional reinsurance obligations which relate to line of business number 2; and so on.	
25	Non-proportional casualty reinsurance	Non-proportional reinsurance obligations relating to obligations included in 1 and 5.
26	Non-proportional marine, aviation and transport reinsurance	Non-proportional reinsurance obligations relating to obligations included in 3.
27	Non-proportional property reinsurance	Non-proportional reinsurance obligations relating to obligations included in 2, 4 and 6 to 9.
28	Non-proportional health reinsurance	Non-proportional reinsurance obligations relating to obligations included in 10 to 12.

SCHEDULE 7

[Regulation 11]

REQUIREMENTS OF RING-FENCED FUNDS

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

(1) Where an insurer has ring fenced funds, it must identify the assets and liabilities of those ring-fenced funds and comply with the requirements of this Schedule.

(2) The assets in a ring-fenced fund of an insurer are those arising from the investment of premiums received by the insurer in relation to the contracts which comprise the ring-fenced fund, along with any other payments into and assets provided to, the fund.

(3) The liabilities in a ring-fenced fund comprise those liabilities attributable to the insurance contracts or risks covered by the ring-fenced fund.

(4) An insurer must attribute liabilities to the ring-fenced fund only if honouring those liabilities would entail an appropriate and permitted use of the restricted assets or eligible own-funds.

2 Materiality and valuation of a ring-fenced fund

(1) When determining whether a ring-fenced fund is material an insurer must have regard to the following—

(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—

(i) the amount of restricted own-funds within the ring-fenced fund;

(ii) volatility of these those amounts over time; and

(iii) the proportion of its total own-funds represented by restricted own-funds;

(c) the proportion of the insurer’s total assets and SCR that the ring-fenced fund represents, both individually for each ring-fenced fund and on a combined basis with the insurer’s other ring-fenced funds; and

(d) the likely impact of the ring-fenced fund on the calculation of the insurer’s SCR due to the reduced scope for risk diversification.

(2) An insurer must determine technical provisions for each of its material ring-fenced funds in accordance with regulation 15.

3 Determining the SCR for ring-fenced funds

(1) An insurer must calculate a notional SCR for each material ring-fenced fund and its residual assets and liabilities.

(2) If the insurer has determined it has a non-material ring-fenced fund, the assets and liabilities of that ring-fenced fund must be included within the residual of the insurer's portfolio.

(3) An insurer's SCR is the sum of—

(a) the notional SCRs for each material ring-fenced fund; and

(b) the SCR for the residual.

(4) If a ring-fenced fund is determined to have a negative notional SCR, the notional SCR must be set to zero before being aggregated with positive notional SCRs.

(5) An insurer must determine its notional SCRs before making any adjustment to its basic own-funds, to avoid circularity in the calculation.

(6) An insurer must calculate its notional SCRs in accordance with regulation 23, with the exception that for the capital requirements involving multiple stresses, the stress that has the most negative impact on the insurer's basic own-funds as a whole must be used to determine the insurer's capital requirement.

(7) For the purposes of sub-paragraph (6), where the capital requirement is determined by the stress that has the most negative impact on the insurer's basic own-funds as a whole, this is determined by aggregating the capital requirement for each stress within that scenario, across each ring-fenced fund and the residual and then considering which stress determines the capital requirement under that scenario.

4 Adjustments to eligible basic own-funds for ring-fenced funds

(1) In this Schedule, "restricted own-funds" means the own-funds of an insurer that belong to a ring-fenced fund.

(2) Future transfers attributable to shareholders are not classed as restricted own-fund items.

(3) Where a material ring-fenced fund exists, the amount by which the value of the insurer's restricted own-fund items in respect of that ring-fenced fund exceed the notional SCR of the ring-fenced fund must be deducted

from the reconciliation reserve calculation in paragraph 1(2) of Schedule 9.

(4) If a ring-fenced fund is deemed immaterial, the insurer must reduce its eligible basic own-funds by the total amount of restricted own-fund items in respect of that ring-fenced fund.

SCHEDULE 8

[Regulation 26]

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 EACI the following requirements must be met—

(e) an insurer must use the same EACI for all exposures of a particular type;

(f) an insurer must use its nominated ECAIs in a continuous and consistent way over time;

(g) an insurer must only use nominated ECAI credit assessments that take into account all amounts of principal and interest owed to it;

(h) if only one credit assessment is available for a securitisation position it must be assumed that no credit assessment is available;

(i) 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;

(j) 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 (i) applies to these two assessments; and

(k) 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 9

[Regulations 73 to 75]

ASSESSING THE QUALITY OF BASIC OWN-FUND ITEMS INTO TIER 1, TIER 2 AND TIER 3

1 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 sub-paragraph 1(3)—

(a) paid-up ordinary share capital and the paid-up related share premium account;

(b) paid-up initial funds, members' contributions or the equivalent basic own-fund item for mutual and mutual-type entities;

(c) paid-up subordinated mutual member accounts;

(d) surplus funds that are not considered as insurance liabilities;

(e) paid-up preference shares and the paid-up related share premium account;

(f) the reconciliation reserve;

(g) any other item that meets the requirements of paragraph (3), 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, distributions and charges as determined under paragraphs (4) and (5) respectively; less

(d) the items in sub-paragraphs (1)(a) to (1)(e) and (1)(g) (tier 1 own-funds), paragraphs 2(1)(a) to 2(1)(e) (tier 2 basic own-funds), and paragraphs 3(1)(a) to 3(1)(d) (tier 3 basic own-funds).

(3) 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 (f)(i) and (f)(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.

(4) Under paragraph 3(c), insurers must consider a dividend or distribution to be foreseeable at the latest of when it is declared or approved by the Board, regardless of any requirement for approval at an annual general meeting or equivalent.

(5) Under paragraph 3(c), insurers must consider the amount of foreseeable charges taken into account to be —

(a) the amount of taxes which are foreseeable and are not already recognised as a liability on the regulatory balance sheet; or

(b) the amount of any obligations or circumstances arising during the related reporting period which are likely to reduce the profits of the insurer where the Authority has determined they have not been appropriately captured by the valuation of assets and liabilities under regulation 14.

2 Tier 2 basic own-fund items

(1) The following basic own-fund items are classed as Tier 2, if they meet all of the features in sub-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 paragraph 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 paragraph 1(3), but the limit set in regulation 73(3) for items of its type, is exceeded so it is instead classified as Tier 2 under regulation 73(2)(a)(ii).

3 Tier 3 basic own-fund items

(1) The following basic own-fund items are classed as Tier 3 if they meet all of the features in sub-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.

SCHEDULE 10

[Regulation 21]

RISK MARGIN CALCULATION

1 Assumptions underlying the risk margin calculation

(1) The risk margin determined under regulation 21(2) 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) Under regulation 21(2) the SCR must be determined using 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.

(3) 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 (2).

(4) 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.

EXPLANATORY NOTE

(This note is not part of the Regulations)

These Regulations apply to non long-term insurance business and impose requirements for the calculation of the minimum capital requirement ("MCR") and solvency capital requirement ("SCR") under section 12 of the Insurance Act 2008. The Regulations include requirements for the valuation of corresponding assets and liabilities.