Statutory Document No. 960/07

INSURANCE ACT 1986

INSURANCE (VALUATION OF LONG TERM LIABILITIES) REGULATIONS 2007

Laid before Tynwald : 15th January 2008
Coming into operation : 31st March 2008

In exercise of the powers conferred on the Insurance and Pensions Authority by section 32 of, and Schedule 4 to, the Insurance Act 1986[a] and of all other enabling powers, and having consulted the Treasury and such other organisations and persons as appear to it to be likely to be affected, the following Regulations are hereby made:-

Citation and commencement

1. These Regulations may be cited as the Insurance (Valuation of Long Term Liabilities) Regulations 2007 and shall come into operation on the 31st March 2008.

Application of these Regulations

2. These Regulations apply in respect of long term business (other than restricted) carried on under the Insurance Act 1986.

General valuation requirements

3. Subject to these Regulations, the amount of liabilities of an insurance company in respect of long-term business (the "long-term liabilities") shall be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance companies. All contingent and prospective long-term liabilities shall be taken into account, together with all liabilities in respect of capital that requires ongoing servicing or is not perpetual.

4. (1) An insurance company which has or may have (following the exercise of any right by a third party) an obligation under a contract other than a long-term business contract to deliver assets or make payments shall identify the assets held by it which it considers most suitable to cover such obligations and make prudent provision for the effect on the excess of its assets over its liabilities of possible adverse variations between the value of the identified assets and the value of its obligations under the contract.

(2) Sub-paragraph (1) does not apply to a contract to the extent that it relates to an investment in land which is to be occupied by the insurer for the conduct of its business.

Price £1.80

[a] 1986 c.24.

5. The determination of the amount of long-term liabilities (other than long-term liabilities which have fallen due for payment before the valuation date) shall be made by the actuary appointed under the Act (the "Actuary") on actuarial principles, having due regard to the fair treatment of policyholders.

6. The amount of the long-term liability determined in respect of a group of contracts shall not be less than such amount as, if the assumptions adopted for the valuation were to remain unaltered and were fulfilled in practice, would enable long-term liabilities similarly determined at all times in the future to be covered from resources arising solely from the contracts and the assets covering the amount of the long-term liability determined at the current valuation.

7. The determination shall take account of all prospective long-term liabilities as determined by the policy conditions for each existing contract, taking credit for contractual premiums payable after the valuation date.

8. Reasonable steps shall be taken to ensure that the data is accurate and complete and where there are doubts as to the accuracy and completeness of the data, a long-term liability shall be held.

Prudence

9. Provision for all long-term liabilities shall be made on prudent assumptions that shall include appropriate margins for adverse deviation of the relevant factors. Each individual assumption shall satisfy the prudence requirement, unless the Actuary is satisfied that in aggregate the assumptions contain sufficient prudence.

10. The appropriate margins for adverse deviation must be sufficiently prudent to ensure that, without taking account of assets in excess of the liabilities so calculated, there is no significant foreseeable risk that long-term liabilities to policyholders will not be met as they fall due.

Method of calculation

11. The amount of the long-term liabilities shall be determined in compliance with these Regulations and shall take into account, inter alia, the following factors:

- (a) all guaranteed benefits, including guaranteed surrender values;
- (b) bonuses or other benefits to which policyholders are already either collectively or individually contractually entitled;
- (c) all options available to the policyholder under the terms of the contract;
- (d) discretionary charges and deductions, in so far as they are consistent with the fair treatment of policyholders;
- (e) all future bonuses or other discretionary benefits consistent with the fair treatment of policyholders and assumed future experience;
- (f) the existing investments and continuing investment policy;
- (g) expenses, including commissions; and
- (h) any rights under reinsurance arrangements.

12. (1) Subject to sub-paragraphs (2) and (3) below, the amount of the long-term liabilities shall be determined separately for each contract by a prospective calculation.

(2) A retrospective calculation may be applied to determine the long-term liabilities where a prospective method cannot be applied to a particular type of contract or benefit, or where it can be

demonstrated that the resulting amount of the long-term liabilities would be no lower than would be required by a prudent prospective calculation.

(3) Appropriate approximations or generalisations may be made where in the Actuary's opinion they provide the same, or a higher, result than individual calculations of the same amount of the long-term liabilities in respect of each contract.

13. A negative reserve may be held in respect of a contract for long-term business, provided this is in accordance with the other Regulations, particularly Regulations 6, 9, 10 and 14.

14. The total long-term liability in relation to each product group must be at least as large as the total surrender value for that product group at the valuation date. While the long-term liability for an individual policy may be lower than its surrender value, prudent allowance should be made for the possibility of the selective voluntary discontinuance of contracts.

15. The determination of the amount of the long-term liabilities shall take into account the relationship between the nature, term and currency of the long-term liabilities and the nature, term and currency of the assets deemed to be held in respect of those long-term liabilities and shall include provision against the effects of possible future changes in the value of the assets and liabilities due to fluctuations in investment conditions and currency movements on:

(a) the ability of the company to meet its obligations arising under contracts for long-term business as they arise; and

(b) the adequacy of the assets to meet the long-term liabilities as determined in accordance with these Regulations.

16. The amount of the long-term liabilities shall take into account all counterparty exposures, including the possibility of default of reinsurers and intra-group counterparties.

Rates of interest, including unit growth rates

17. (1) The rates of interest and unit growth rates to be used in calculating the present value of future payments by or to an insurance company shall be based on the rates of interest determined from a prudent assessment of the yields on existing assets attributed to the long-term business, net of tax and any charges, and, to the extent appropriate, the yields which it is expected will be obtained on sums to be invested in the future, net of tax and any charges.

(2) For the purpose of determining the rates of interest and unit growth rates to be used in valuing a particular category of contracts the assets may, where appropriate, be notionally apportioned between different categories of contracts.

(3) In determining what constitutes a prudent assessment of the net of tax yields on existing assets, the yields should not be less prudent than the yield that could be obtained from risk free investments of a similar term denominated in a similar currency.

(4) The allowance for prudence for each group of contracts in determining the valuation rates of interest in sub-paragraph (3) above shall take the form of an addition or a deduction to the yield, depending on whether the net cash flow being discounted is positive or negative, respectively.

Mortality and morbidity

18. The amount of the long-term liability in respect of any category of contract shall, where relevant, be determined on the basis of prudent rates of mortality and morbidity that have regard to relevant trends in experience within the company and/or market.

Expenses

19. (1) The provision for expenses, whether implicit or explicit, shall be not less than the amount required, on prudent assumptions, to meet the total net cost that would be likely to be incurred in fulfilling existing contracts under the most onerous of the following scenarios:

(a) a going concern basis; and

(b) closure of the company to new business twelve months after the valuation date, in this case also allowing for the acquisition costs incurred.

(2) It must also have regard, inter alia, to the following factors:-

(a) current levels of expenses;

(b) the possibility that preferential service agreements might be altered or terminated;

(c) the effects of inflation on future expenses on prudent assumptions; and

(d) where credit is taken for management actions under the closure scenarios (e.g. transfer of the portfolio to a third party and outsourcing of administration), transitional costs and potential difficulties and delays in effecting these actions.

(3) Where future reductions in expense levels are anticipated, these may be taken into account in the choice of expense assumption only to the extent that the assumption demonstrably satisfies the prudence requirement.

Surrenders and policyholder options

20. Allowance may be made for voluntary discontinuance in determining the long-term liabilities, provided this is in accordance with the prudence requirement.

21. (1) Prudent provision shall be made to cover increases in long-term liabilities caused by policyholders exercising options under their contracts, including, inter alia:

(a) where allowed under the terms of the contract, taking one-off and/or regular withdrawals; and

(b) for regular premium contracts, converting to paid-up status.

(2) In assessing the need for a provision in sub-paragraph (1) above in respect of each policyholder option, a take-up rate of less than 100% may be assumed provided this is consistent with the prudence requirement.

Reinsurance

22. In determining the amount of the long-term liabilities consideration shall be given to the following:-

(a) any financing arrangements under reinsurance contracts; and

(b) the possibility that reinsurance contracts may lapse or prove unenforceable in certain circumstances.

23. Where the company is the reinsurer, and to the extent that it is not already reflected in the financial statements, provision shall be made to cover, inter alia, the following factors:

(a) the portion of premiums already received in respect of periods of cover unexpired at the valuation date;
(b) any liability to make payments in respect of outstanding claims;
(c) any liability to meet claims that may reasonably have been incurred but not yet reported in accordance with the company's experience regarding the notification of claims; and
(d) any sharing of profits with the cedant company.

Non-unit long-term liabilities for Class 1 and Class 10 business

24. In assessing the provision for expenses in accordance with Regulation 11 and Regulation 19, a non-unit long-term liability shall be calculated for each Class 1 and Class 10 contract in accordance with the Regulations relating to methodology and basis assumptions. Non-unit long-term liabilities may be negative provided the total long-term liability established for each contract satisfies the other Regulations, particularly Regulations 6, 9, 10 and 14.

Contingency long-term liabilities

25. In accordance with Regulation 3, and to the extent it is not already reflected in the financial statements, a contingency long-term liability shall be held in relation to:
(a) any litigation, policyholder complaints or other activity that might (on prudent assumptions) lead to policyholder compensation or additional payments being made; and
(b) any other reason that might lead to additional long-term liabilities not explicitly covered by the other long-term liabilities held.

Disclosure

26. The information set out in Schedule 1 shall be included within the Actuary's report produced in accordance with Regulation 11 of the Insurance Regulations 1986[(b)].

Made 12th December 2007

Chairman

[(b)] G.C. 319/86

Regulation 26

SCHEDULE 1

Valuation of Liabilities - Disclosures

1. (1) For each type of contract of insurance business, details of the contract type including:-

(a) a description of the premiums and benefits under the contract, including any discretionary benefits, and how they are determined;

(b) details of the charges including whether or not they may be varied and any restrictions on increases;

(c) any options or guarantees; and

(d) a description of any other features of the contract not disclosed above which are material to the method and basis of valuation.

(2) The information required by sub-paragraph (1) above need not be provided for types of contract where the long-term liabilities at the valuation date in respect of the contract type in question represent less than 1% of the total net of reinsurance long-term liabilities established at the valuation date, unless the Actuary considers that the disclosure is required.

(3) A statement of the proportion of long-term liabilities at the valuation date described in sub-paragraph (1).

2. (1) A breakdown by product at the date of the valuation of the following information:-

(a) number of policies;

(b) annualised premium payable;

(c) benefits currently guaranteed on death;

(d) benefits currently guaranteed at maturity;

(e) unit long-term liabilities; and

(f) non-unit long-term liabilities.

(2) The information provided in (1) shall be shown and totalled separately for:

(a) direct business and reinsurance accepted; and

(b) reinsurance ceded.

3. (1) A detailed description of the method of valuation and details of the valuation assumptions for each product.

(2) The information required by sub-paragraph (1) above need not be provided for types of contract where the long-term liabilities at the valuation date in respect of the contract type in question represent less than 1% of the total long-term liabilities established at the valuation date, unless the Actuary considers that the disclosure is required.

4. The amounts of the following items and a description of their derivation (even if the amount of long-term liability held is zero), including the assumptions underlying the calculation:

(a) long-term liabilities for expenses in the event of closure to new business, including results of the projection carried out;

(b) long-term liabilities for any projected expense overruns, including results of the projection carried out;

(c) long-term liabilities for mismatching between assets and liabilities including currency mismatching;

(d) long-term liabilities for counterparty default risk;

(e) any provision for adverse changes calculated in accordance with Regulation 4; and

(f) any other long-term liabilities not included above or in the breakdown by product.

5. (1) A breakdown of expenses attributable to the long-term business fund in the year preceding the valuation date between one-off, initial and renewal expenses and a description of the method of apportionment used. A comparison of the derived renewal expenses with the valuation loadings for renewal expenses in the previous year.

(2) The information provided in (1) shall apportion expenses between one-off, initial and renewal expenses as follows:

(a) expenses of a non-recurring nature, such as those incurred in developing new systems or new premises, or the costs of corporate restructuring, shall be reported as one-off expenses;

(b) expenses incurred in writing new business (or in obtaining incremental (but not indexed) premiums on existing business), such as underwriting, policy issue, setting up (or amending) records, and the maintenance and development of the sales and marketing function shall be reported as initial expenses; and

(c) all other expenses shall be reported as renewal expenses.

6. A comparison between:

(a) the aggregate amounts arising during the twelve months after the valuation date from implicit and explicit long-term liabilities made in the valuation to meet expenses in fulfilling contracts in force at the valuation date; and

(b) expenses expected to be incurred during the twelve months after the valuation date in respect of fulfilling contracts in force at the valuation date.

7. For each treaty of reinsurance:

(a) whether the company is the cedant or the reinsurer;

(b) the name of the reinsurer (or cedant if appropriate);

(c) whether the company and reinsurer (or cedant if appropriate) are connected;

(d) the nature and extent of the cover given under the treaty;

(e) the premium payable/receivable in the year preceding the date of the valuation;

(f) claims payable/receivable in the year preceding the date of the valuation;

(g) the amount deposited at the date of the valuation in respect of the treaty under any deposit back arrangements;

(h) details of any commission loan advances (or financing payments having an equivalent effect) and outstanding balances;
(i) if the company is the cedant, the extent to which provision has been made for any liability of the company to refund any amounts of reinsurance commission in the event of lapses or surrenders of the contract; and
(j) whether the treaty is open or closed to new business.

8. A statement of any other factors which the actuary considers are material to the present or future valuation of long-term liabilities.

EXPLANATORY NOTE

(This note is not part of the regulations)

These regulations, which come into operation on the 31st March 2008, are made under section 32 of and Schedule 4 to the Insurance Act 1986, to make provision for the valuation of long term insurance liabilities.

The purpose of the regulations is to set out rules for the calculation and disclosure of long term insurance liabilities by the appointed actuaries of Isle of Man insurance companies. The regulations are intended to codify requirements that are, to a large extent, already in place in this regard.

Regulations 1 and 2 provide for the citation, commencement and application of the regulations.

Regulation 3 establishes that generally accepted accounting concepts, bases and policies shall apply to the valuation of long term liabilities.

Regulations 4 to 8 provide that

- The company shall make prudent provision for possible adverse variations in the value of it obligations under insurance contracts and the value of its assets, except in respect of land to be occupied by the insurer.
- The actuary shall have due regard to the fair treatment of policyholders.
- The valuation of liabilities for groups of contracts must be sufficient to avoid any future valuation strain from arising if the assumptions underlying the valuation basis are borne out in practice.
- The actuary may take credit for future premiums due under a contract.
- A provision shall be established if there is uncertainty as to the accuracy or completeness of data used in the valuation.

Regulations 9 and 10 set out the degree of prudence that shall be adopted in performing the valuation.

Regulation 11 sets out a non-exhaustive list of matters to be taken into account in determining the value of liabilities.

Regulation 12 stipulates that, where possible, a prospective calculation method shall be used, unless a non-prospective method can demonstrably produce at least as prudent a result, and that certain approximations may be used if appropriate.

Regulation 13 allows the establishment of negative reserves in respect of long-term business contracts in certain circumstances.

Regulation 14 stipulates that the liability value of a group of contracts must be at least as high as its surrender value.

Regulation 15 requires provision to be made for potential fluctuations between the value of liabilities and the value of assets deemed to be held in respect of them, resulting from differences in their nature, term or currency.

Regulation 16 requires account to be taken of all counterparty exposures.

Regulation 17 sets out how rates of interest and unit growth rates appropriate for use in a valuation calculation shall be determined.

Regulation 18 requires appropriate mortality and morbidity assumptions to be used where relevant.

Regulation 19 sets out the basis for calculating expense reserves, sets out a non-exhaustive list of matters to be considered in calculating expense reserves and places a restriction upon the extent to which credit may be taken for anticipated expense reductions.

Regulations 20 and 21 set out that credit may be taken for voluntary discontinuance of contracts on a prudent basis, and that provision must be made for potential increases in liabilities caused by policyholders exercising options.

Regulations 22 and 23 set out matters that should be considered in assessing the value that can be placed on outward and inward reinsurance arrangements respectively.

Regulation 24 allows the creation of negative non-unit reserves for linked long-term business, subject to defined limitations.

Regulation 25 dictates that a contingency reserve shall, where necessary, be established, and sets out matters that may require the establishment of such a reserve.

Regulation 26 requires the disclosure of matters covered in Schedule 1 to be included in the Actuary’s report.

Schedule 1 sets out the matters required, by Regulation 26, to be included within the Actuary’s report.