Guidance

Accounting and Reporting

Financial Reporting Council

March 2018

Implementation Guidance to accompany FRS 103 *Insurance Contracts*

Guidance for entities issuing insurance contracts on applying:

- FRS 103;
- the requirements or principles of FRS 102 to insurance contracts; and
- Schedule 3 to the Regulations.

The FRC's mission is to promote transparency and integrity in business. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

Financial Reporting Council

March 2018

Implementation Guidance to accompany FRS 103 *Insurance Contracts*

Guidance for entities issuing insurance contracts on applying:

- FRS 103;
- the requirements or principles of FRS 102 to insurance contracts; and
- Schedule 3 to the Regulations.

Contents

	Page
Overview	3
Implementation Guidance to accompany FRS 103 *Insurance Contracts*	5
1 Guidance for entities with long-term insurance business	6
2 Guidance for entities with general insurance business or long-term insurance business	9
3 Guidance on capital disclosures for entities with long-term insurance business	25

Overview

(i) This Implementation Guidance accompanies, but is not part of, FRS 103 *Insurance Contracts*. Accordingly, it does not carry the authority of an accounting standard and shall not be regarded as mandatory. It provides guidance on applying:

(a) the requirements of FRS 103;

(b) the requirements or principles of FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* by entities with general insurance business or long-term insurance business; and

(c) the requirements of Schedule 3 to the Regulations.

(ii) A number of the sections of FRS 102 exclude insurance contracts from their scope. However, FRS 102 requires entities developing accounting policies for transactions, other events or conditions not specifically addressed in FRS 102 (or another FRS) to consider the applicability of the requirements and guidance in FRS 102 (or another FRS) dealing with similar or related issues. Therefore, where relevant, this Implementation Guidance includes guidance on the application of the principles of certain sections of FRS 102 to insurance contracts, even though insurance contracts may not be within the scope of those sections. This is consistent with selecting accounting policies in accordance with the principles of FRS 102 and FRS 103.

(iii) This Implementation Guidance has been developed from material that was previously included in either FRS 27 *Life Assurance* or the Association of British Insurers' *Statement of Recommended Practice on Accounting for Insurance Business* (the ABI SORP) (published in December 2005 and amended in December 2006). Paragraphs that have been sourced from the ABI SORP, and to a lesser extent those from FRS 27, have been revised where they needed updating, for example to reflect new legislative requirements or for consistency with FRS 102. Each section of the Implementation Guidance specifies the requirements that it relates to.

(iv) Terms defined in the Glossary to FRS 103 are in **bold type** the first time they appear in each section in the Implementation Guidance.

(v) This edition of the *Implementation Guidance to accompany FRS 103* issued in March 2018 updates the edition of the Implementation Guidance issued in February 2017 for some minor typographical or presentational corrections.

Implementation Guidance to accompany FRS 103 *Insurance Contracts*

Guidance for entities issuing insurance contracts on applying:

- **FRS 103;**
- **the requirements or principles of FRS 102 to insurance contracts; and**
- **Schedule 3 to the Regulations.**

This Implementation Guidance accompanies, but is not part of, FRS 103 Insurance Contracts. Accordingly it does not carry the authority of an accounting standard and shall not be regarded as mandatory.

Implementation Guidance – Section 1
Guidance for entities with long-term insurance business

This guidance accompanies, but is not part of, FRS 103. It provides guidance for applying the requirements of FRS 103.

Recognition and measurement: with-profits business

Paragraphs IG1.1 to IG1.13 provide guidance for applying the requirements of paragraphs 3.11 to 3.15 of FRS 103.

Measurement of with-profits liabilities and related assets

IG1.1 An entity may, but is not required to, adopt the requirements of paragraph 3.12 of **FRS 103** *Insurance Contracts* for UK[1] **with-profits business** that does not fall within the scope of paragraph 3.1(b) of FRS 103. If an entity changes its **accounting policy** for such with-profits business it shall only do so in accordance with paragraph 2.3 of FRS 103.

IG1.2 The shareholders' share of projected future **bonuses** deducted in accordance with paragraph 3.12(a) of FRS 103 should be calculated as the value of future transfers to shareholders calculated using market consistent financial assumptions, and assuming that transfers take place at a level consistent with those assumptions used to calculate the **realistic value of liabilities**. Where an explicit assumption is not required in order to calculate the **liabilities** then continuation of the current profit sharing arrangements should be assumed unless the firm has plans to change this approach. Non-economic projection assumptions should be consistent with those used in determining the realistic value of liabilities. The amount deducted in accordance with this paragraph should be taken to the **fund for future appropriations (FFA)**. If shareholders transfers have been included as part of the realistic value of liabilities (or otherwise included in liabilities) then the amount of such transfers should be taken out of liabilities and included in the FFA, together with any related tax liability. If shareholders transfers have not been set up as part of the realistic value of liabilities or elsewhere, no adjustment is required.

IG1.3 In determining the realistic value of liabilities, a with-profits life fund may take account of the value of future profits expected to arise from any **non-participating business** that forms part of the with-profits fund – sometimes referred to as the **value of in-force life assurance business (VIF)**. Excluding the VIF from the **statement of financial position** whilst recognising the **realistic value of liabilities** in full, and valuing the non-participating liabilities in the with-profits fund on a statutory basis, would give rise to an inconsistency in the fund's net assets. An entity is therefore permitted to recognise the VIF if that business has been taken into account in measuring the liability, in the circumstances of paragraph 3.12(c) of FRS 103, even though there is not a direct link between the value of the asset and the amount of the liabilities. Where there is not a direct link between the value of the business and the amount of realistic liabilities, but the value is taken into account in determining those liabilities, it is appropriate to recognise the total value of the business. Although not separately identifiable, any excess value over that included in realistic liabilities will be taken to the FFA.

IG1.4 Paragraph 3.12(c) of FRS 103 permits an amount to be recognised for VIF on non-participating business written in a with-profits fund when the determination of the realistic value of liabilities takes account of this value either directly or indirectly. Where

[1] And Republic of Ireland with-profits funds.

with-profits **policyholders** are entitled to a share of the profits on non-participating business it would generally be expected that the determination of the realistic liabilities would take account, directly or indirectly, of the value of future profits on this business.

IG1.5 The amount recognised under paragraph 3.12(c) or 3.12(d) of FRS 103 may be regarded either as an additional asset, representing the value of future cash flows from the related insurance business; or as an adjustment to the measurement of liabilities and the FFA, being the deduction from these items of the obligation to transfer an unrecognised asset or other source of value. Paragraph 5.3 of FRS 103 requires entities to present this as an adjustment to liabilities, unless this would not be in compliance with the statutory requirements that apply to the entity, in which case FRS 103 permits the amount to be recognised as an asset.

IG1.6 The VIF recognised within assets as described in paragraph IG1.3 is determined as the discounted value of future profits expected to arise from the policies, taking into account liabilities relating to the policies measured on the **statutory solvency basis**. This includes adjustments made onto a **modified statutory solvency basis (MSSB)** for the purposes of the **financial statements** (for example, to adjust liabilities to exclude certain additional reserves included in the liabilities when measured on the statutory solvency basis, or where future income included in the VIF covers **deferred acquisition costs** included in the statement of financial position). A corresponding adjustment to the value of in-force policies will need to be made in order to ensure a consistent valuation.

IG1.7 Paragraph IG1.4 explains that the value calculated must be adjusted to ensure consistency where adjustments have been made onto the MSSB measurement basis in relation to non-participating contracts. The measurement of the VIF asset may take into account the release of capital requirements for non-participating business. It would not be appropriate to recognise this release of capital requirements within the VIF asset presented in the accounts because the MSSB liabilities do not include an allowance for capital. Therefore the amount of the VIF asset should be adjusted accordingly.

IG1.8 The profit recognition profile for non-participating contracts which do not satisfy FRS 103's definition of an insurance contract or contain a **discretionary participation feature** will be determined by the requirements of Sections 11, 12 and 23 of **FRS 102**. Where these contracts are written in a with-profits fund, paragraph IG1.4 will apply but the VIF recognised for such contracts should be adjusted to reflect the difference in the profit recognition bases between the basis used to determine the VIF taken into account in determining the realistic value of liabilities and the profit recognition profile determined by FRS 102.

IG1.9 Paragraph 3.12(d) of FRS 103 permits that when a with-profits fund has an interest in a subsidiary or associate and the determination of the realistic value of liabilities takes account of a value for that interest at an amount in excess of the net amounts that would be included in the entity's consolidated accounts, an amount may be recognised representing this excess. As explained in paragraph 3.15 of FRS 103 this situation could arise where the subsidiary or associate writes non-participating business and the value of the subsidiary or associate incorporates the VIF of non-participating business written in the subsidiary or associate. The value of the subsidiary or associate is reduced by the subsidiary's or associate's capital requirement as noted in rule 1.3.33(3) of **INSPRU** as at 31 December 2015. When preparing both consolidated and non-consolidated accounts, the excess value that may be recognised should therefore be taken as the excess before deduction of the subsidiary's or associate's capital requirement.

IG1.10 Where the amounts on a 'realistic' basis determined in accordance with paragraph 3.12 of FRS 103 are different from the amounts on the MSSB, a corresponding amount is transferred to or from the FFA, so that there is no effect on **equity**. The potential shareholders' share corresponding to additional bonuses to policyholders that have been included in the policyholders' liability should be accounted for in the FFA. As a result, there will generally be no change in the profit for the **reporting period** except where the adjustments result in a negative balance on the FFA and the entity determines that this negative balance should result in a deduction from equity through **profit or loss**.

Policyholders' options and guarantees

IG1.11 Entities with with-profits business within the scope of paragraph 3.1(b) of FRS 103 are required to measure the liability of that business in respect of **options and guarantees** relating to policyholders either at **fair value** or at an amount estimated using a **market-consistent stochastic model**.

IG1.12 For all entities with **long-term insurance business**, the best basis for measuring policyholders' options and guarantees is one that includes their time value[2]. Any **deterministic approach** to valuation of a policy with a guarantee or optionality feature will generally fail to deal appropriately with the time value of the option. Therefore stochastic modelling techniques to evaluate the range of potential outcomes should be used unless a market value for the option is available. The regulatory framework includes a requirement to value options and guarantees on this basis. For the liabilities of businesses not falling within the scope of paragraph 3.1(b) of FRS 103, entities are encouraged, but not required, to adopt these valuation techniques. Where options are not valued on this basis, additional disclosures are required; these are set out in paragraph IG3.14(c).

IG1.13 In determining the value of guarantees and options under the regulatory framework, the entity will take into account under each scenario in the market-consistent stochastic modelling management actions it anticipates would be taken in response to variations in market variables (such as changing the balance of the investment portfolio between debt instruments and equity, varying the amount charged to policyholders, or varying its bonus policy) that will affect the amount payable under the guarantee or option. Such actions must be realistically capable of being implemented within the timescale assumed in the scenario analysis, and be consistent with the entity's published **principles and practices of financial managements (PPFM)**.

[2] The value of an option or guarantee comprises two elements; the intrinsic value and the time value. The intrinsic value is the amount that would be payable if the option or guarantee were exercised immediately – that is, the amount it is currently 'in the money', or nil if it is 'out of the money'. The time value is the additional value that reflects the possibility of the intrinsic value increasing in future, before the expiry date of the option or guarantee.

Implementation Guidance – Section 2
Guidance for entities with general insurance business or long-term insurance business

This guidance accompanies, but is not part of, FRS 103. It provides guidance for applying:

- *the requirements of FRS 103;*
- *the requirements or principles of FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland by entities with general insurance business or long-term insurance business; and*
- *the requirements of Schedule 3 to the Regulations.*

Gross written premiums

Paragraphs IG2.1 to IG2.8 provide guidance for applying the principles of Section 23 Revenue of FRS 102 to general insurance contracts.

IG2.1 Underwriting results should be determined on an annual basis, notwithstanding that this will normally require some estimation to be made at the reporting date, particularly with regard to outstanding claims.

IG2.2 **Written premiums** should comprise the total premiums receivable for the whole period of cover provided by the contracts entered into during the **reporting period**, regardless of whether these are wholly due for payment in the reporting period, together with any adjustments arising in the reporting period to such premiums receivable in respect of business written in prior reporting periods.

IG2.3 Regardless of the method by which commission is remitted (eg by an intermediary), grossing up for the commission should be applied, if necessary on an estimated basis, as this correctly reflects the contractual arrangements in force. This also applies where the premiums are determined by an intermediary. Where, however, policies are issued to intermediaries on a wholesale basis and they are themselves responsible for setting the final amount payable by the insured without reference to the **insurer**, the written premium will normally comprise the premium payable to the insurer and grossing up will be inappropriate unless it reflects the contractual position.

IG2.4 Written premiums should include an estimate for **pipeline premiums** relating only to those underlying contracts of insurance where the period of cover has commenced prior to the reporting date.

IG2.5 Where an insurer has offered renewal and is therefore contractually liable to pay claims if renewal is subsequently confirmed by the **policyholder**, it should recognise the renewal premium in income, subject to making a provision for anticipated lapses and the necessary proportion of unearned premiums.

IG2.6 Under some policies written premiums may be adjusted retrospectively in the light of claims experience or where the risk covered cannot be assessed accurately at the commencement of cover. Where written premiums are subject to an increase retrospectively, **recognition** of potential increases should be deferred until the additional amount can be ascertained with reasonable certainty. Where written premiums are subject to a reduction, a remeasurement taking account of such a reduction should be made as soon as the entity has an obligation to the policyholder.

IG2.7 Additional or return premiums should be treated as a remeasurement of the initial premium. Where a claims event causes a reinstatement premium to be paid, the recognition of the reinstatement premium and the effect on the initial premium should reflect the respective incidence of risk attaching to those premiums in determining under the annual accounting basis that proportion earned and unearned at the reporting date.

IG2.8 Written premiums should be recognised as **earned premiums** over the period of the policy having regard to the incidence of risk. Time apportionment of the premium is normally appropriate if the incidence of risk is the same throughout the period of cover. If there is a marked unevenness in the incidence of risk over the period of cover, a basis which reflects the profile of risk should be used. The proportion of the written premiums relating to the unexpired period of these policies should be carried forward as an **unearned premiums provision** at the reporting date.

Claims

Paragraphs IG2.9 to IG2.13 provide guidance for applying the principles of Section 21 Provisions and Contingencies of FRS 102 to general insurance contracts.

IG2.9 The entity should recognise a provision in the **statement of financial position,** and recognise the amount of the provision as an expense, for the expected ultimate cost of settlement of all claims in respect of events up to the reporting date, whether reported or not, together with related internal and external claims handling expenses, less amounts already paid.

IG2.10 In relation to an entity's **existing accounting policies**, the level of claims provisions should continue to be set such that no adverse **run-off deviation** is envisaged. In determining the estimate of the amount required to settle the obligation at the reporting date consideration should be given to the probability and magnitude of future experience being more adverse than previously assumed. An entity may not introduce this practice either if it changes its existing accounting policies or develops a new accounting policy.

Claims handling expenses

IG2.11 Provision should be made at the reporting date for all claims handling expenses to cover the anticipated future costs of negotiating and settling claims which have been incurred, whether reported or not, up to the reporting date. Separate provisions should be assessed for each **category of business**.

IG2.12 In determining the provision for claims handling expenses, unless clear evidence is available to the contrary, it should be assumed that the activity of the claims handling department will remain at its current level and therefore that the contribution to its costs from future new business will remain at the same level.

IG2.13 The provision for claims handling expenses should be included within the provision for **claims outstanding** but need not be separately disclosed. Claims handling expenses incurred should be included within **claims incurred** in the **technical account** for general business.

Discounting

Paragraphs IG2.14 to IG2.20 provide guidance for applying the requirements of paragraph 54 of Schedule 3 to the Regulations. They are only relevant to general insurance business.

IG2.14 Paragraph 54 of Schedule 3 to the **Regulations** permits explicit **discounting** subject to certain conditions, one of which is that the expected average interval between the date for the settlement of claims being discounted and the reporting date must be at least four years. The four-year test should be applied by reference to the end of each reporting period in respect of all claims outstanding at that date, and not just once in the accounting period in which the claims were incurred.

IG2.15 Where applied, explicit discounting should normally be adopted by reference to categories of claims (with similar characteristics but not solely by length of settlement pattern), rather than to individual claims.

IG2.16 The calculation of the average interval referred to in paragraph IG2.14 should be weighted on the basis of expected claims before any deduction for reinsurance.

IG2.17 Discounting should be considered only if there is adequate data available to construct a reliable model of the rate of claims settlement. The principal factors to be considered are the amount of future claims settlements, the timing of future cash flows and the discount rate. Procedures should be undertaken to assess the accuracy of the claims settlement pattern predicted by the model in prior periods and the current model should be adjusted, as appropriate, to reflect the out-turn and conclusions of analyses in the previous period. Cash flows should be modelled gross and net of reinsurance as **reinsurance recoveries** may arise later than the related claims payments.

IG2.18 For the purpose of determining an appropriate discount rate, justification of the rate requires consideration of the returns achieved over the period in question to the extent that this is relevant to the future.

IG2.19 The effect of the unwinding of discounted claims provisions during a reporting period should be disregarded in considering whether material adverse run-off deviations have arisen requiring disclosure under note 4 of the Notes to the Profit and Loss Account format in Schedule 3 to the Regulations.

IG2.20 Investment return associated with any unwinding of the discount on **general insurance business** claims provisions in a reporting period should be recorded under the headings for investment income or gains in the appropriate sections of the **income statement** (referred to as the profit and loss account in the **Act**). Separate disclosure should then be made, where material, of the amount of the **investment return** which corresponds to the unwinding of the discount.

Unexpired risks provision

Paragraphs IG2.21 to IG2.27 provide guidance for applying the requirements of paragraphs 2.14 to 2.19 of FRS 103 and the principles of Section 21 Provisions and Contingencies and Section 32 Events after the End of the Reporting Period of FRS 102. They are only relevant to general insurance business.

IG2.21 Subject to paragraph IG2.26, where the estimated value of claims and expenses attributable to the unexpired periods of policies in force at the reporting date exceeds the unearned premiums provision in relation to such policies after deduction of any **deferred acquisition costs**, an **unexpired risks provision** should be established. If material, this provision shall be disclosed separately either in the statement of financial position or in the **notes to the financial statements**.

IG2.22 The assessment of whether an unexpired risks provision is necessary should be made for each grouping of business which is managed together. Any unexpired risks surpluses and deficits within that grouping should be offset in that assessment. For this purpose 'managed together' is defined in paragraph IG2.23.

IG2.23 Business should only be regarded as being managed together where no constraints exist on the ability to use assets held in relation to such business to meet any of the associated liabilities and either:

(a) there are significant common characteristics, which are relevant to the assessment of risk and setting of premiums for the business lines in question; or

(b) the lines of business are written together as separate parts of the same **insurance contracts**.

IG2.24 For **delegated authorities** (ie where the insurer is unable to influence the terms on which policies are issued) a provision should be established at the reporting date for any anticipated losses arising on policies issued in the period after the reporting date which the delegated authority entered into before that date.

IG2.25 The assessment of whether an unexpired risks provision is required, and if so its amount, should be based on information available at the reporting date which may include evidence of relevant previous claims experience on similar contracts adjusted for known differences, events not expected to recur and, where appropriate, the normal level of seasonal claims if the previous reporting period was not typical in this respect. The assessment should not however take into account any new claims events occurring after the reporting date, as these are non-adjusting events. In accordance with paragraph 32.10 of **FRS 102** exceptional claims events occurring after the end of the reporting period but before the **financial statements** are authorised for issue shall be disclosed in the notes to the financial statements together with an estimate of their financial effect. Where there is uncertainty concerning future events, in accordance with paragraph 2.9 of FRS 102, an insurer shall include a degree of caution in the exercise of the judgements needed in making the estimates required such that liabilities are not understated.

IG2.26 In calculating the best estimate of the amount required to settle future claims in relation to the unexpired periods of risk on policies in force at the reporting date, the future investment return arising on investments supporting the unearned premiums provision and the unexpired risks provision may be taken into account. For the purposes of calculating this provision, the deferred acquisition costs should be deducted from the unearned premiums provision. The investment return will be that expected to be earned by the investments held until the future claims are settled.

IG2.27 Deferred acquisition costs should not be written off, in whole or in part, to **profit or loss** as being irrecoverable for the purpose of reducing or eliminating the need for an unexpired risks provision.

Equalisation reserves

Paragraph IG2.28 provides guidance for applying the requirements of note 24 of the Notes to the Balance Sheet format in Schedule 3 to the Regulations. They are only relevant to general insurance business.

IG2.28 Disclosure should be made where an equalisation reserve has been established in accordance with the **PRA** Rulebook. Where equalisation reserves are established, an entity should disclose the following in the notes to the financial statements:

(a) that the amounts provided are not liabilities because they are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the reporting date;

(b) notwithstanding this, they are required by Schedule 3 to the Regulations to be included within technical provisions; and

(c) the impact of the equalisation reserves on **equity** and the effect of movements in the reserves on the profit or loss for the reporting period.

Portfolio premiums and claims

Paragraphs IG2.29 to IG2.32 provide guidance for applying the principles of Section 23 Revenue of FRS 102. They are only relevant to general insurance business.

IG2.29 **Portfolio premiums** payable should be included within premiums for reinsurance outwards in the financial statements of the transferor undertaking but deferred to subsequent reporting periods as appropriate in respect of any unexpired period of risk at the reporting date. In the financial statements of the transferee undertaking they should be included within written premiums with any amount unearned at the reporting date being carried forward in the unearned premiums provision.

IG2.30 **Portfolio claims** transfers should be recognised in the financial statements of the transferor undertaking as payments in settlement of the claims transferred in accordance with the requirements of note 4 of the Notes to the Profit and Loss Account format in Schedule 3 to the Regulations.

IG2.31 Similarly, the consideration receivable by the transferee undertaking should be credited to claims payable in the statement of financial position.

IG2.32 Disclosure should be made in notes to the financial statements of any claims **portfolio transfers**, which materially affect the transferee undertaking's exposure to risk.

Structured settlements

Paragraph IG2.33 provides guidance applying the requirements of paragraph 2.13(c) of FRS 103. They are only relevant to general insurance business.

IG2.33 Where, pursuant to a **structured settlement** arrangement falling within one of the cases referred to in sections 731 to 734 of the Income Tax (Trading and Other Income) Act 2005, either:

(a) an annuity is purchased by a general insurance undertaking under which the structured settlement beneficiary is the annuitant; or

(b) an annuity previously purchased by a general insurance undertaking for its own account to fund the periodic payments under a structured settlement agreement is assigned to the structured settlement beneficiary,

the general insurance company will normally remain liable to the policyholder should the annuity provider fail. An annuity, paid by an annuity provider, which exactly matches the amount and timing of this **liability** should be recognised as an asset and measured at the same amount as the related obligation.

Deferred acquisition costs

Paragraphs IG2.34 to IG2.36 provide guidance for applying the requirements of paragraph 13 of Schedule 3 to the Regulations to general insurance business.

IG2.34 **Acquisition costs** should be deferred commensurate with the unearned premiums provision. The proportion of acquisition costs to be deferred will be the same proportion of the total acquisition costs as the ratio of unearned premiums to gross written premiums for the class of business in question. For this purpose acquisition expenses should be allocated to classes of business. Where this is not possible for reinsurance business inwards an estimate should be made.

IG2.35 Advertising costs should not be deferred unless they are directly attributable to the acquisition of new business.

IG2.36 Related reinsurance commissions deferred should not be netted against deferred acquisition costs but should be shown as liabilities in the statement of financial position.

Insurance business in run off

Paragraph IG2.37 provides guidance for applying the principles of Section 21 of FRS 102. It is relevant to general insurance business and to long-term insurance business.

IG2.37 Where a decision has been taken to cease writing the whole, or a material category, of the insurance business, that business does not constitute a **discontinued operation**, but it may be a **restructuring** to which paragraphs 21.11C and 21.11D of FRS 102 apply.

Technical provisions

Paragraph IG2.38 provides guidance for applying the requirements of Part 1 General Rules and Formats of Schedule 3 to the Regulations. This paragraph is only relevant to long-term insurance business.

IG2.38 Balance sheet liabilities item C.4 (Provision for bonuses and rebates) and line II.7 (Bonuses and rebates, net of reinsurance) in the technical account for long-term business should not be used. **Bonuses** and rebates attributable to the reporting period, other than those included within claims payable, should be included in line II.6(a) (Change in other technical provisions – long term business provision) and in Balance Sheet Liabilities item C.2 (Long term business provision).

Long-term business provision

Paragraphs IG2.39 to IG2.44 provide guidance for applying the requirements of paragraph 52 of Schedule 3 to the Regulations. They are only relevant to long-term insurance business.

IG2.39 The **gross premium method** should be used for every class of insurance business except those for which the **net premium method** is used in the related regulatory returns, but policyholder liabilities of overseas subsidiaries may be computed on a local basis, subject to Part 3 of Schedule 6 to the Regulations.

IG2.40 Where the valuation is performed using a net premium method, bonuses should be included in the long-term business provision only if they have vested or have been declared as a result of the current valuation.

IG2.41 Liabilities should be measured on a basis consistent with the bases adopted for valuing the corresponding assets. In determining the long-term business provision and the technical provision for linked liabilities, no policy may have an overall negative provision except as allowed by PRA rules, or a provision which is less than any guaranteed surrender or transfer value.

IG2.42 The long-term business provision may be calculated on the basis used for regulatory reporting subject to appropriate adjustments including the reversal of any reduction in policyholder liabilities where these liabilities already implicitly take account of a pension fund surplus through future expense assumptions which reflect lower expected contributions.

IG2.43 Paragraph 52(2) of Schedule 3 to the Regulations requires that a summary of the principal assumptions in making the long-term business provision shall be given in the notes to the financial statements. In order to comply with this requirement an entity should disclose for each principal category of business the more significant assumptions relating to the following:

(a) premiums;

(b) persistency;

(c) mortality and morbidity;

(d) interest rates;

(e) the discount rates used with, if relevant, explanation of the basis of reflecting risk margins; and

(f) if applicable, any other significant factors.

IG2.44 Where the long-term business provision has been determined on an actuarial basis that, in assessing the future net cash flows, has regard to the timing of tax relief where assumed expenses exceed attributable income, such tax relief should be excluded from the determination of **deferred tax**.

Paragraphs IG2.45 and IG2.46 provide guidance for applying the requirements of Section 5 of FRS 103. They are only relevant to long-term insurance business.

IG2.45 For each significant class of with-profits insurance business, the insurer should disclose the extent to which the basis of preparation of the long-term business provision incorporates allowance for future bonuses. For example, it should be stated (if it is the case) that explicit provision is made only for vested bonuses (including those vesting following the current valuation) and that no such provision is made for future regular or terminal bonuses. If practical, insurers should disclose the amount that has been included explicitly in the long-term business provision in relation to future bonuses provided this can be done without undue cost or effort. If the valuation method makes implicit allowance for future bonuses by adjusting the discount rate used or by another method, this fact should be stated together with a broad description of the means by which such allowance is made.

IG2.46 The aggregate of the bonuses added to policies in the reporting period should be disclosed in the notes to the financial statements.

Technical provisions for linked liabilities

Paragraphs IG2.47 to IG2.49 provide guidance for applying the requirements of note 26 of the Notes to the Balance Sheet format in Schedule 3 to the Regulations. They are only relevant to long-term insurance business.

IG2.47 The relevant provision for any contract should not be less than the element of any surrender or transfer value which is calculated by reference to the relevant fund or funds or index.

IG2.48 The net assets held to cover linked liabilities at the reporting date may differ from the technical provisions for linked liabilities. The reasons for any significant mismatching should be disclosed.

IG2.49 Where the technical provision for linked liabilities has regard to the timing of the tax obligation, the effect of this should be excluded from the determination of deferred tax.

Fund for future appropriations

Paragraphs IG2.50 and IG2.51 provide guidance for applying the requirements of note 19 of the Notes to the Balance Sheet format in Schedule 3 to the Regulations. They are only relevant to long-term insurance business.

IG2.50 In the case of funds where there is reasonable certainty over the allocation to policyholders or to **owners** of all items recognised in the technical account for long-term business, it is inappropriate to establish a **fund for future appropriations (FFA)**. However, certain long-term business funds of:

(a) proprietary insurers are established in such a way that allocation between equity and policyholders' liabilities is not clear cut; and

(b) **mutual** insurers are established in such a way that allocation between disclosed surplus and policyholders' liabilities is not clear cut; and

therefore it is appropriate to establish a FFA.

IG2.51 Where a FFA is established, the notes to the financial statements should indicate the reasons for its use and the nature of the funds involved.

Reserves relating to long-term business

Paragraphs IG2.52 and IG2.53 provide guidance for applying the requirements of paragraph 52 of Schedule 3 to the Regulations. They are only relevant to long-term insurance business.

IG2.52 Investment reserves (realised and unrealised investment gains and exchange gains), surpluses carried forward, resilience and similar reserves, contingency and closed fund reserves which may be included in the statutory liabilities for solvency purposes under the PRA rules, should be considered to assess the extent to which they should be included in the long-term business provision (see paragraph IG2.42).

IG2.53 The investment return (which includes movements in realised and **unrealised investment gains and losses**) and related tax charges on assets representing reserves which are held for the relevant **long-term insurance business** for solvency purposes should be credited to the technical account for long-term business. Allocations may then be made as appropriate to the **non-technical account** in accordance with paragraphs IG2.65 and IG2.66 or to the FFA. When the regulatory framework does not require the entity to set up a long-term fund for its long-term insurance business, the entity shall make the allocations as appropriate between the technical and non-technical account and disclose the basis of its allocation in the notes to the financial statements.

Present value of acquired in-force business

Paragraphs IG2.54 and IG2.55 provide guidance for applying the principles of Section 18 Intangible Assets other than Goodwill and Section 19 Business Combinations and Goodwill of FRS 102, and paragraphs 2.27 to 2.29 and 3.16 to 3.18 of FRS 103. They are only relevant to long-term insurance business.

IG2.54 An entity shall provide the disclosures set out in paragraphs 18.27 and 18.28(a) of FRS 102 in relation to the **value of in-force life assurance business (VIF)** asset.

IG2.55 Where a group reconstruction occurs and the new group carries on substantially the same insurance business as the group which it replaces (for example where a demutualisation is effected through the establishment of a proprietary company to acquire the business of an existing mutual insurer), any VIF which would be regarded as internally-generated under the former group structure should continue to be treated as such in the new group.

Disaggregated information about single and regular premiums

Paragraphs IG2.56 to IG2.58 are only relevant to long-term insurance business.

IG2.56 New life insurance premiums are defined in the PRA rules as following:

‘Single premium contracts shall consist of those contracts under which there is no expectation of continuing premiums being paid at regular intervals. Additional single premiums paid in respect of existing individual contracts shall be included.

Regular premium contracts shall include those contracts under which premiums are payable at regular intervals during the policy year, including repeated or recurrent single premiums where the level of premiums is defined’.

IG2.57 New annual and single premiums should be disclosed separately in the financial statements together with an explanation of the basis adopted for recognising premiums as either annual or single premiums. New annual premiums should be shown as the premiums payable in a full year (ie annual equivalent premium). DWP[3] rebates received on certain pensions contracts should be treated as single premiums.

IG2.58 Internal transfers between products where open market options are available should be counted as new business. If no open market option exists, the transfer should not be treated as new business.

Income Statement (which is referred to as the profit and loss account in the Act)

Paragraphs IG2.59 and IG2.60 provide guidance for applying the requirements of Part 1 General Rules and Formats of Schedule 3 to the Regulations, and the requirements of paragraphs 3.5 and 9.13(a) of FRS 102. They are relevant to general insurance business and to long-term insurance business.

IG2.59 Where the amounts of general or long-term business are not material, the results should be disclosed as ‘other technical income, net of reinsurance’ or ‘other technical charges, net of reinsurance’ in the technical account for the business which is material. Appropriate additional disclosure should be made in the notes to the financial statements in relation to the business accounted for in this way.

IG2.60 On consolidation, the profit or loss of any non-insurance entity belonging to the long–term fund (as defined in **INSPRU** as at 31 December 2015) may be included directly in the technical account for long-term business. Where material, more detailed disclosure should be provided in the notes to the financial statements. Where an entity carrying on general insurance business is an asset of the long-term insurance business, the profit or loss of this business should be transferred from the non-technical

[3] The Department for Work and Pensions.

account to the technical account for long-term business using new lines for this purpose.

Valuation of reinsurance asset

Paragraph IG2.61 provides guidance on the application of Section 2 of FRS 102.

IG2.61 Assets created by reinsurance transactions should be measured on a basis consistent with the measurement of the related liability, so that the net amount reflects the exposure of the entity. Changing the measurement of the liability may therefore give rise to a change in the related **reinsurance asset**. An exception to this paragraph is where a provision is made for any shortfall in value (eg any anticipated inability on the part of the **reinsurer** to meet its obligations to the **cedant**, when they are expected to fall due).

Reinsurance balance

Paragraph IG2.62 provides guidance for applying the requirements of paragraphs 85(1)(e) and 86(1)(b) of Schedule 3 to the Regulations. It is relevant to general insurance business and to long-term insurance business.

IG2.62 For the purpose of the disclosure required under paragraphs 85 and 86 of Schedule 3 to the Regulations, the 'reinsurance balance' means for general business the aggregate total of all those items included in the technical account for general business which relate to reinsurance outwards transactions including items recorded under item I.7(d) (Reinsurance Commissions and Profit Participation) and for **long-term insurance business** the corresponding items in the technical account for long-term business including items recorded under item II.8(d) (Reinsurance Commissions and Profit Participation).

Allocation of investment return

Paragraphs IG2.63 to IG2.71 provide guidance for applying the requirements of note 10 of the Notes on the Profit and Loss Account format in Schedule 3 of the Regulations.

IG2.63 For the purpose of calculating the **longer term rate of investment return**, it may be appropriate to spread the realised gains or losses over the period to maturity (or deemed maturity) of the investments sold (see paragraph IG2.76).

IG2.64 **FRS 103** permits, but does not require, a form of presentation which enables users of the financial statements to identify operating profit or loss based on the longer term rate of investment return. This return may be recorded within the general business and long-term business technical accounts and may also be disclosed separately as part of the total operating profit.

IG2.65 Where investment return is allocated, it should be on one of the following bases:

(a) the longer term rate of return basis (see paragraphs IG2.67 to IG2.70); or

(b) an allocation of the actual investment return on investments supporting the general insurance technical provisions and associated equity should be made from the non-technical account to the technical account for general business.

IG2.66 To ensure consistency of treatment in the case of an entity transacting both general and long-term insurance business:

(a) where the longer term rate of return basis is used, it must be applied to both the general and long-term insurance business; and

(b) where an allocation of the actual investment return on investments supporting the general business technical provisions and associated equity is made from the non-technical account to the technical account for general business, no allocation of investment return should be made from the technical account for long-term business to the non-technical account.

Longer term rate of return basis

IG2.67 The allocation of investment return from the technical account for long-term business to the non-technical account should be such that the investment return remaining in the technical account for long-term business on investments directly attributable to owners reflects the longer term rate of return on these investments.

IG2.68 The allocation from the non-technical account to the technical account for general business should be based on the longer term rate of investment return on investments supporting the general insurance technical provisions and all the relevant equity.

IG2.69 Where it is necessary for the purpose of reflecting the longer term rate of investment return in the technical account for general business, the allocation referred to in paragraph IG2.68 may exceed the actual investment return of the reporting period on the corresponding investments. Similarly, the allocation referred to in paragraph IG2.67 may be of a negative amount which increases rather than decreases the amount of investment return included in the long-term business technical account.

IG2.70 The allocation referred to in paragraph IG2.67 should be included in the long-term business technical account and the non-technical account gross of any attributable tax. The tax attributable to the allocated investment return should be deducted from the tax attributable to long-term business and added to the tax on profit or loss on ordinary activities.

Disclosure

IG2.71 Where technical results are disclosed which reflect the longer term rate of investment return, the following disclosures should be made in the notes to the financial statements:

(a) the methodology used to determine the longer term rate of return for each investment category;

(b) for each investment category and material currency, both the longer term rates of return and, if applicable, the long-term dividend and rental yields used to calculate the grossing-up factor for equities and property;

(c) a comparison over a longer term (at least five years) of the actual return achieved with the return allocated using the longer term rate of return analysed between returns relating to general business, long-term business and other; and

(d) the sensitivity of the longer term investment return to a 1% decrease and a 1% increase in the longer term rate of investment return.

The longer term rate of investment return

Paragraphs IG2.72 to IG2.77 provide guidance on applying the requirements of paragraphs IG2.67 to IG2.70.

Equities and properties

IG2.72 The longer term investment return on equities and properties should be determined using one of the following methods:

(a) Grossing-up actual income earned for each asset class by a factor representing the longer term rate of investment return divided by an assumed long-term dividend or rental yield (based on the assumption that income will reflect the mix of assets held during the reporting period). Adjustments will be required for special factors which may distort the underlying yields of the portfolio such as (in the case of equities), special or stock dividends and share buy-backs.

(b) Applying the longer term rate of return to investible assets held during the period (taking account of new money invested and changes in portfolio mix) by reference to the quarterly or monthly weighted average of each group of assets after excluding the effect of short-term market movements.

IG2.73 The longer term rate of return should be determined separately for equities and property and for each material currency in which relevant investments are held.

IG2.74 Taking into account the investment policy followed by the entity, the longer term rate of investment return should reflect a combination of historical experience and current market expectations for each geographical area and each category of investments. The rates chosen should be best estimates based on historical market real rates of return and current inflation expectations, having regard, where appropriate, to the following factors:

(a) comparison of the business's actual returns and market returns over the previous five years or such longer period as may be appropriate;

(b) longer term rates of return currently used in the business for other purposes, for example, product pricing, with-profits bonus policy, and pensions funding;

(c) the rate used for the purpose of achieved profits method reporting;

(d) consensus economic and investment market forecasts of investment returns; and

(e) any political and economic factors which may influence current returns.

IG2.75 Rates of return should be set with a view to ensuring that longer term returns credited to operating results do not consistently exceed or fall below actual returns being earned. Any downturn in expectations of longer term returns should be recognised immediately by reducing the assumed rate of return. Rates used should be reviewed at least annually although changes would be expected to be infrequent.

Fixed income securities

IG2.76 In the case of redeemable fixed income securities, the longer term rate of return may be determined by using either:

(a) a redemption yield calculated so that any excess of the purchase price over the amount repayable on maturity is recognised in profit or loss by instalments so that it is written off by the time that the security is redeemed; or

(b) **amortised cost** with realised gains and losses subject to continuing amortisation over the remaining period to the maturity date.

However, it may be based on interest earned where the net effect of amortisation would be immaterial. In the case of irredeemable fixed interest securities and short-term assets, the allocated longer term rate of investment return should be the interest income receivable in respect of the reporting period.

Derivatives

IG2.77 Where **derivatives** have a material effect and are used to adjust exposure to the various classes of investments, the calculation of the longer term rate of return in paragraphs IG2.72 to IG2.75 should be adjusted to reflect the underlying economic exposure.

Investments in Unit Trusts/Open Ended Investment Companies (OEICs)

Paragraph IG2.78 provides guidance for applying the requirements of Part 1 General Rules and Formats of Schedule 3 to the Regulations and paragraph 11.41 of FRS 102.

IG2.78 Except for investments held to cover linked liabilities all investments in unit trusts and OEICs should be included in the balance sheet under assets item C.III.1 (Shares and other variable yield securities and units in unit trusts) regardless of the nature of the underlying assets of the unit trusts.

Attributing tax to the transfer to the non-technical account

Paragraphs IG2.79 and IG2.80 provide guidance on applying the requirements of Part 1 General Rules and Formats of Schedule 3 to the Regulations. Paragraph IG2.81 provides guidance on applying the requirements of paragraph 29.27(b) of FRS 102.

IG2.79 In common with other types of business, taxable profits for UK entities[4] with long-term insurance business are now derived from pre-tax profits reported in the financial statements. However, the requirement for tax expense (income) to be allocated to the same account (technical or non-technical) as the transaction or other event that resulted in the tax expense (income) means that the amount shown in the non-technical account as the transfer from (to) the long-term business technical account is net of tax. There is therefore a requirement for the tax attributable to the transfer to be brought into account in arriving at profit before tax in the non-technical account.

IG2.80 Entities should determine the amount to be brought into account in the non-technical account in respect of the transfer from (to) the long-term business technical account using a method which is consistent with the approach in paragraph 29.22 of FRS 102 and which fairly represents that part of the tax expense (income) in the long-term business technical account which is based on pre-tax accounting profits or on timing differences in the recognition of such profits for accounting and tax purposes.

IG2.81 The reconciliation required by paragraph 29.27(b) of FRS 102 should apply only to the tax expense (income) that appears in the non-technical account.

[4] And for Republic of Ireland entities.

Appendix to Implementation Guidance Section 2
Republic of Ireland legal references

The table below should be read in conjunction with Appendix IV of FRS 103.

Paragraph	UK Reference	RoI Reference
Title page, paragraph (i) of the Overview and page 5	Schedule 3 to the Regulations	Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.14 and IG2.14	Paragraph 54 of Schedule 3 to the Regulations	Paragraph 59(2) and 59(3) of Part IV of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.19, IG2.30	Note 4 of the Notes to the Profit and Loss Account format in Schedule 3 to the Regulations	Note 4 fo the Notes on the Profit and Loss Account formats in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.28	Note 24 of the Notes to the Balance Sheet format in Schedule 3 to the Regulations	Note 27 of the Notes on the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.28(b)	Schedule 3 to the Regulations	Insurance Undertakings Regulations 2015 (as amended)
IG2.33	Sections 731 to 734 of the Income Tax (Trading and Other Income) Act 2005	There is no equivalent Irish legislation.
Sub-heading before IG2.34	Paragraph 13 of Schedule 3 to the Regulations	Note 15 of the Notes on the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.38	Part 1 General Rules and Formats of Schedule 3 to the Regulations	Sections A and B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.38	'Balance sheet liabilities item C.4 (provision for bonuses and rebates)'	Liabilities item C.4 in the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.38	'line II.7 (Bonuses and rebates, net of reinsurance)'	Line II.7 in the Profit and Loss Account formats in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)

Paragraph	UK Reference	RoI Reference
IG2.38	'line II.6(a) (Change in other technical provisions – long term business provision)'	Line II.6(a) in the Profit and Loss Account formats in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.38	'Balance Sheet Liabilities item C.2 (Long term business provision)'	Liabilities item C.2 in the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.39	Paragraph 52 of Schedule 3 to the Regulations	Paragraph 57 of Part IV of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.39	Part 3 of Schedule 6 to the Regulations	Schedule 2 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.43	Paragraph 52(2) of Schedule 3 to the Regulations	Paragraph 57(3) of Part IV of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.47	Note 26 of the Notes to the Balance Sheet format in Schedule 3 to the Regulations	Note 28 of the Notes on the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.50	Note 19 of the Notes to the Balance Sheet format in Schedule 3 to the Regulations	Note 20 of the Notes on the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.52	Paragraph 52 of Schedule 3 to the Regulations	Paragraph 57 of Part IV of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.59	Part 1 General Rules and Formats of Schedule 3 to the Regulations	Sections A and B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.62	Paragraphs 85(1)(e) and 86(1)(b) of Schedule 3 to the Regulations	Paragraphs 84(1)(e) and 85(1)(b) of Part V of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.62	Paragraphs 85 and 86 of Schedule 3 to the Regulations	Paragraphs 84 and 85 of Part V of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)

Paragraph	UK Reference	RoI Reference
IG2.62	'items included in the technical account for general business which relate to reinsurance outwards transactions including items recorded under item I.7(d) (Reinsurance Commissions and Profit Participation)'	Item I.7(d) in the Technical Account – Non-life insurance in the Profit and Loss account formats in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.62	'for long-term insurance business the corresponding items in the technical account for long-term business including items recorded under item II.8(d) (Reinsurance Commissions and Profit Participation)'	Item II.8(d) in the Technical Account – Life assurance business in the Profit and Loss account formats in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.63	Note 10 of the Notes on the Profit and Loss Account format in Schedule 3 to the Regulations	Note 9 of the Notes on the Profit and Loss Account formats in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.78	Part 1 General Rules and Formats of Schedule 3 to the Regulations	Sections A and B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
IG2.78	'assets item C.III.1 (Shares and other variable yield securities and units in unit trusts'	Assets item C.III.1 in the Balance Sheet format in Section B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)
Sub-heading before IG2.79	Part 1 General Rules and Formats of Schedule 3 to the Regulations	Sections A and B of Part II of Schedule 1 to the Insurance Undertakings Regulations 2015 (as amended)

Implementation Guidance – Section 3
Guidance on capital disclosures for entities with long-term insurance business

This guidance accompanies, but is not part of, FRS 103. It provides guidance for providing capital disclosures in accordance with paragraph 34.31 of FRS 102. It is only relevant to entities with long-term insurance business.

Capital statement

IG3.1 An entity should present a statement setting out its total **regulatory capital resources** relating to **long-term insurance business**. The statement should show, for each section of that business as defined in paragraph IG3.3:

(a) equity (or in the case of a **mutual**, the equivalent, often described as disclosed surplus);

(b) adjustments to restate these amounts in accordance with regulatory requirements;

(c) each additional component of capital included for regulatory purposes, including capital retained within a life fund whether attributable to shareholders, **policyholders** or not yet allocated between shareholders and policyholders; and

(d) the total capital available to meet regulatory capital requirements.

IG3.2 Available capital will comprise a number of distinct elements, each of which will be separately disclosed, including:

(a) equity as included in the published **statement of financial position**, represented by surplus held within a life fund or by assets held separately from those of the fund itself;

(b) amounts that are wholly attributable to owners, but held within a life fund and where the distribution out of the fund is restricted by regulatory or other considerations;

(c) surplus held in life funds that has yet to be attributed or allocated between owners and policyholders (in the case of a mutual all such surplus is attributable to policyholders but is not treated as a **liability**); and

(d) qualifying debt capital, whether issued by the life entity itself or by another entity within the group.

IG3.3 The capital statement should show as separate sections:

(a) each UK[5] with-profits life fund that is material to the group; and

(b) the entity's other long-term insurance business, showing the extent to which the various components of capital are subject to constraints such that they are available to meet requirements in only part of the entity's business, or are available to meet risks and regulatory capital requirements in all parts of the business.

IG3.4 The purpose of the capital statement is to set out the financial strength of the entity and to provide an analysis of the nature of capital, and constraints over the availability of the capital to meet risks and regulatory requirements. It is important that sources of capital are shown separately and the extent to which the capital in each section is subject to

[5] Or, for an entity in the Republic of Ireland, each with-profits fund in the Republic of Ireland.

constraint in its availability to meet requirements in other parts of the entity. Such constraints can arise for any of the following reasons:

(a) Ownership – the capital may be subject to specific ownership considerations (for example, the **fund for future appropriations (FFA)** of a UK[6] with-profits fund, for which the allocation between policyholders and shareholders has not been determined);

(b) Regulatory – local regulatory limitations may require the maintenance of solvency margins in particular funds or countries; or

(c) Financial – the availability of capital in certain cases can be restricted due to the imposition of taxes or other financial penalty in the event of the capital being required to be redeployed across the group.

IG3.5 The aggregate amount of regulatory capital resources included in the capital statement should be reconciled to equity, FFA and other amounts shown in the entity's statement of financial position, showing separately for each component of capital the amount relating to the entity's business other than long-term insurance business. Where such other business is significant, an explanation should be given of the extent to which this capital can be used to meet the requirements of the life assurance business.

IG3.6 Although the detailed requirements apply to long-term insurance business, entities will need to incorporate information on other parts of the business, together with consolidation adjustments, in order to demonstrate how the aggregated capital attributed to the long-term insurance business reconciles to the total shown in the consolidated statement of financial position, and the extent to which capital outside the long-term insurance business may be made available to meet the capital requirements of the long-term insurance business. This reconciliation applies to each different type of capital shown in the capital statement.

IG3.7 Where the entity is a subsidiary, narrative supporting the capital statement should explain the extent to which the capital of the entity is able to be transferred to a parent or fellow subsidiaries, or the extent to which it is required to be retained within the entity.

IG3.8 Entities with life assurance liabilities should reconcile their regulatory capital resources to their shareholders' funds. Adjustments to reconcile the capital shown in the statement of financial position to the amount for regulatory purposes may include the following:

(a) the difference between provisions measured on the realistic basis and the regulatory basis;

(b) the inclusion in capital of the FFA;

(c) the exclusion from capital of the shareholders' share of accrued bonus;

(d) the exclusion of goodwill and other **intangible assets**, such as an amount attributed to the acquired **value of in-force life assurance business (VIF)**; and

(e) changes to the valuation of assets and the exclusion of certain non-admissible assets for regulatory purposes, for example any regulatory adjustment to a pension fund deficit that is recognised as a liability.

Disclosure of these adjustments should be sufficient to give a clear picture of the capital position from a regulatory perspective and its relationship to the equity shown in the consolidated statement of financial position.

---

[6] Or, for an entity in the Republic of Ireland, each with-profits fund in the Republic of Ireland.

IG3.9 Where the amount of a capital instrument that qualifies for inclusion as regulatory capital is restricted (for example, where a limited percentage of total regulatory capital may be in the form of debt) the full amount of the instrument should be included, with a separate deduction for the amount in excess of the restriction.

IG3.10 Disclosure should be made of any formal intra-group arrangements to provide capital to particular funds or business units, including intra-group loans and contingent arrangements. Where the entity is a subsidiary, disclosure should also be made of similar arrangements between the entity and a parent or fellow subsidiary.

IG3.11 Separate disclosure of each class of capital is important to an understanding of the funding of the business and the way any future losses would be absorbed or new business financed. Regulatory capital can include both equity and surplus within the fund. Such surplus may be wholly attributable to **owners**, or remain unallocated as part of the FFA. In a mutual fund, all surplus is attributable to policyholders. Debt instruments qualifying as capital may be also be issued from the fund itself, or may form part of the owners' equity outside the life fund; a debt instrument issued by the fund to the owners may effectively transfer capital from the owners to the fund.

IG3.12 Intra-group arrangements should be included in the regulatory capital of a section only where they are subject to formal arrangements.

Disclosures relating to liabilities and capital

IG3.13 The capital statement should be supported by the following disclosures:

(a) narrative or quantified information on the regulatory capital requirements applying to each section of the business shown in the capital statement, and on the capital targets set by management for that section;

(b) narrative disclosure of the basis of determining regulatory capital and the corresponding regulatory capital requirements, and any major inconsistencies in this basis between the different sections of the business;

(c) narrative disclosure showing the sensitivity of regulatory liabilities (including **options and guarantees**), and the components of total capital, to changes in market conditions, key assumptions and other variables, as well as future management actions in response to changes in market conditions; and

(d) narrative disclosure of the entity's capital management policies and objectives, and its approach to managing the risks that would affect the capital position.

These disclosures are important to the user's ability to understand the management of capital by the entity, its financial adaptability in changing circumstances, and the resources available to each group of policyholders.

IG3.14 In relation to liabilities arising from long-term insurance business, the entity should include the following additional information:

(a) the process used to determine the assumptions that have the greatest effect on the measurement of liabilities including options and guarantees and, where practicable, quantified disclosure of those assumptions;

(b) those terms and conditions of options and guarantees relating to long-term **insurance contracts** that could in aggregate have a material effect on the amount, timing and uncertainty of the entity's future cash flows; and

(c) information about exposures to interest rate risk or **market risk** under options and guarantees if the entity does not measure these at **fair value** or at an amount estimated using a market-consistent stochastic model.

IG3.15 Although it is important to explain all movements in liabilities and capital during the period that are material to the group, this does not imply that the impact of each change in assumption needs to be shown separately. Where there is a common cause for the change of assumption the impacts can be grouped together. As an example, the impact of changes in **investment return** attributable to changing market circumstances does not need to be broken down between the various classes of investment.

IG3.16 The description of the process would include the objective (whether a best-estimate or a given level of assurance is intended); the sources of data; whether assumptions are consistent with observable market data or other published information; how past experience, current conditions and future trends are taken into account; correlations between different assumptions; management's policy for future **bonuses**; and the nature and extent of uncertainties affecting the assumptions.

IG3.17 Options and guarantees are features of life assurance contracts that:

(a) confer potentially valuable guarantees underlying the level or nature of policyholder benefits; or

(b) are options to change these benefits exercisable at the discretion of the policyholder.

For the purposes of **FRS 103**, the term is used to refer only to those options and guarantees whose potential value is affected by the behaviour of financial variables, and not to potential changes in policyholder benefits arising solely from **insurance risk** (including mortality and morbidity), or from changes in the entity's creditworthiness. It includes a financial guarantee or option that applies if a policy lapses, but does not include the option to **surrender** or allow a policy to lapse.

IG3.18 To comply with paragraph IG3.14(c), an **insurer** should disclose:

(a) a description of the nature and extent of the options and guarantees;

(b) the basis of measurement for the amount at which these options and guarantees are stated, and the amount included, if any, for the additional payment that may arise in excess of the amounts expected to be paid if the policies did not include the option or guarantee feature;

(c) the main variables that determine the amount payable under the option or guarantee; and

(d) information on the potential effects of adverse changes in those market conditions that affect the entity's obligations under options and guarantees.

IG3.19 The requirement of paragraph IG3.18(d) may be met by disclosing:

(a) for options and guarantees that would result in additional payments to policyholders if current asset values and market rates continued unchanged (ie those that are 'in the money' for the policyholder), an indication of the change in these amounts if the variables moved adversely by a stated amount; and

(b) for options and guarantees that would result in additional payments to policyholders only if there was an adverse change in current asset values and market rates (ie those that are 'out of the money' for the policyholder):

(i) an indication of the change in these variables, from current levels, which would cause material amounts to become payable under the options and guarantees; and

(ii) an indication of the amount that would result from a specified adverse change in these variables from the levels at which amounts first become payable under the options and guarantees.

The above disclosures may be made in aggregate for classes of options and guarantees that do not differ materially, or which are not individually material.

IG3.20 The capital statement should show the amount of policyholder liabilities attributed to each section of the business shown in the statement, analysed between:

(a) **with-profits business**;

(b) **linked business**;

(c) other long-term insurance business; and

(d) insurance business accounted for as **financial instruments** in accordance with the requirements of Sections 11 *Basic Financial Instruments* and 12 *Other Financial Instruments Issues* of FRS 102.

The total of these policyholder liabilities should be the amounts shown in the entity's statement of financial position.

Movements in capital

IG3.21 An entity should include a reconciliation of the movements in the total amount of available capital for long-term insurance business shown in the capital statement from the comparative amounts at the end of the previous **reporting period**. This disclosure should cover individually each UK life fund[7] that is separately shown in the capital statement required under paragraph IG3.1, and other long-term insurance business in aggregate.

IG3.22 This disclosure should set out in tabular form the effect of changes resulting from:

(a) changes in assumptions used to measure liabilities from long-term insurance business, showing separately the effect of each change in an assumption that has had a material effect on the group;

(b) changes in management policy;

(c) changes in regulatory requirements and similar external developments; and

(d) new business and other factors (for example changing market prices affecting assets and liabilities, surrenders, lapses and maturities), describing any material items.

IG3.23 In paragraph IG3.22(b) changes in management policy refers to significant changes in the management of the fund such as changes in investment policy or changes in the use of the **inherited estate**. Where management actions are clearly directly related to changes in assumptions or other factors it will be appropriate to show the net impact, but the narrative should discuss the constituent factors. An example might be the combined effect of a reduced level of bonuses assumed as a result of a reduction in the assumed level of future investment return and a reduction in investment returns earned in the period.

[7] Or, for an entity in the Republic of Ireland, each life fund in the Republic of Ireland.

Further copies, £15.00 (post-free) can be obtained from:

FRC Publications
Lexis House
30 Farringdon Street
London
EC4A 4HH

Tel: **0330 161 1234**
Email: **customer.services@lexisnexis.co.uk**
Or order online at: **www.frcpublications.com**

ISBN 978-0-7545-5583-4
9 780754 555834