EXPLANATORY NOTE

(This note is not part of the Regulations)

The Friendly Societies Act 1992 ("the 1992 Act") provides for the establishment of a new type of friendly society, the incorporated friendly society. These Regulations apply to incorporated friendly societies which carry on insurance business. They do not apply to friendly societies which remain registered under the Friendly Societies Act 1974.

These Regulations implement for incorporated friendly societies provisions of (a) the First Council Directive on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance, Directive 79/267/EEC (O.J. No. L63, 13.3.79, p.1); (b) the First Council Directive on the co-ordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct insurance other than life assurance, Directive 73/239/EEC (O.J. No. L228, 16.8.73, p.3); and (c) the Second Council Directive on the co-ordination of laws, regulations and administrative provisions relating to direct insurance other than life assurance and laying down provisons to facilitate the effective exercise of freedom to provide services and amending Directive 73/239/EEC, Directive 88/357/EEC (O.J. No. L172, 4.7.88, p.1).

The Regulations are divided into seven Parts: Part I contains the usual preliminary provisions as to citation and interpretation; Part II deals with margins of solvency; Part III deals with matching and localisation; Parts IV and V set out the rules to be applied in valuing assets and determining liabilities; Part VI makes special provision for linked long term contracts; and Part VII contains final provisions of a miscellaneous nature.

Part I is largely self-explanatory. Regulation 1 provides that the Regulations apply to incorporated societies from 19th February 1993.

In Part II, regulation 4 deals with the margins of solvency to be maintained by incorporated friendly societies. Regulation 4 is made under section 48 of the 1992 Act, which provides for the amount of the margin to be prescribed by or determined in accordance with regulations. The margin for the various classes of long term business is to be determined in accordance with the detailed rules in Schedule 1. The margin for general business is the higher of the results given by the methods of calculation set out in Schedules 2 and 3 respectively. Regulation 5, which is made under section 49 of the 1992 Act, sets out the minimum level of the margin of solvency. Regulation 5 refers to that level as the "guarantee fund" which is defined as one-third of the required margin of solvency subject in any event to a minimum amount referred to as the "minimum guarantee fund". The minimum guarantee fund is arrived at in accordance with regulation 6 with respect to long term business and regulation 7 for general business. The guarantee fund therefore cannot be quantified until the required margin of solvency has been calculated. If the margin of solvency falls below the guarantee fund, the Commission may request the society concerned to submit a short-term financial scheme to restore the position (section 49 of the 1992 Act). Regulation 5(3) limits the extent to which implicit items may be taken into account in the composition of the guarantee fund and minimum guarantee fund for long term business. Implicit items are future surpluses, zillmerising and hidden reserves, as provided in regulations 8-11 which are valuation regulations made under section 45 of the 1992 Act.

Regulations 12 to 18 in Part III are necessary to implement the above-mentioned directives as regards matching and localisation. Matching means holding assets in a currency appropriate to the society's liabilities, and localisation means holding those assets in the country appropriate to them.

Parts IV and V are valuation regulations made under section 45 of the 1992 Act. They are essentially adaptations of Parts V and VI of the Insurance Companies Regulations 1981. Part IV is intended

to ensure a satisfactory spread of assets by requiring that any asset, the valuation of which is not provided for in the Regulations, is to be left out of account altogether, and assets of a description specified in Schedule 5 may be taken into account only within the limits specified in that Schedule; this is consistent with similar provision applying to insurance companies. Regulations 21 and 22 make provision for valuation of shares in and debts due from dependants. Dependants are defined as subsidiaries of, or bodies jointly controlled by, an incorporated friendly society within the meaning of section 13 of the 1992 Act. Part V contains, in regulation 38, provision for valuation of future premiums by the net premium method, subject to the exclusion of certain types of sickness insurance carried on by Holloway and other societies, to which the net premium method is not appropriate.

In Part VI, regulation 47 makes provision for all long term linked contracts entered into by incorporated societies (including those entered into prior to the coming into force of these Regulations) other than contracts expressly excluded by regulation 47(4) and is made under section 56 of the 1992 Act.

Part VII contains miscellaneous provisions. Regulation 48 (in conjunction with section 46(1)(a) of the 1992 Act) ensures that all incorporated societies carrying on long term business are required to carry out annual actuarial investigations into their financial condition. Regulation 49 prescribes the persons required to sign one copy of the abstract of the actuary's report for the purposes of section 46(3) of the 1992 Act.