SCHEDULE 3

INSURANCE COMPANIES: COMPANIES ACT INDIVIDUAL ACCOUNTS

PART 2

ACCOUNTING PRINCIPLES AND RULES

SECTION E

RULES FOR DETERMINING PROVISIONS

Provisions for claims outstanding

General business

53.—(1) A provision must in principle be computed separately for each claim on the basis of the costs still expected to arise, save that statistical methods may be used if they result in an adequate provision having regard to the nature of the risks.

(2) This provision must also allow for claims incurred but not reported by the balance sheet date, the amount of the allowance being determined having regard to past experience as to the number and magnitude of claims reported after previous balance sheet dates.

(3) All claims settlement costs (whether direct or indirect) must be included in the calculation of the provision.

(4) Recoverable amounts arising out of subrogation or salvage must be estimated on a prudent basis and either deducted from the provision for claims outstanding (in which case if the amounts are material they must be shown in the notes to the accounts) or shown as assets.

(5) In sub-paragraph (4), “subrogation” means the acquisition of the rights of policy holders with respect to third parties, and “salvage” means the acquisition of the legal ownership of insured property.

(6) Where benefits resulting from a claim must be paid in the form of annuity, the amounts to be set aside for that purpose must be calculated by recognised actuarial methods, and paragraph 54 does not apply to such calculations.

(7) Implicit discounting or deductions, whether resulting from the placing of a current value on a provision for an outstanding claim which is expected to be settled later at a higher figure or otherwise effected, is prohibited.

54.—(1) Explicit discounting or deductions to take account of investment income is permitted, subject to the following conditions—

(a) the expected average interval between the date for the settlement of claims being discounted and the accounting date must be at least four years;

(b) the discounting or deductions must be effected on a recognised prudential basis;

(c) when calculating the total cost of settling claims, the company must take account of all factors that could cause increases in that cost;

(d) the company must have adequate data at its disposal to construct a reliable model of the rate of claims settlements;

(e) the rate of interest used for the calculation of present values must not exceed a rate prudently estimated to be earned by assets of the company which are appropriate in

magnitude and nature to cover the provisions for claims being discounted during the period necessary for the payment of such claims, and must not exceed either—

(i) a rate justified by the performance of such assets over the preceding five years, or

(ii) a rate justified by the performance of such assets during the year preceding the balance sheet date.

(2) When discounting or effecting deductions, the company must, in the notes to the accounts, disclose—

(a) the total amount of provisions before discounting or deductions,

(b) the categories of claims which are discounted or from which deductions have been made,

(c) for each category of claims, the methods used, in particular the rates used for the estimates referred to in sub-paragraph (1)(d) and (e), and the criteria adopted for estimating the period that will elapse before the claims are settled.

Long-term business

55. The amount of the provision for claims must be equal to the sums due to beneficiaries, plus the costs of settling claims.

Equalisation reserves

56. The amount of any equalisation reserve maintained in respect of general business by the company, in accordance with the rules in section 1.4 of the Prudential Sourcebook for Insurers made by the Financial Services Authority under Part 10 of the Financial Services and Markets Act 2000(**1**), must be determined in accordance with such rules.

Accounting on a non-annual basis

57.—(1) Either of the methods described in paragraphs 58 and 59 may be applied where, because of the nature of the class or type of insurance in question, information about premiums receivable or claims payable (or both) for the underwriting years is insufficient when the accounts are drawn up for reliable estimates to be made.

(2) The use of either of the methods referred to in sub-paragraph (1) must be disclosed in the notes to the accounts together with the reasons for adopting it.

(3) Where one of the methods referred to in sub-paragraph (1) is adopted, it must be applied systematically in successive years unless circumstances justify a change.

(4) In the event of a change in the method applied, the effect on the assets, liabilities, financial position and profit or loss must be stated in the notes to the accounts.

(5) For the purposes of this paragraph and paragraph 58, “underwriting year” means the financial year in which the insurance contracts in the class or type of insurance in question commenced.

58.—(1) The excess of the premiums written over the claims and expenses paid in respect of contracts commencing in the underwriting year shall form a technical provision included in the technical provision for claims outstanding shown in the balance sheet under liabilities item C.3.

(2) The provision may also be computed on the basis of a given percentage of the premiums written where such a method is appropriate for the type of risk insured.

(3) If necessary, the amount of this technical provision must be increased to make it sufficient to meet present and future obligations.

(**1**) FSA 2006/42.

(4) The technical provision constituted under this paragraph must be replaced by a provision for claims outstanding estimated in accordance with paragraph 53 as soon as sufficient information has been gathered and not later than the end of the third year following the underwriting year.

(5) The length of time that elapses before a provision for claims outstanding is constituted in accordance with sub-paragraph (4) must be disclosed in the notes to the accounts.

59.—(1) The figures shown in the technical account or in certain items within it must relate to a year which wholly or partly precedes the financial year (but by no more than 12 months).

(2) The amounts of the technical provisions shown in the accounts must if necessary be increased to make them sufficient to meet present and future obligations.

(3) The length of time by which the earlier year to which the figures relate precedes the financial year and the magnitude of the transactions concerned must be disclosed in the notes to the accounts.