STATUTORY INSTRUMENTS

1993 No. 2520

The Friendly Societies (Insurance Business No. 2) Regulations 1993

PART V

DETERMINATION OF LIABILITIES

Interpretation: Part V

32. In this Part of these Regulations–

"long term liabilities" means liabilities of a society arising under or in connection with contracts for long term business including liabilities arising from deposit back arrangements;

"the valuation date", in relation to an actuarial investigation, means the date to which the investigation relates.

Application: Part V

33. This Part of these Regulations applies with respect to the determination of the amount of liabilities of a friendly society for the purposes of–

(a) section 48 of the 1992 Act;

(b) any actuarial investigation to which section 46 or 47 of the 1992 Act applies; and

(c) such other actuarial investigation as may be required by the Commission in the exercise of its powers under Part V of the 1992 Act.

Long term and general business

34.—(1) Subject to this Part of these Regulations, the amount of liabilities of a society in respect of long term and general business and other lawful activities shall be determined in accordance with generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance business.

(2) In determining under paragraph (1) above the amount of liabilities of a society, all contingent and prospective liabilities shall be taken into account.

Long term liabilities

35. The determination of the amount of long term liabilities (other than liabilities which have fallen due for payment before the valuation date) shall be made on actuarial principles and shall make proper provision for all liabilities on prudent assumptions in regard to the relevant factors; and the amount of the liability for each category of contract shall not be less than the amount calculated in accordance with regulations 36 to 45 below in so far as they are applicable.

Nature and term of assets

36. The determination of the amount of long term liabilities shall take into account the nature and terms of the assets representing the long term business funds and the value placed upon them and shall include appropriate provision against the effect of possible future changes in the value of the assets on their adequacy to meet the liabilities.

Avoidance of future valuation strain

37. The amount of the 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 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 liability determined at the current valuation.

Valuation of future premiums

38.—(1) Subject to paragraph (4) below, where further specified premiums are payable by the policyholder under a contract under which benefits (other than benefits arising from a distribution of surplus) are determined from the outset in relation to the total premiums payable thereunder, then, subject to regulation 39 below–

(a) where the premiums under the contract are at a uniform rate throughout the period for which they are payable, the premiums to be valued shall not be greater than such level premiums as, if payable for the same period as the actual premiums under the contract and calculated according to the rates of interest and rates of mortality or disability which are to be employed in calculating the liability under the contract, would have been sufficient at the outset to provide for the benefits under the contract according to the contingencies upon which they are payable, exclusive of any additions for profits, expenses or other charges;

(b) where the premiums under the contract are not at a uniform rate throughout the period for which they are payable, the premiums to be valued shall not be greater than such premiums as would be determined on the principles set out in subparagraph (a) above modified as appropriate to take account of the variations in the premiums payable by the policyholder in each year;

save that a premium to be valued shall in no year be greater than the amount of the premium payable by the policyholder.

(2) Where the terms of the contract have changed since the contract was first made (the terms of the contract being taken to change for the purposes of this paragraph if the change is indicated in an endorsement on the policy but not if a new policy is issued), then, for the purposes of paragraph (1) above it shall be assumed that those changes from the time they occurred were provided for in the contract at the time it was made.

(3) Subject to paragraph (4) below, where under a contract–

(a) each premium paid increases the benefits (other than benefits arising from a distribution of surplus) provided under the contract, or

(b) the amount of a premium payable in future is not determinable until it comes to be paid,

future premiums and the corresponding liability may be left out of account so long as adequate provision is made against any risk that the increase in the liabilities of the society resulting from the payment of future premiums might exceed the amount of the premiums.

(4) The provisions of this regulation do not apply to a contract which is a linked long term contract, a permanent health contract, or a contract whose principal object is permanent health insurance but which contains related and subsidiary provisions for life or birth insurance business.

Acquisition expenses

39.—(1) In order to take account of acquisition expenses, the maximum annual premium to be valued under regulation 38 above may (subject to paragraph (2) below) be increased by an amount not greater than the equivalent, taken over the whole period of premium payments and calculated according to the rates of interest and rates of mortality or disability employed in valuing the contract, of 3.5 per cent (or the defined percentage, if it is lower than 3.5 per cent) of the relevant capital sum under the contract.

(2) For the purposes of paragraph (1) above "the defined percentage" is the percentage arrived at by taking (for all contracts of the same type as the contract in question for which an adjustment is made) the average of the percentages of the relevant capital sum under each such contract that represent the acquisition costs for which, after allowing for the effects of taxation, allowance is made in the premiums.

(3) The increase permitted by paragraph (1) above shall be subject to the limitation that a premium to be valued shall in no year be greater than the amount of the premium payable by the policyholder.

(4) For the purposes of this regulation–

(a) for contracts other than temporary assurances, the relevant capital sum under a contract shall be arrived at in accordance with regulation 10(4) above, and

(b) for temporary assurances, the relevant capital sum shall be the sum assured on the valuation date.

Rates of interest

40.—(1) In determining the rates of interest to be used in calculating the present value of future payments by or to a society, regard shall be had to the yields on the existing assets attributed to the long term business and, to the extent appropriate, to the yield which it is expected will be obtained on sums to be invested in the future.

(2) For the purposes of paragraph (1) above, the assumed yield on an asset attributed to the long term business, before any adjustment to take account of the effect of taxation, shall not exceed the yield on that asset calculated in accordance with paragraphs (3) to (6) below, reduced by 7.5 per cent of that yield.

(3) For the purpose of calculating the yield on an asset–

(a) the asset shall be valued in accordance with Part IV of these Regulations, excluding any provision under which assets may be taken at lower book values for the purposes of an investigation to which section 46 of the 1992 Act applies; and

(b) where a particular asset is required to be taken into account only to a specified extent by the operation of regulation 31 above, the future income to be taken into account (whether interest, dividends or repayments of capital) shall be correspondingly reduced.

(4) For fixed interest investments (that is to say, investments which are fixed interest securities as defined in regulation 19(1) above) the yield on an asset, subject to paragraph (6) below, shall be that annual rate of interest which, if used to calculate the present value of future payments of interest before the deduction of tax and the present value of repayments of capital, would result in the sum of those amounts being equal to the value of the asset.

(5) For variable interest investments (that is to say, investments which are not fixed interest securities as defined in regulation 19(1) above) the yield on an asset, subject to paragraph (6) below, shall be the ratio to the value of the asset of the income before deduction of tax which would be received in the period of twelve months following the valuation date on the assumption that the assets will be held throughout that period and that the factors which affect income will remain unchanged, so however that account shall be taken of any changes in those factors known to have occurred by the valuation date and in particular, without prejudice to the generality of the foregoing, of–

(a) any known changes in the rental income from property or in dividends on equity shares,

(b) any forecast changes in dividends which have been publicly announced by the valuation date,

(c) the effect of any alterations in capital structure, and

(d) the value (at the most recent date for which it is known at the valuation date) of any determinant of the amount of any future interest payment, the said value being deemed to remain unaltered for all subsequent dates.

(6) In calculating the yield on an asset under this regulation–

(a) if the asset does not consist of equity shares or land–

(i) an adjustment shall be made to exclude that part of the yield estimated to represent compensation for the risk that the income from the asset might not be maintained or that capital repayments might not be received as they fall due, and

(ii) in making that adjustment, regard shall be had wherever possible to the yields on risk–free investments of a similar term in the same currency;

(b) for assets which are equity shares or land, adjustments to yields shall be made as appropriate to exclude that part, if any, of the total yield from those assets, taken together, that is needed to compensate for the risk that the aggregate income from those assets taking one year with another might not be maintained, so however that the yield assumed on an asset shall not be greater than that on British Government 2 ½ % Consolidated Stock on the valuation date.

(7) To the extent that it is necessary to make an assumption about the yields which will be obtained on sums to be invested in future, the yield assumed on any investment to be made more than three years after the valuation date shall not exceed 7.2 per cent per annum before any adjustment to take account of the effect of taxation.

(8) In no case shall a rate of interest determined for the purposes of paragraph (1) above exceed the adjusted overall yield on assets calculated as the weighted average of the reduced yields on the individual assets arrived at under paragraph (2) above; and when that weighted average is calculated–

(a) the weight given to each investment shall be its value as an asset determined in accordance with Part IV of these Regulations, excluding any provision under which assets may be taken at lower book values for the purposes of an investigation to which section 46 of the 1992 Act applies, and

(b) except in relation to the rate of interest used in valuing payments of property linked benefits (as defined in regulation 19(1) above), both the yield and the value of any linked assets (as so defined) shall be omitted from the calculation.

(9) For the purpose of determining the rates of interest to be used in valuing a particular category of contracts the assets may, where appropriate, be notionally apportioned between different categories of contracts and in such cases the limit under paragraph (8) above shall be applied on the basis of the overall yield on the assets apportioned to the contracts in question.

Rates of mortality and disability

41. The amount of the liability in respect of any category of contract shall, where relevant, be determined on the basis of appropriate rates of mortality and disability that take into account–

(a) relevant published tables of rates of mortality and disability, and

(b) the rates of mortality and disability experienced in connection with any similar contracts issued by the society in the past.

Expenses

42.—(1) Provision shall be made for meeting the expenses likely to be incurred in future in fulfilling the existing contracts, taking account of the effect of taxation as appropriate, but credit may be taken to the extent appropriate for the fractions of future premiums left out of account pursuant to regulation 38(1) above.

(2) The provision mentioned in paragraph (1) above shall have regard to, among other things, the society's actual expenses in the last twelve months before the valuation date and the contingency that the society may cease to transact new business.

Options

43.—(1) Provision shall be made to cover any increase in liabilities caused by policyholders exercising options under their contracts.

(2) Where a contract includes an option whereby the policyholder could secure a guaranteed cash payment within twelve months following the valuation date, the provision for that option shall be such as to ensure that the value placed on the contract is not less than the amount required to provide for the payments that would have to be made if the option were exercised.

Contracts not to be treated as assets

44. No contract for long term business shall be treated as an asset.

No credit for profits from voluntary discontinuance

45. Allowance shall not be made in the valuation for the voluntary discontinuance of any contract if the amount of the liability so determined would thereby be reduced.