PRA RULEBOOK: SOLVENCY II FIRMS: SURPLUS FUNDS INSTRUMENT 2015

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137G (the PRA's general rules); and
(2) section 137T (general supplementary powers).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (consultation with the Financial Conduct Authority), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Solvency II Firms: Surplus Funds Instrument 2015

D. The PRA makes the rules in the Annex to this instrument.

Commencement

E. This instrument comes into force on 1 January 2016.

Citation

F. This instrument may be cited as the PRA Rulebook: Solvency II Firms: Surplus Funds Instrument 2015.

By order of the Board of the Prudential Regulation Authority
17 March 2015

Annex

In this Annex, the text is all new and is not underlined.

Part

SURPLUS FUNDS

Chapter content

Links

1 APPLICATION AND DEFINITIONS

1.1 Unless otherwise stated, this Part applies to a *UK Solvency II firm* carrying on *with-profits insurance business*.

1.2 In this Part, the following definitions shall apply:

surplus funds

means, in relation to a *with-profits fund*, accumulated profits which have not been made available for distribution to policyholders or other *beneficiaries* and which:

(1) satisfy the criteria for classification as *Tier 1 own funds* set out in Own Funds 3.1; and

(2) are represented by the output of the calculations set out in 3.

with-profits assets

means the assets in a *with-profits fund* except those meeting liabilities in respect of non-profit insurance.

2 SURPLUS FUNDS AND TECHNICAL PROVISIONS

2.1 A *firm* shall not treat *surplus funds* as insurance and *reinsurance* obligations when valuing payments to *policyholders* and *beneficiaries* in the calculation of *technical provisions* in accordance with Technical Provisions 2.

[Note: Art. 78(3) and Art. 91(2) of the *Solvency II Directive*]

2.2 In order to comply with 2.1, a *firm* must calculate the amount, if any, of its *surplus funds* in accordance with 3.

3 CALCULATION OF SURPLUS FUNDS

3.1 A *firm* must calculate the amount (if any) of its *surplus funds* in relation to each of its *with-profits funds* as follows:

(1) the value of *with-profits assets;*

less

(2) the value of *with-profits policy liabilities;*

less

(3) the amount of any tax or other costs which will arise on the recognition of future shareholder transfers properly attributable to that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*, to the extent that such amounts are not included in (2);

less

(4) the value of any other liabilities (not being liabilities attributable to *with-profits policies* or any other policies in the *with-profits fund*) properly attributable to that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook;* and

less

(5) the value attributable to any future shareholder transfers (calculated by reference to the benefits referred to in 3.5(3) and in a manner consistent with the method of calculation specified in 3.4) relating to *with-profits polices* in that *with-profits fund* which may properly be made out of that *with-profits fund* in accordance with any relevant provisions of the *FCA Handbook*.

3.2 A *firm* must value its *with-profits policy liabilities* (other than *future policy-related liabilities*) in accordance with 3.3 unless:

(1) valuation under 3.3 does not adequately reflect the value of some or all of such liabilities; or

(2) the *firm* can demonstrate that valuation under 3.3 is impracticable in respect of some or all of such liabilities;

in which case the *firm* must value such liabilities in accordance with 3.4.

3.3 Unless the circumstances set out in 3.2 apply, a *firm* must calculate the value of its *with-profits policy liabilities* (other than *future policy-related liabilities*) as the aggregate of the retrospective value, in respect of each *with-profits policy,* of the following (treating items that increase the future liability to *policyholders* as positive values and treating items that reduce the future liability to *policyholders* as negative values):

(1) *premiums* received;

(2) any investment income on, and any increases (or decreases) in, asset values;

(3) any amounts representing permanent enhancements which the *firm* will take into account when determining the benefits ultimately payable;

(4) any past miscellaneous surplus (or deficit) which has been allocated;

(5) any expenses incurred (or deductions made in respect of expenses);

(6) any past deductions for the cost of guarantees and smoothing, options and provision of life cover and any other benefits provided;

(7) any partial benefits paid or due (other than benefits in respect of which deductions have been made under (6));

(8) any tax paid or payable which is properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook;*

(9) any amounts received (or paid) under contracts of *reinsurance* or arrangements which have a similar financial effect, which relate to that *with-profits policy* (other than in respect of benefits for which deductions have been made under (6)); and

(10) any past shareholder transfers which are properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook,*

but deducting from that aggregate value any implicit allowance for the value of future shareholder transfers.

3.4 Where the circumstances set out in 3.2 apply, a *firm* must calculate the value of its *with-profits policy liabilities* (other than *future policy-related liabilities*) on a prospective basis as the aggregate of the net present values of the following expected future cash-flows in respect of each *with-profits policy*:

(1) future *premiums*;

(2) expenses expected to be incurred (or deductions expected to be made in respect of expenses);

(3) planned deductions for the cost of guarantees and smoothing, options and provision of life cover and any other benefits;

(4) any benefits payable of the type (or substantially similar to the type) specified in 3.5;

(5) any amounts receivable (or payable) under contracts of *reinsurance* or arrangements which have a similar financial effect which relate to that *with-profits policy* but excluding amounts in respect of benefits:

(a) which have been allowed for under (3); or

(b) for which deductions have previously been made with the result that they do not fall under (3); and

(6) tax payable which is properly attributable to that *with-profits policy* in accordance with any relevant provisions of the *FCA Handbook*.

3.5 The benefits referred to in 3.4(4) are:

(1) all guaranteed benefits, including amounts guaranteed to be payable on death and maturity (or on other events), guaranteed surrender values and paid-up values;

(2) declared bonuses to which the *policyholder* is contractually entitled; and

(3) future discretionary additions to guaranteed benefits and discretionary payments, in addition to the guaranteed benefits, which are expected to be made when the benefits under the *with-profits policy* becomes payable but only if and to the extent they are additions to benefits or payments which, if the *firm* had been able to effect the calculation required by 3.3, are consistent with those for which allowance would have been made in accordance with that calculation.

3.6 A *firm* must not attribute any charges to a *with-profits policy* for the purposes of this Part unless permitted to do so by any relevant provisions of the *FCA Handbook.*

4 CONSISTENCY OF CALCULATION

4.1 A *firm* must ensure that the valuations included in the calculations required to be carried out in accordance with 3.1 are consistent with the valuation methodologies adopted for the calculation of its *technical provisions* in accordance with Technical Provisions 2.