Financial Services Commission

Insurance Guidance Note No. 4

Insurance Companies Ordinance 1987

Valuation Of Assets

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Introduction

1. These notes provide guidance on the Insurance Companies (Valuation of Assets and Liabilities) Regulations 1996 ("the 1996 Regulations") as they now stand since being amended by the Insurance Companies (Valuation of Assets and Liabilities) (Amendments) Regulations 1997 ("the Amendments"). They have been prepared to assist insurance companies, their auditors and others who may be concerned in the application of the legislation relevant to the valuation of assets of insurance companies for the purposes of demonstrating coverage of the technical reserve and the solvency margin. It is not possible to cover all possible situations in these guidance notes but we have aimed to expand on the more general areas and common difficulties.

2. The notes should not be regarded as a substitute for reading the Regulations and taking your own professional advice. They deal with the valuation and admissibility of assets but do not address how these items should be reported in the Annual Returns.

3. The guidance notes do not specifically cover the determination of liabilities, but in some cases the general principles on asset valuation will apply equally to liabilities, and reference is made where relevant.

4. The Commissioner of Insurance ("the Commissioner") considers this guidance is relevant for the purposes of the Directors' certificate required under paragraph 7 of Schedule 5 to the Insurance Companies (Accounts and Statements) Regulations 1996.

Overview Of The Regulations

5. The valuation rules are set out in the 1996 Regulations (Legal Notice No 68 of 1996), as amended. A consolidated version of the Regulations as they now stand is available on the FSC's internet. (http://www.gibraltar.gi/fsc).

6. The broad purposes of the 1996 Regulations are to establish broad standards of the valuation of assets and to ensure that companies maintain a prudent spread of investments. It is not the intention to impose strict requirements upon what insurers can and cannot invest in.

7. The valuation rules have remained largely unaffected by the Amendments. The main change is that the admissibility rules, as set out in regulation 15 of, and Schedule 1 to, the 1996 Regulations, have been completely replaced. The main reasons for changes to the structure of the admissibility rules have been:

   - to improve clarity where aggregate exposure rules interact, and
   - the need to take account of new investment products and other developments since the previous set of rules were devised.

8. Complementing the revision to the admissibility rules are a number of changes to address problems which arose under the 1996 Regulations in respect of the admissibility and valuation of certain investments, namely Traded debt securities ("Eurobonds") and Unlisted Securities. The changes are explained more fully in the section on Valuation Rules, but in essence the main reasons for the changes to these specific areas were:

   - Eurobonds - the uncertainty over the admissibility of "Eurobonds" has been addressed. The treatment of the "Eurobond" under the asset valuation rules ("the AVRs") has been modified so that its admissibility is no longer dependent on the type of market through which it is traded.

- Unlisted Securities - the 1996 Regulations often provided an unintentionally harsh result for the valuation of unlisted securities. The new rules bring the valuation more into line with methodologies applied in the preparation of shareholder accounts and allow the companies to apply generally accepted accounting principles to reach a valuation.

9. The basis approach of the AVR's is as follows:

- STEP 1

  - determine how the asset is to be defined under the regulations. A number of definitions do not strictly accord with common parlance.

- STEP 2

  - apply a series of rules, based on prudent valuation methods to determine the value of the asset which would be realised in an orderly run-off. The valuation methods will in many cases differ from that used for accounts purposes which are drawn up on the basis that the company is a going concern. It should be noted that if there is no valuation rule explicitly mentioned in the regulations for a particular asset (e.g. for gold) then a nil value should be ascribed.

- STEP 3

  - apply the admissibility rules to determine how much of the value determined in Step 2 can be included within the solvency margin calculation. The new admissibility rules introduced by the Amendments supply a 'menu-style' set of instructions which detail the admissibility restrictions which are to apply on the exposure to each asset, investment, or counterparty. This particular area can be intricate and consequently the section on Admissibility Limits concentrates on this aspect.

This admissibility limits approach is complemented by the general principle of section 64B of the Insurance Companies Ordinance 1987 ("the Ordinance") which requires companies to cover their liabilities with assets with adequate diversification and of appropriate safety, yield and marketability. It should be noted that compliance with the admissibility limits does not necessarily mean automatic compliance with section 64B. Companies will need to consider separately whether the requirements of section 64B are met.

10. The detailed AVRs are set out in Part II of the 1996 Regulations, although some aspects of Part III (which deals with the determination of liabilities) are also relevant - primarily in relation to derivative instruments which are capable of being either an asset or a liability. For property linked assets, none of the AVRs apply - since the liability to policy holders is matched by whatever value is placed on the linked assets. Instead, there are restrictions on what investments linked funds can make. Insurance Guidance Note No. 12 provides guidance on linked contracts.

Schedule 3 Amendments

11. The Amendments introduce a revised Schedule 3 listing the assets by reference to which policyholder benefits under long term linked contracts of insurance may be determined. There are no significant changes of principle; the reason for amending the new Schedule 3 is to keep it consistent with the asset descriptions and cross-references which occur elsewhere in the AVRs following the changes.

Section 113 Concessions

12. At times, strict application of the AVR's may produce an unintentionally harsh result for an individual company. When this occurs, the Commissioner may consider a request to issue an order under section 113 of the Ordinance to modify their application. There is no guarantee that such a concession will be granted and it may be given only on a temporary basis and, possibly, with conditions attached. Indeed, where the AVR's derive directly from the detailed requirements of the Third Insurance Directives, the Commissioner is unable to grant a concession except "in exceptional circumstances ..... temporarily and under a proper reasoned decision".

Step 1 - Definitions And General Interpretation

13. Regulation 2 lists most of the definitions which are used to interpret the AVRs generally. The definitions which deal more specifically with admissibility limits are mainly included within the revised Schedule 1. In a number of cases, the definitions in regulation 2 may not strictly accord with market parlance. Care must therefore be taken to ensure that the asset is correctly defined under the AVRs since this may have an important impact on the valuation and/or admissibility of the asset. Attention is drawn in particular to the following items:-

Approved/Regulated Institutions

14. There are definitions for a number of different types of institution, and admissibility limits grade the level of debt that can be accumulated with any one institution according to the type of institution. The different types of institution in order of credit "grading" are:-

- "approved financial institutions" - are listed in regulation 2 and are largely European central banks. The definition is used in part to define approved securities.
- "approved securities" - are essentially limited to government securities and deposits with approved financial institutions. Only securities backed by governments/public authorities of countries classified as "Zone A" are included. Debt securities issued by certain supra national authorities are also included. Securities issued by Zone A countries are all countries which are full members of OECD, together with those countries which have concluded special lending arrangements with the International Monetary Fund associated with the General Agreement to Borrow. It follows that Government securities from "non Zone A" countries are subject to the general debt rules.
- "approved credit institutions" - are essentially banks and building societies authorised under the second banking co-ordination directive. A credit institution is also an approved counterparty and also a regulated institution.
- "approved counterparties" - are essentially approved credit institutions plus certain investment firms authorised to engage in wholesale market activities or derivative transactions. For the purposes of calculating aggregate exposure for the admissibility limits, the term "counterparty" has been given its own definition.
- "regulated institutions" - include the above approved credit institutions (including friendly societies) plus all authorised insurance companies regulated in the EEA and approved investment firms. As a

general rule, the vast majority of "approved counterparties" will also fall under the definition of a regulated institution.

- "approved investment firms" - are those firms regulated under the EC Investment Services directive.

Listed Securities

15. The Amendments introduce a revised definition of listed (and hence unlisted) which is now closer to common parlance and is wider than the previous definition. Investments will be defined as "listed" provided they are either officially listed on an EEA stock exchange or the investments have the facility to be traded on a regulated market. A regulated market is further defined in Regulation 2 in terms of criteria which must be satisfied. It is for the directors and auditors to satisfy themselves that these criteria have been met. Key factors which the Commissioner considers relevant for insurers are set out in appendix D.

16. If an investment falls within the definition of "listed" in regulation 2 but is, in practice, rarely traded, then it is likely that the company will need to look to see whether the investment can be deemed to be "readily realisable". If a listed investment is not deemed to be "readily realisable", then it shall be treated as though it were unlisted. In essence, the rationale is to distinguish between securities which can be disposed of at a price reasonably close to the market value from those which are so rarely traded that they are likely to be disposed of at a discount to the quoted market price. Dealings will therefore need to be frequent enough to be able to satisfy this test. These principles are discussed in the section on Valuation Rules.

Hybrid Securities

17. Those debt securities, other than "approved securities", which are akin to equity and are characterised by being either irredeemable or subject to long period repayment terms, may fall within the definition of hybrid securities in Part I of Schedule 1.

18. If this is the case, the company's holding of such debt securities will be treated under the valuation and admissibility rules in the same way as a holding in equity shares.

19. Subordinated debt securities will now fall under the definition of hybrid securities. Because of the nature of a subordinated debt, the debt will not be entitled to be repaid until all claims from the general creditors have been settled. Since, therefore, the holder of subordinated debt security does not possess an unconditional right to payment, subordinated debt securities fall within the definition of hybrid security in Part I of Schedule 1.

Linked Assets

20. The definition of linked assets refers only to assets held by an insurance company and identified in its records as assets by reference to which property linked benefits are to be determined (the term 'property' in this context is wider than just land and buildings); it does not refer to assets held to cover index-linked benefits. The Amendments introduce within Part I of Schedule 1 a definition of 'property linked liabilities'. The AVRs allow index-linked assets to be treated as non-linked assets, although they are exempt from some of the admissibility limits by virtue of regulation 15(6). Further guidance on the difference between index-linked and property-linked contracts is contained in Insurance Guidance Note No. 12.

Stock Lending and Repo

21. The definition of a stock lending transaction has been removed and substituted by a generic description which will also apply to Repo transactions. This allows stock lending and Repo transactions to be treated on the same footing. Further details of the basic principles and treatment are set out in the following section on Valuation Rules.

Step 2 - Valuation Rules

General Principles

22. The valuation rules have remained largely unaffected by the Amendments. Unless a specific valuation rule is prescribed in the regulations (other than cash which is assigned its face value), then no value can be given. Cash in this context is limited to cash in hand i.e. notes and coins - it does not include cash at bank. Cash deposited at a bank, for the purpose of the AVRs, is treated as a debt due from the bank.

23. Examples of assets which have no value under the AVRs include gold and other commodities, goodwill, expected allocations to shareholders from future life fund surpluses, and tax 'credits' recoverable only against tax on future profits.

24. There are two types of valuation rules; those that require the asset to be valued as at a prescribed amount (e.g listed securities valued at their market value); and those which specify that the value shall be "not greater than" a certain amount (e.g land valued at an amount not greater than the most recent proper valuation). There is, however, an overriding rule for all valuations (Regulation 3(4)) which requires that a lesser value must be taken if the value prescribed by the regulations is unlikely to be realisable. In determining whether or not a lesser value should be taken, regard must be taken of the underlying security of the asset and, if a debt, the credit standing of the counterparty.

Post Balance Sheet Events

25. In normal circumstances, the Annual Return for an insurance company is based on the information included in the statutory accounts which the directors have approved and which the auditor has reported on at a particular date. If, however, there has been a post balance sheet event before the date the Annual Return is signed which is of such significance that it materially affects the view shown by the return, then the return should be adjusted and the reasons for the adjustment disclosed in the notes to the return. This will obviously apply in cases where either the value of assets or liabilities of the company are affected.

26. The extent of the post balance sheet review required between finalisation of the accounts and returns will be a matter of judgement, but the Commissioner considers it appropriate that the general principles contained in Gibraltar Financial Reporting Standard No. 17 should be applied. Where a post balance sheet general business liability is identified, the Commissioner might be prepared to accept an additional amount to be disclosed as a one line entry on the balance sheet forms of the Annual Return (with appropriate explanation in the notes) without an adjustment to all the detailed analysis forms.

Shares In And Debts Due From Dependants

27. Guidance on the application of the requirements for the valuation of shares in and debts due to a Group Undertaking is contained in Appendix C.

Debts, Deposits And Other Rights

32. As with all other types of asset, the 3 step approach to debt, deposits and other rights is required.

- Categorise the type of debt and other rights under one of the definitions within regulations 2 and 7.
- Value the debt and other rights must be valued by applying regulation 7.
- Determine the amount which can be taken into account for solvency purposes by applying the admissibility rules.

The key elements of the rules are described below and worked examples are given in appendix A.

33. The term 'debt' covers a wide variety of rights which are legally debts although not always recognised as such. Such items may include accrued interest and rents receivable. Certain debts are given a higher admissibility limit than others and this is dealt with in greater detail in the section on Admissibility Limits (see para. 108). The valuation rules are separate from the reporting rules which are found in the Insurance Companies (Accounts and Statements) Regulations 1996 and it is important to remember that other items which may not necessarily be disclosed in the Annual Return as a debt fall under the debt valuation rules.

Off-Set

34. The valuation and admissibility limits relating to debts, including reinsurers share of the technical account, are normally considered on a gross basis unless there is any legally enforceable right of off-set. For example, debts due from one counterparty would normally be valued gross of any amounts due by the insurance company to that counterparty.

35. To the extent that regulation 18 (valuation of liabilities in accordance with generally accepted accounting practice) applies, further guidance can be obtained from Financial Reporting Standard No. 5 (FRS 5). The key tests which must be satisfied before assets and liabilities can be offset are set out in paragraph 29 of FRS 5 which is:-

(a) the insurer and the counterparty owe each other determinable monetary amounts which are denominated in the same currency or readily convertible; and

(b) the insurer has the ability to insist on net settlement and can enforce a net settlement in all situations of default by the counterparty; and

(c) the ability to insist on net settlement is assured beyond doubt and can survive insolvency of the other party.

From these conditions it is clear that debts will not normally be able to be off-set against claim or other provisions. In particular, in relation to derivatives, the provisions for adverse changes cannot be offset against debts due from an approved counterparty since the provision for adverse changes is not a determinable amount owed to the other party, i.e. it fails test (a) above.

Basic Valuation Rule

36. Similar valuation rules apply for both secured and unsecured debts. The rules differ only by the fact that, for secured debts, due account should be taken of the quality and nature of the security. The AVRs then distinguish between the timing of the debt, as follows:

Length of debt	Valuation rule
due within 12 months	amount that can reasonably be expected to be recovered
due in more than 12 months	immediate assignment value

"Immediate assignment" value does not necessarily mean that there must be a specific buyer for the debt identified but that it would be possible to find someone to assign the debt to immediately. It will also mean that, in valuing the debt, account should be taken of the true value of money which can reflect the period of the debt, interest rates, status of the borrower and any other relevant conditions. Unlisted, unsecured deep discount or zero coupon bonds will certainly need to be discounted in order to arrive at a realistic assignment value.

Reinsurance Recoveries/Debts

37. In the past, all rights and debts under a contract of reinsurance were fully admissible. The Amendments introduce a set of rules, as regulation 7(5) & (5A), which distinguish between differing types of reinsurance recoveries for long term business. The distinction is made between debts actually due at the relevant date (which will include, in the main, reinsurance recoveries due against liabilities which have already been discharged by the company) and rights to future recoveries under long term contracts of reinsurance.

38. The new rules for amounts due or to become due under contracts of reinsurance can be summarised as follows:

Type of right under a contract of reinsurance	Valuation rule	Admissibility
Rights under a long term contract of reinsurance which are not debts which have crystallised as being due as at the relevant date.	The amount on the right is offset against the related liabilities (provided this is standard actuarial treatment). Thus, the liability will be reduced by the amount of the rights.	100% (since admissibility limits do not apply to liabilities)
Rights/debts due from a dependant	regulation 12(4)	dependant rules apply
Rights under a contract of reinsurance (others)	regulation 7(5)	100% (regulation 15(5))

Other Debts

39. Aside from reinsurance recoveries, there are a number of exceptions to the basic rule. The main types of exceptions are described in the table below with an indication of where the relevant rules are to be found in the AVRs.

Type of debt	Valuation rule	Regulation	Comment
Amount due under a letter of credit (LOC)	Nil value	7(2)	This is essentially a double counting provision i.e. any underlying debt which is secured by a LOC is admissible but you cannot also take credit

Type of debt	Valuation rule	Regulation	Comment
			for the LOC in addition to the underlying debt.
Any debt secured on a life policy issued by the company	If fully secured, the amount of the debt	7(3)	If not fully secured, usual debt rules apply. The secured element of the debt remains within the secured debt rules.
Advance commission to intermediaries (contingent asset)	Nil value	7(6)	This relates primarily to contingent commission advanced in relation to the sale of life policies before such commission has actually been fully earned.
Unpaid share capital	Nil value	7(6)	See paragraph 40
Subordinated debt due from a company of which it is a dependant	Nil value	7(6)	See paragraph 41
Premium debts more than 3 months overdue.	Nil value	7(6) & (7)	See paragraph 42
Premium debts (other)	The amount expected to be recovered.	7(1) & (4)	100% admissible. regulation 15(5)
Quasi derivatives	Depends on the circumstances	7(12)	See paragraph 44

Unpaid Share Capital

40. Regulation 7(6)(b) requires any debt due in respect of unpaid share capital of the company to be left out of account. There are circumstances under regulation 4 of the Insurance Companies (Solvency Margins and Guarantee Funds) Regulations 1996 where a company which has issued partly paid shares is able to count one-half of the unpaid amount towards its solvency requirements, provided that the admissible value of the other assets is at least equal to its liabilities. The relevant conditions which need to be met are, principally, that at least one-quarter of the nominal value and share premium has been paid up. However, the attention of companies is drawn to section 24A(3) of the Ordinance which prohibits a licence being granted to an insurance company which has issued partly paid shares after 6th March 1997. If an existing company were to issue fresh partly paid shares, there might be adverse consequences under section 105 of the Ordinance. This allows the Commissioner to prohibit insurers from undertaking new business if there exists a ground under which a licence could not be granted.

Subordinated Debt

41. Subordinated debt is defined in regulation 2, and is essentially any debt that ranks after general creditors, in the event of a winding up of the debtor, and that is not to be repaid until the claims of those general creditors have been

settled. There is, however, an express provision in regulation 7(6) which prohibits an insurance company from assigning a value to such subordinated debt if issued by its holding company. For admissibility purposes, subordinated debt falls within the definition of "hybrid security" and will, therefore, benefit from the same admissibility limits as equity share capital.

Premium Debtors And The '3 Month Rule' - Applies To All Premium Debts

42. It should also be noted that the 3 month rule applies to all premium debts whether in relation to direct business or inwards reinsurance business. Debts in relation to outwards reinsurance (i.e. essentially reinsurance recoveries) are not caught by these premium debt rules.

43. Any premiums which have been 'recorded in the company's records as due and payable' and have been outstanding for more than 3 months can have no value for solvency purposes. The key here to determining valuation is to establish when the clock starts running for the purpose of the 3 month test. In general, the due date will run from the time the company books the debt as due and the 3 month period will run from after the expiry of any agreed credit terms. For example, in the case of an instalment premium, an instalment not due until 6 months time will only fail the 3 month test if it has still not been paid within 9 months (i.e. 3 months from the date it is due). The Commissioner would expect the company to be able to demonstrate clearly from its records when debts are actually due for payment. If a company has recorded a debt, but simply not yet made any effort to collect, then it cannot claim that the amount is not yet payable. Similarly, it is unlikely that a company would be deemed to have sound and prudent management if it were to grant extended credit terms beyond those needed for normal commercial purposes (especially if granted to a connected company) in order to extend the admissibility of its premium debts.

Quasi Derivatives

44. Except in limited circumstances (which are described in paragraph 106) quasi derivatives (e.g. where the principal is repayable in full and it is simply the coupon which is linked to an unapproved index) are given a NIL value. However, any 'true debt' element which is receivable under an unconditional right can be assigned a value using the normal debt rules.

Amounts Due From The Long Term Business Fund

45. The regulations do not specifically cover balances due between the long term business fund and shareholders' funds or between separate long term business funds maintained by a company. Given the requirement for separate identification of the long term business fund by sections 73, 75, 83 and 86 of the Ordinance, such balances do arise in practice and may feature in the shareholders' accounts. There is a difficulty in reflecting these in the returns since the life fund is not a separate legal entity and, legally speaking, there is not a 'debt' that can be valued under the regulations. The view is that the allocation of assets between the life funds and shareholders' funds should be made to ensure that no such 'interfund' balances exist.

Secured Debts

46. The AVRs make the distinction between secured and unsecured debts. Moreover, they allow a debt to be split into a secured element and an unsecured element, and the two parts are able to be treated separately when applying the AVRs and the admissibility rules. Note that the AVRs do not expressly distinguish between the types of security (e.g. floating or fixed) but

instead set out the criteria against which each type of security should be assessed to determine whether the debt ranks as "secured" under the AVRs.

47. The Amendments slightly relax the conditions which need to be satisfied before a debt can be classified as being "secured", thereby offering conditions which can be more closely related to common parlance. The definition of a secured debt is found in regulation 2(3).

48. A debt is deemed to be secured only to the extent that it is secured by:

(a) a letter of credit established with an approved credit institution; or

(b) a guarantee provided by an approved credit institution; or

(c) assets which are of a sufficient value to allow the debt to be discharged in full (provided the assets can themselves be valued under the AVRs, and provided that the exposure to that class of assets does not exceed the permitted limits once the assets providing security have been aggregated with the other exposures to that class of assets).

49. In the case of (a) and (b) above, the letter of credit or guarantee can only count as security to the extent that the counterparty exposure to the credit institution does not exceed the permitted limits once the letter of credit or guarantee has been aggregated with the other exposures.

50. The valuation rules are broadly the same for both secured and unsecured debts (paragraph 36 above) - the only difference being that, for secured debt, due account should be taken of the quality and nature of the security. The main difference in treatment between secured and unsecured debts is in relation to the Admissibility Limits which are discussed later.

51. When assessing counterparty exposure to credit institutions which have provided guarantees to act as security, the Commissioner would expect companies to also bear in mind their potential counterparty exposure to that credit institution concerned in the context of section 64B of the Ordinance (the requirement to have assets appropriately spread).

52. A letter of credit is normally different in economic terms from a guarantee since, under a LOC scheme, the credit institution operating the scheme is in effect ensuring that the debtor will honour the debt by holding assets which belong to the debtor, and only permitting them to be released to the benefit of the creditor in settling the debt due. This is quite different from the credit institution actually offering itself to guarantee the repayment of the amount due. When looking at counterparty exposure, if letters of credit are involved, insurers will need to look at the legal structure of their own arrangements in each case but, in general, we would not expect amounts due under LOCs operating as described above to be included within the overall counterparty exposure for the credit institution operating the scheme. An exception to this generality is that, when assessing whether a LOC can count as security for a debt, regulation 2(3) states that the counterparty exposure to the credit institution should be taken into account (paragraph 49 above refers).

53. Some worked examples on how secured debts are valued are given in Appendix A.

Stock Lending and Repo Transactions

54. The definitions and rules relating to stock lending and repo transactions have been simplified by the Amendments. Stock lending transactions and repos are treated on the same footing.

Basic Principles

55. The overall principle which is applied to 'approved' stock lending and repos is to 'look through' the transaction. That is, provided certain conditions are met, values shall be ascribed to the stock lent as though it were still retained by the insurance company, but no value shall be ascribed to the collateral 'transferred in'. This rule is spelt out in regulation 11(1).

56. The transaction must be with an "approved credit institution" or an "approved investment firm" (both as defined in regulation 2) and the maturity period should not exceed 6 months, or must be 'on demand'. Finally, the transaction must satisfy the conditions set out in regulation 11(2) together with either

- those set out in regulation 11(3) {which caters for securities purchased}

or

- those set out in regulation 11(4) {which caters for securities sold or lent}

Many of the conditions in regulation 11 relate to the nature and quantum of the collateral. The AVRs operate in a significantly smoother fashion if the company has ensured its transactions are appropriately collateralised and can benefit from the "look through" approach. Since it is assumed that the vast majority of companies will carry out stock lending and repo transactions with appropriate collateral, it is not proposed to offer detailed guidance of the calculations required if an arrangement has collateral which fails the conditions in regulation 11. Companies should be aware, however, that if the collateral is such that the conditions in regulation 11 fail, and the look through approach is not permitted, the company will then have to carry out a number of additional calculations in order to apply the AVRs using first principles (i.e. treat the outward and reverse transactions as futures contracts, requiring therefore to take account of counterparty exposure etc.).

The Conditions Set Out In Regulation 11(2)

57. The conditions described within regulation 11(2) broadly require the collateral to maintain a value which does not fall beneath 97½% of the value of the old stock sold. If the value does fall below this evel, additional collateral is required by the end of the next working day to bring it back up to the 100% level.

The Conditions Set Out In Regulation 11(3)

58. If, under the agreement, it is the insurance company which has purchased the securities, using a consideration which is other than by way of a sale of securities, then the conditions which must be met to allow the 'look through' approach are set out in regulation 11(3) and are as follows:

- the securities purchased must be gilts, listed securities, or securities issued by an approved credit institution; and
- the securities purchased must satisfy the extra conditions set out in paragraph 59 below.

59. In addition, for an insurance company purchasing securities, then in order for the look through approach to apply, the 'extra conditions' are that the package of securities purchased must NOT include

(i) securities issued by the same counterparty, the aggregate value of which exceeds 15% of the value of the total package of securities purchased,

or, if (i) is not satisfied,

(ii) securities which, if aggregated with the company's existing other holdings, would cause a breach in the relevant admissibility limits.

These 'extra conditions' would not, in practice, apply if the assets transferred to the insurance company are gilts or other types of "approved securities".

The Conditions Set Out In Regulation 11(4)

60. If, on the other hand, it is the insurance company which has sold securities to an approved credit institution or an approved investment firm, then the conditions in regulation 11(4) apply and are as follows:

- the consideration received must be of a certain nature; (see paragraph 61); and,
- the consideration (unless in the form of gilts or cash) received must satisfy extra conditions; (see paragraph 61)
- if cash was received as collateral, then cash shall be returned in the same currency;
- if securities were offered as collateral, then "equivalent securities" (as defined by regulation 2) shall be returned.

61. In addition, for an insurance company selling securities, then for the look through approach to be allowed, the 'extra conditions' require that the 'collateral' received must NOT include either

(i) consideration which causes exposure to the same counterparty to exceed 15% of the value of the total package of the 'collateral'

or, to the extent that (i) is not satisfied

(ii) consideration which, if aggregated with the company's existing other holdings, would cause a breach in the relevant admissibility limits.

('consideration' in the context of (i) above comprises....

- securities (other than gilts and other approved securities) issued by,

or - letters of credit established with,

or - guarantees provided by,

or - cash held with,

or - a charge over cash held with,

or - a charge over securities issued by,

the same counterparty.)

These 'extra conditions' would not, in practice, apply if the 'collateral' received by the insurance company is gilts or other types of approved securities.

'Look Through' Approach For Stock Purchased

62. If the conditions are met, the insurance company should value the consideration as if such consideration had been retained by it. At the same time, NO value shall be given to the stock 'purchased', except to the extent that the stock is non-returnable and represents payment for services rendered.

'Look Through' Approach For Old Stock Sold

63. Under similar 'look through' principles, providing the conditions are satisfied, the insurance company should value the stock 'sold' as if such stock had been retained by it. At the same time, NO value shall be given to the 'collateral' which the insurance company received as part of the transaction, except to the extent that the assets received as 'collateral' are non-returnable and represents payment for services rendered.

Admissibility Implications

64. Those assets which are able to be given a value (see paragraphs 62 & 63 above) will be included within the company's exposure to assets of the same description. At the same time, if the conditions are satisfied, there will be no counterparty exposure to the assignee by virtue of the fact that no value shall be given to the assets received by the insurance company.

65. Regulation 11(7) allows insurance companies to adopt a pragmatic approach where the company has entered into a number of stock lending or repo transactions. It allows the agreements which are yet to mature at the relevant date to be aggregated and treated (for the purposes of testing the conditions set out in regulations 11(3) & (4)) as though they were one agreement. In practical terms, therefore, when a company assesses whether the collateral causes a breach in any of the permitted exposure limits, it can look at ALL such collateral collectively.

What If The Conditions Are Not Met?

66. In such instances, the transaction should be assessed using first principles. In the majority of cases, stock lending and repo transactions will be a series of futures contracts and should be treated under the AVRs and admissibility rules accordingly. This will undoubtedly require a number of additional calculations to be carried out (the paragraphs on 'futures and options contracts' in the section on Admissibility Limits also refers). The purpose of the conditions set out in regulation 11 is to provide a simple, pragmatic treatment for the preferred types of stock lending and repo transactions.

What If The Company Reinvests The Collateral?

67. In certain instances, it may be considered commercially advantageous to reinvest the 'collateral' received when the insurance company has 'sold' securities under a stock lending or repo transaction. If the conditions in 11(2) & (4) are satisfied then the 'look through approach' applies not only to the original collateral, but also to any assets which have been acquired as a result of the reinvestment. In other words, the original collateral, or any assets purchased by it, are given a NIL value.

68. However, in such circumstances, the company must consider the effects of regulation 19(1)(b) which caters for imprudent reinvestment of collateral received under a stock lending or repo transaction. The regulation requires the company to provide, as an additional liability, any adverse variations (taken in the context of the overall level of assets party to this and similar transactions) which may occur between the value of the original assets received as collateral and the assets it has acquired upon reinvestment of the collateral.

69. Regulation 19(1)(b) is reliant on the company being able to 'earmark' assets to match the obligation it has taken on under the transaction - as instructed to do so by regulation 19(1)(a). For pragmatic reasons, it is reasonable for a company to have regard to the overall availability of the assets of the description in question before carrying out the 'earmarking' process. For example, if the

company were to identify cash as a suitable asset to cover its obligation, and if the company had an abundance of cash reserves elsewhere, it would obviously be unnecessary for the company to earmark specific pound notes and coins for the purpose or regulation 19(1)(a).

Annual Return Reporting

70. For the purposes of the Annual Returns, the asset sold or lent will be reported in the line or Form INS 5 appropriate to the asset to which title has been transferred, and not as a debt. This is consistent with existing practice for most companies.

Land And Buildings

71. Regulation 4 requires that land is valued on the basis of the most recent "proper valuation" after deduction of reasonable expenses of sale. If there has been no "proper valuation", the land shall have a nil value. The term "land" includes any interest in land such as a lease or option and also includes buildings, but does not include a remainder or a reversionary interest which in the case of life companies should be valued under regulation 9 and will have no value for general companies. It does not include debts secured on land which should be valued as debts.

72. The definitions of "proper valuation" and "qualified valuer" are to be found in regulation 2. The former makes clear that any mortgage or charge is to be excluded from consideration; it is not the equity on redemption which is to be valued as might have been thought to be the case without this specific reference. If the company has used a valuer who does not hold one of the specified qualifications, then the company will need to apply to the Commissioner for a specific exemption under a section 113 Order to allow value to be assigned to the land.

73. The definition of a 'proper valuation' requires it to have been made not more than three years earlier by a qualified valuer. This is, however, a "not greater than" rule (see para. 24). If circumstances likely to affect the realisable value have become less favourable since such a valuation was made, or if there is any other adverse consideration arising from a qualification in the valuer's report (for example, calling for other professional advice), an appropriate lower value must be taken. Where a property has been acquired at open market value after obtaining a professional valuation, this valuation is likely to be adequate for the purposes of regulation 4.

74. Valuation of buildings should normally be in accordance with the Royal Institute of Chartered Surveyors guidelines for the valuation of properties of insurance companies. The deduction for reasonable expenses of sale, which the guidelines recommend should be left to the insurance company to assess, may need to include relocation costs where the company occupies its own premises. Where the company or a related company occupy the property, then the valuation should be on a vacant possession basis, not sale and lease back unless a lower value is more appropriate.

75. Where a number of pieces of land are valued together they may attract a collective admissibility limit under paragraph 1 of Schedule 1. Regulation 4(2) provides that the amount of any interest in land which is determinable upon a future event (including death of any person) shall be its immediate transfer value.

Equipment

76. Regulation 8 provides for the rapid write-off of all forms of operating equipment. This is a "not greater than" rule and so a faster rate of write down should be used if that is considered reasonable for particular items of equipment. Such a circumstance may arise if, for example, a company's computer equipment has become outmoded because of technological developments and would, therefore, have little realisable value. There is no definition of computer equipment, but in practice the Commissioner considers it appropriate that computer hardware is included but not computer software.

77. Regulation 8 only applies to equipment owned by the insurance company. Leased assets have to be left out of account. In the interests of consistency, there is no need to provide for the accounting liability in respect of future finance lease payments which would appear in the shareholder accounts by virtue of Gibraltar Financial Reporting Standard No. 21. However, where the present value of future lease payment commitments exceeds the value of the assets (valued in accordance with the appropriate AVRs) then the net liability (or the cost of breaking the lease, if lower) should be included as a liability for the purposes of solvency.

Investments - Securities And Beneficial Interests In Limited Partnerships

Overview

78. All securities and all beneficial interests in limited partnerships are now valued in accordance with the new rules set out in regulation 6 introduced under the Amendments. There are three exceptions, however; interests in collective investment schemes; securities issued by dependants and derivatives should be valued using their own more specific rules found at regulations 10, 12 and 14 respectively. the previous regulation 6 (which had set out the rules for valuing unlisted securities) and the previous regulation 5 (which had set out the rules for valuing listed investments) have been removed.

79. The Amendments now mean that the same valuation rules apply regardless of whether the security is listed or unlisted. However, a distinction still remains between listed and unlisted securities within the admissibility rules which are described in the section on Admissibility limits.

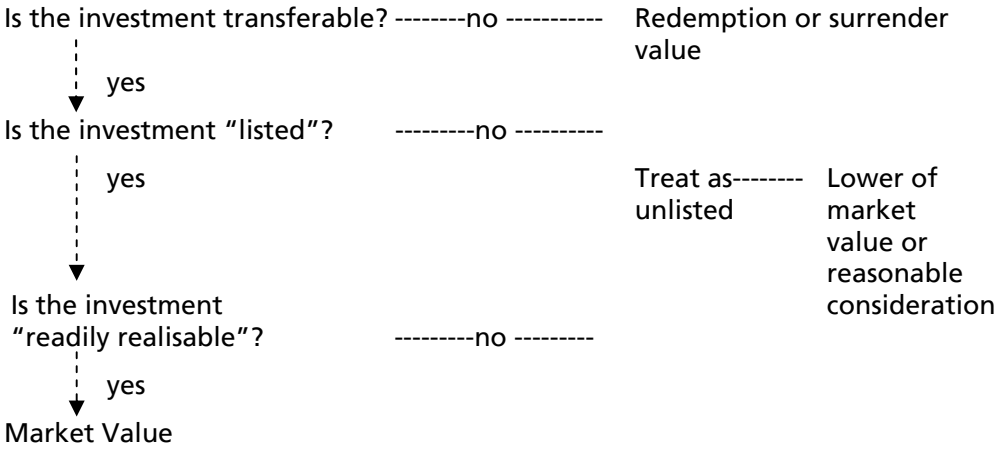
80. The Amendments introduce, however, a new area for distinguishing between different securities. The question as to whether the securities are "readily realisable" has a direct impact on both the valuation rule and the admissibility rule.

81. 'Readily realisable' securities are those where it would be reasonable to assume that, had they been sold at the relevant date, the selling price would have been at least 97½% or more of the "market value". 'Readily realisable' securities are afforded different valuation and admissibility rules. The underlying principles are further explained in paragraphs 88 to 92 below.

82. Regulation 6 itself does not allow a lower valuation than that prescribed to be taken. Consequently, there is no option to show an amount other than that determined in accordance with the rules in the regulation. This is in contrast to the previous rules, which had allowed a lower value to be ascribed to certain unlisted securities. However, as with all valuations, the application of the 'overriding rule' in regulation 3(4) (see paragraph 24 above) should be considered before ascribing a value to the investment. In addition, it should be remembered that the valuation should be in accordance with generally accepted accounting practice which, in itself, allows the necessary degree of

flexibility when valuing securities. Directors must, however, be able to support and justify the valuation methods used to the company's auditors.

Summary Valuation Rules



Unlisted Investments

83. The new rule is that the company should assign a value in accordance with generally accepted accounting practice. The company's auditor will be responsible for forming an opinion on whether the methodologies used in valuing unlisted investments fall within the scope of generally accepted accounting practice and give an appropriate estimation of the investment's value.

84. The Commissioner believes it reasonable to assume that, when estimating the value of unlisted securities, the following matters should be considered:

- For bonds - compare with a range of similar securities, or obtain an independent quotation by an investment firm.
- For equities and other investment interests - have regard to the valuation guidelines given by the British Venture Capital Association document, "Guidelines for the Valuation and Disclosure of Venture Capital Portfolios", or obtain an independent quotation from an investment firm.

Consideration should also be given to the average price at which the unlisted securities were traded at the balance sheet date, if it is the case that a market exists for such investments.

85. It should also be noted that the AVRs are not intended to require companies to assign a 'forced sale' valuation to such securities. This may be particularly relevant when assessing the value to assign under regulation 6(3)(b)(ii).

Listed Investments

86. Regulation 6 caters for listed debt securities (including local authority capital issues and listed Eurobonds) and listed shares.

87. Other listed investments are assigned the 'market value as determined in accordance with general accepted accounting practice', except for securities (listed or unlisted) which have the effect of an inadmissible derivative contract (in which case the valuation issues are discussed below). Similarly, it follows that fixed interest redeemable investments should also be shown at their 'market value as determined by generally accepted accounting practice' and hence may not be valued on an amortisation basis.

Investments Which Are "Readily Realisable"

88. Regulation 6(4) requires the company to assess whether it would have been able to sell the investment at the ascribed value. The security would fail the "readily realisable" test if it is reasonable to assume that, if the investment had been sold at the relevant date, the maximum selling price which could have been achieved would not be sufficiently close to the ascribed value.

89. In order to determine whether the investment is "readily realisable", the company must first assign the "market value" (i.e. the value ascribed using generally accepted accounting practice) to the security. The company must then be in a position to be able to demonstrate to its auditors that the investment could have been sold or transferred under an orderly arms length sale at the relevant date* (having had seven days to negotiate the sale), at a selling price which is not less than 97½ per cent of the ascribed value.

(*i.e. the financial year end reporting date)

90. If the company is unable to so demonstrate, then the investment will not be considered "readily realisable" and, in essence, it will be treated under the admissibility rules as though it were unlisted (see the summary rules table above). This then has the knock on effect that 'listed but not readily realisable' investments are included, together with unlisted securities, within the aggregate limit in paragraph 12 of Part II of Schedule 1. This is in contrast to the treatment of readily realisable listed investments, where there are no aggregate limits.

91. The regulations allow certain investments which may, on the face of it, otherwise fail the test in regulation 6(4), but can still be classed as "readily realisable". An investment does not fail the "readily realisable test if (but only if) it failed the requirements of regulation 6(4) due to either

(a) a temporary suspension of the listing, or

(b) the size of the holding being so large that it would not be possible to carry out an orderly arms length sale on the relevant date of that entire holding at the ascribed value.

Non-transferable Securities

92. Any investment, regardless of whether it is listed or unlisted, which is not transferable will be assigned a value which would be payable on surrender or redemption of the investment at the relevant date. In this regard, the 'transferable test' is not intended to define investments which are 'not readily transferable'. Instead, the intention is to make a distinction for those securities where there is a prohibition on any transfer.

Traded Debt Securities ("Eurobonds")

93. The term "listed securities" now includes all debt securities in respect of which there has been granted, and not withdrawn, a listing on any stock exchange in an EEA State and includes all debt securities which have been granted a trading facility on a regulated market. Debt securities are catered for under regulation 6, as described above.

Other Commercial Paper

94. Commercial paper which is not "listed" will be treated as an "unlisted debt security" and will be valued under regulation 6. Since the valuation rule ascribes "market value" to such items, it is possible for the value of the commercial paper to be stated inclusive of accrued interest.

Unit Trusts And Other Collective Investment Schemes

95. The Amendments introduced a revised regulation 10 which clarifies the treatment for unit trusts. Instead of using the term 'unit trust' which, in certain cases, may be too restrictive, the new regulation describes the characteristics of those collective investment schemes which can be given a value. Provided the criteria are satisfied, the holding/beneficial interest in the scheme can be valued and admitted for solvency margin purposes. A consequence of the Amendments is that all UCITs are now incorporated within regulation 10.

96. The valuation rule now distinguishes those collective investment schemes where the issuer cannot be required to buy back the units. In such circumstances, the valuation which should be ascribed is determined by applying the rules set out in regulation 6.

97. The admissibility rules distinguish between collective investment schemes recognised under the EC UCITs directive (which are admissible without restriction) and other authorised/recognised schemes (which are admissible up to 5% of the business amount).

98. Schemes which are not authorised, or are not recognised, under the Financial Services Ordinance can be ascribed a value, provided certain conditions are met. The admissibility limit for such schemes is 1% of the business amount.

Derivatives

99. Regulation 14A defines the criteria which apply for a contract to be treated under the AVRs as though it were a derivative contract. This regulation is intended to catch investments which, although they may not have the legal form of a derivative, nevertheless have the effect of operating in the same manner to a derivative. Regulation 14A conveys the spirit that both those contracts which are derivatives, and those which act as though they are derivatives, shall be treated on an equal footing.

100. Regulation 14 is a new regulation which has been introduced by the Amendments and replaces the previous valuation rule. The regulation includes the definition of an "approved derivative contract". Only those contracts which fall under the definition of an "approved derivative contract" can be ascribed a value for solvency purposes. A contract which gives rise to a liability (whether "approved" or not) will be valued in accordance with generally accepted accounting practice, following the rules set out in regulation 18.

101. The conditions which must all be satisfied in order for the contract to be treated as an approved derivative contract are:

(a) the contract can be readily closed out; and

(b) the contract is listed, or if OTC ("Over the Counter"), is with an approved counterparty; and

(c) the investment is for the purpose of efficient portfolio management or a reduction in investment risks; and

(d) the contract must be held in connection with assets which are themselves admissible under the AVRs for the purposes set out in (c) above; and

(e) the contract must be covered - i.e. the insurance company will have, as far as can reasonably be foreseen, appropriate assets at the settlement date to be able to fulfil its obligations under the derivative contract; and

(f) the contract must use a prescribed pricing basis.

The rights to recover the initial margin are now catered for (through the Amendments) under regulation 7.

102. A derivative contract would not be "covered" if, under the rules in regulation 19, it would require a significant provision to be made. Although it is a matter ultimately for the directors to agree with their auditors, the Commissioner would take the view that the term "significant provision" should be taken in the context of the value of the contract - not in the context of the fund within which the contract is used.

103. Listed derivatives are valued at their "market value" ("market value" being defined by regulation 2); the valuation for unlisted derivatives remains as before, being the amount which would reasonably be paid for closing out the contract. The value of both listed and unlisted derivatives shall be reduced by any amounts which have already been received by the company under the contract, for example, by way of a variation margin.

104. Regulation 19 will also require consideration, when valuing derivative contracts, to determine whether an additional liability should be made in respect of a provision for adverse changes.

105. Whilst the above paragraphs provide an overview of the derivatives rules within the AVRs, fuller guidance on the valuation and admissibility of derivatives will be give in Insurance Guidance Note No.11 "The use of derivative contracts in insurance funds". It is recommended that this more detailed guidance should be referred to when seeking to value derivatives contracts for solvency margin purposes.

106. Regulation 14A sets out the valuation rules for contracts or assets which have the effect of derivative contracts. In essence, such contracts or assets are valued at market value. Those which have the effect of inadmissible derivative contracts have a NIL value, except in respect of an unconditional right to receive a specified amount. Such an amount is treated as a debt and valued accordingly.

Other Assets

107. Previously, those forms of asset for which a value should be ascribed which were not covered elsewhere in the Regulations could be taken into account only if they were specified in the previous regulation 11 (now repealed). The Amendments have clarified many of the valuation rules, and have incorporated the 'other assets' within the most appropriate valuation regulation. There is, therefore, no further need for an "other assets" category, and it has been removed.

Step 3 - Admissibility Limits

General Principles

108. The admissibility rules are contained in regulation 15 and Schedule 1 to the 1996 Regulations and cover "STEP 3" referred to in paragraph 9, that of determining how much of the value attributed in Step 2 can be counted for solvency purposes. This is achieved in the Regulations by stipulating in Schedule 1 percentages which represent the maximum value for a particular asset or category of assets that may be taken into account for solvency purposes. Regulation 15(5) sets out exemptions from the admissibility rules for certain assets and regulation 15(6) sets out the special considerations that apply to index-linked assets. If an asset falls within one of the exemptions catered for in regulation 15(5) then it is fully admissible without restriction (paragraph 131 refers and provides a list of such assets).

109. A company is not directly prohibited from holding a greater amount of a particular asset, but it will receive no credit for the excess holding in determining whether it has complied with solvency requirements. While this may not be unduly significant for a company with a substantial excess of available assets over the required minimum margin, a company with less of a cushion will need to be careful to ensure that undue concentrations in particular assets do not lead to statutory solvency requirements being breached.

110. Schedule 1 promotes the concept of "aggregate exposure" to particular assets or classes of assets. The limits are graded so that more restrictive treatment is applied to assets which are subject to higher risks and/or have lower security (both in terms of collateral provided and status of the counterparty). In addition, the admissibility rules introduce the concept of 'counterparty exposure' and thereby places restrictions on large exposures to any particular counterparty or any of its connected companies. Both aggregate exposure and counterparty exposure are discussed more fully below.

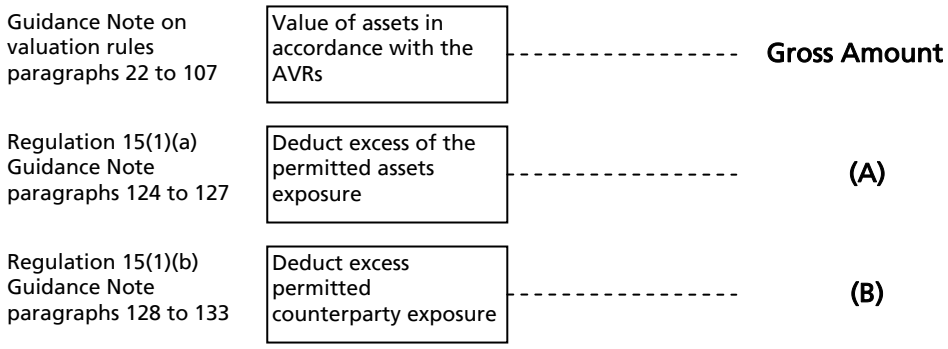
111. The limits relate to amounts determined by calculating the ascribed percentages of the "general business amount" ("GBA") and the "long term business amount" ("LTBA"). A company carrying on only general business will restrict all its assets by reference to the GBA, and a company carrying on only long term business will restrict all its non-linked assets, whether shareholder or policyholder, by reference to the LTBA. A composite will restrict its long term business assets by reference to the LTBA and its other than long term business assets by reference to the GBA.

112. If a company only undertakes long term business and has assets which are partly attributable to both the policyholders and the shareholders, then any reduction due to admissibility restrictions shall be made to the long term assets in the same proportion as the attribution to the policyholders (regulation 15(4)). Similarly, the same principle applies if a company has more than one long term business fund for which assets are separately appropriated and a reduction is required that will affect more than one fund.

113. The calculations of GBA and LTBA have both been revised by the Amendments and are discussed in paragraphs 155 to 158 below, although the broad principle remains that the GBA/LTBA approximates to the net technical liabilities.

Calculation Of Admissible Assets

114. The Amendments introduced a menu-style approach to the admissibility rules. Firstly, the assets are required to be valued in accordance with the AVRs and then, secondly, a series of admissibility adjustments is applied in turn. Regulation 15(1) provides the framework for the necessary admissibility adjustments and can be summarised as follows:



Regulation 15(1)(c) Guidance Note paragraphs 134 & 135	Deduct excess of the permitted concentration with a no. of counterparties	(C)
Regulation 15(1)(d) & (e) Guidance Note paragraph 136	Deduct an amount representing the value of assets transferred by way of an inadmissible derivatve contract	(D)

For reporting purposes, the difference between the "Gross Amount" and the "Admissible Amount" (being the total amount by which the assets exceeded the admissibility limits in Schedule 1) is separately disclosed in Form INS 1 of the Annual Return.

115. You will note from the above that the adjustments, in the main, are as a result of excess exposure to any one particular asset class, or to any one counterparty. The concept of 'aggregate exposure' has been introduced to take into account the fact that insurers can be exposed to movements in the value of assets other than those which it actually held at the balance sheet date, e.g., where it has entered into a derivative contract or where it has taken a particular asset as security for a debt.

116. The admissibility rules operate in order that the amounts which are able to be counted toward the solvency margin calculation are restricted if there is too much concentration in one particular type of asset, or in one particular counterparty.

117. The approach to admissibility restrictions introduced by the Amendments is, firstly, to set out the rules to allow the company to calculate its exposure to assets or exposure to counterparty and then, secondly, to define what the "excess exposure" should be.

Calculation Of Aggregate Exposure To Assets

118. The aggregate exposure to assets of a particular description is determined by applying the calculation now included in Part I of Schedule 1. The calculation is laid out in menu-style format which applies the following logic:-

Aggregate exposure to assets shall be:

assets held directly;

plus or minus

assets which the company is treated as having acquired, or disposed of, under futures contracts;

plus or minus

assets which the company is treated as having acquired, or disposed of, under options contracts;

plus or minus

assets which the company is treated as having acquired, or disposed of, under other derivative contracts (other than futures and options already taken into account above);

plus

assets which have been transferred by the company by way of an initial margin [under a derivatives contract];

plus

assets which have been taken as security for a debt*

This last component (*) is not stated within the menu-style in Schedule 1 itself, but must be taken into account in the calculation of "aggregate exposure" when assessing whether a debt is secured in accordance with regulation 2 (sub-regulation (3)(b)(ii) refers). The worked examples in Appendix A explain how this requirement operates in practice.

119. Paragraphs 54 to 70 describe those stock lending and repo transactions which do not have to be taken into account for aggregate counterparty exposure calculations.

Futures And Options Contracts

120. The underlying principle for futures and options contracts is that, provided certain conditions are met, the company is deemed, for the purposes of aggregate exposure calculations, to have already acquired or disposed of the asset as at the relevant date. Part 1 of Schedule 1 sets out these conditions. In brief, (on the assumption that these conditions are met) the treatment is as follows:

(a) if the contract provides for the acquisition of assets, the company is deemed to have already acquired them at the relevant date.

(b) if the contract provides for the disposal of assets, the company will be deemed to have already disposed of them at the relevant date ONLY IF

(i) the contract is listed,

or

(ii) is not listed, but provides for the disposal of the assets by the company to an approved counterparty within one year of the relevant date.

For options contracts, if it appears prudent to assume that the company will exercise the option, the company will be deemed to have carried out the option at the relevant date. (Note that "prudent to assume" should be a considerably stiffer test than a simple balance of probabilities). If the company is deemed to have carried out the option then (a) and (b) above apply.

121. The principles for the treatment of futures contracts can be applied to stock lending or repo transactions which are not able to benefit from the look through approach (paragraphs 54 to 70 on 'stock lending and repo transactions' refers).

122. It is clear, therefore, that when derivative contracts are part of the aggregate exposure calculation, it is possible for the admissibility reduction which is required to a particular class of asset to be larger than the assets which are actually held. In such cases, regulation 15(2) directs that the necessary reduction is first applied to the assets actually held and any 'unutilised' part of the reduction shall be applied as a deduction against "other assets". For reporting purposes, a separate line is included in Form INS 5 of the Annual Returns for such a deduction. Example 2 in paragraph 153 illustrates this point.

123. Insurance Guidance Note No.11 entitled "Use of Derivative Contracts in Insurance Funds" will provide additional guidance relating to derivatives and should be referred to when valuing derivative contracts under the AVRs. The adjustments in relation to stock lending and secured debts are discussed in the section dealing with Valuation Rules.

Excess Of The Permitted Asset Exposure

124. Once the total aggregate exposure to an asset type has been calculated, the company must restrict the amount which can count toward solvency margin calculations. The restriction is any amount over and above the permitted asset exposure. The permitted asset exposure is determined by multiplying the business amount by the relevant percentage, as found in the table set out in Part II of Schedule 1. If an asset is not covered by Part II of Schedule 1, then unless it falls within one of the exemptions in regulation 15(5), its permitted exposure limit is NIL.

125. The calculation to determine the "excess asset exposure" (see para. 114) is simply:

(A) = (Total exposure to assets of that description) - (permitted asset exposure)

If the figure arrived at is negative then it shall be taken to be zero (i.e. the excess is NIL).

126. It is possible for an asset to interact with more than one admissibility restriction (e.g. the asset could be a preference share issued by an approved counterparty - hence paragraphs 12, 13 and 16 of Part II of Schedule 1 interact). In such cases, the lower admissibility limit shall bite first. The reduction required by the first limit shall be taken into account when calculating the excess exposure in applying the second limit. In other words, if an asset has already been partially disallowed by virtue of one limit then only the admissible element needs to be considered when applying a second limit. This approach is set out in paragraph 12 of Part I of Schedule 1.

127. In circumstances where the company does not hold sufficient assets of that description to eliminate the excess, a deduction is made against "other assets" as described under paragraph 122.

Calculation Of Exposure To A Counterparty

128. Exposure to any one counterparty (when taken together with its connected companies) also falls under the admissibility restrictions.

129. The Regulations require the value of all investments in, debts due from, and rights against, a counterparty to be aggregated in order to calculate the counterparty exposure. The values which are entered into the counterparty exposure calculation are the amounts arrived at after taking account of the permitted asset exposure rules, thus avoiding 'double counting' of the admissibility limits.

130. Certain secured obligations, which may include stock lending and repo transactions, are permitted to be excluded from the aggregation calculation, provided certain conditions are met. The conditions, which relate to the nature of the security given, are set out in paragraph 14 of Part I of Schedule 1.

131. In addition, it is worth noting that not all assets are subject to admissibility restrictions. Regulation 15(5) lists those assets which are permitted without limit;

- approved securities or accrued interest thereon (careful note should be taken of the definition of approved securities)
- debts due under reinsurance contracts
- salvage rights
- subrogations recoverable
- premium debts

- amounts due from public bodies of any state in zone A
- for long term business, debts due, which are secured by a policy of insurance
- general insurance deferred acquisition costs
- UCITS
- shares in, or debts due from, a dependant

Hence, such assets shall be left out of the calculation for counterparty exposure.

Calculation Of "Permitted Counterparty Exposure"

132. The Amendments introduce a revised definition for permitted counterparty exposure, as set out in paragraph 3 of Part I of Schedule 1. The table below provides an illustrative guide as to how the definition operates. As a rule of thumb, the lower limit will always bite first, thereby making the higher limit not applicable.

	"Permitted Counterparty exposure"	**Explanation**
Unincorporated body of persons	5%	para 3(a) applies
Individual	5%	para 3(a) applies
Non Zone A public body	5%	para 3(b) applies
Manufacturing company	5%	para 3(c)(iii) bites first
Approved counterparty	10%	para 3(c)(iii) doesn't apply para 3(c)(ii) bites
approved credit institution - excl deposits	10%	para 3(c)(iii) doesn't apply para 3(c)(ii) bites
approved credit institution - incl deposits	20%	para 3(c)(iii) doesn't apply para 3(c)(ii) does not apply to the deposit element, para 3(c)(i) bites on the aggregate of the deposit coupled with the other assets

Excess Of The Permitted Counterparty Exposure

133. The calculation to determine the excess counterparty exposure is simply:

(B) = (Total exposure to counterparty) - (permitted counterparty exposure)

If the figure arrived at is negative then it shall be taken to zero (i.e. the excess is NIL).

Excess Concentration With A Number Of Counterparties

134. The calculation to determine the excess of concentration with a number of counterparties can be described as:

(C) = (Sum of all the exposures which exceed 5% of the Business Amount) - (40% of the Business Amount)

If the figure arrived at is negative then it shall be taken to be zero (i.e. the excess is NIL).

135. Due to the restrictions of paragraph 3(c) of Part I of Schedule 1, it is only exposures to approved counterparties which are able to exceed 5% of the business amount that can be no more than 10%. This is a tightening of the old rules which had previously allowed exposures to any counterparty to reach 10%. The rules, in effect, place an aggregate limit of 40% of the business amount on those exposures to approved counterparties which exceed 5% but are not greater than 10% of the business amount. If the counterparty exposure is less than 5% of the business amount, then it will not form part of the 'excess concentration with a number of counterparties' calculation. That is, in practical terms, there is no aggregation limit for counterparty exposures of 5% or less.

Assets Transferred By Way Of An Unapproved Derivative Contract

136. Regulation 15(1)(d) & (e) define the scope for the necessary deduction of such amounts from the value as determined under the AVRs. Insurance Guidance Note No.11 on the Use of Derivative Contracts in Insurance Funds includes a number of worked examples which illustrate the operation of the admissibility limits when the company is party to derivative contracts.

Operation Of The Limits

137. The limits are set out in Part II of Schedule 1 to the 1996 Regulations. It is important to note the following:-

(a) Some aggregate limits have been introduced so that, in many cases, more than one limit may apply - both an individual limit, e.g an exposure to ABC shares, and an aggregate limit, e.g all unlisted securities combined; and

(b) Debts limits have been "graded" so that higher limits apply the greater the security or liquidity of the debt. Security in this context refers to the status of the counterparty concerned, as well as to any physical collateral arrangements in place.

138. The aggregate limits take two forms; first as a limit on the total permitted in a particular category of assets and, second, as a limit on "exposure" to a single counterparty and any of its connected companies from whatever source. Connected companies in this case is defined in Part I of Schedule 1 as a parent, a subsidiary or a sister company.

139. Each paragraph of Part II of Schedule 1 is considered in turn. Note that all percentages relate to percentage of the GBA or LTBA. The flowchart in Appendix B summarises the different admissibility limits which apply. In addition, some worked examples on the valuation and admissibility of debts are given in Appendix A. It should be noted that each paragraph operates on a stand alone basis and consequently more than one paragraph may apply in any one instance. If a particular asset falls within the limits of more than one paragraph then all the limits will need to be applied (and, in practice, therefore, the lower limit will bite first).

140. An asset must be expressly described within Part II of Schedule 1 otherwise the asset is inadmissible (but not the asset types which are 100% admissible by virtue of their exclusion from Schedule 1 under the rule set out in regulation 15(5)).

Paragraph 1 Paragraph 2 - Land 5%; Reversionary interest or a Remainder 1%

141. This limit has not been changed by the Amendments and restricts any single piece of land (including the buildings on it) to 5%. The restriction on a piece of land (5%) also extends to a number of pieces of land or buildings close enough to each other to effectively be considered as one investment. Adjacent sub-leases in the same building would not normally fall to be considered as separate pieces of land. Adjacent pieces of land would normally only be considered separately for the purposes of assessing the impact of the admissibility restrictions where there is a clear and distinct difference in land usage. Paragraph 2 introduces a different limit of 1% for a reversionary interest or a remainder not falling within the definition in paragraph 1.

Paragraph 3 - Individual Mortgage Debts 1%

142. This paragraph relates to debts due from individuals which are secured by land or buildings used as that individual's own residence. The individual concerned must not fall within the definition of a connected person in section 2(4) of the Ordinance, i.e. must not be a controller or director of the company (or related to a director).

Paragraphs 4-9 - Debts, Individual Limits 10% -0.25%

143. Appendix B provides a decision tree which provides further guidance through the various admissibility paragraphs of Schedule 1 which affect debts. The table below summarises the position in respect of admissibility for a number of example debts. The terms, "secured", "regulated institution" and "approved counterparty" are defined in regulation 2.

Type of debt	Admissibility limit for each individual issuer	Aggregate exposure to debt of this type, for ALL issuers
1. Sovereign or supranational issuer	No limit (reg 15(6))	None
2. Full secured debt due from an approved counterparty	10% (para 9 of Part II of Sch 1)	None
3. Fully secured debt - other	5% (para 8 of Part II of Sch 1)	None
4. Unsecured debt due from an approved counterparty, including regulated institutions which qualify as being approved counterparties.	10% (para 9 of Part II of Sch 1)	None
5. Unsecured debt due from a regulated institution, which	2½% (para 7 of Part II of Sch 1)	None

Type of debt	Admissibility limit for each individual issuer	Aggregate exposure to debt of this type, for ALL issuers
does not qualify as an approved counterparty.		
6. Unsecured debt from any one unincorporated body	1% (para 5 of Part II of Sch 1) (para 11 of Part II of Sch 1)	5%
7. Unsecured debt – other (para 6 of Part II of Sch 1)	1% (para 11 of Part II of Sch 1)	5%
8. Debt due from an individual (other than those under para 3 of Part II of Sch 1)	¼% (para 4 of Part II of Sch 1)	5% (para 11 of Part II of Sch 1)

When looking at whether a debt is secured or unsecured, the definition set out in regulation 2 allows a partially secured debt to be split into two elements; a fully secured element and the remainder (which is not covered by the security) to be treated as unsecured. Consequently, the fully secured element will be able to take advantage of the higher admissibility limits which usually apply to secured debts. Debt securities are excluded from the limits in paras 5-11 of Part II of Schedule 1. These are dealt with in paras 15 and 16 of Part II of Schedule 1, which are described below. Reference should also be made to the exclusions in regulation 15(5) which have the effect of allowing 100% admissibility for those asset types listed within that regulation.

The Commissioner is not aware of any approved counterparties which do not also fall under the definition of a regulated institution. In practice, therefore, unsecured debts due from approved counterparties will generally be exempt from paras 5 to 8 of Part II of Schedule 1. Clearly, however, if there are any such bodies which whilst being an approved counterparty do not qualify as being a regulated institution, then the lower limit will apply. Similarly, if an approved counterparty is an individual, then paras 3 and 4 of Part II of Schedule 1 would apply first.

Paragraph 10 - Deposits And Debts With Approved Credit Institutions 20%

144. This paragraph covers all debts, including monies held in "short term deposit" accounts, that are held with any one credit institution and any of its connected companies. This is in contrast to para 9 of Part II of Schedule 1 which excludes amounts which are "short term deposits" and applies a 10% limit to all other debts (other than debt securities) due from any one approved counterparty. The definition of "short term deposit" is set out in Part I of Schedule 1. The definition is sufficiently flexible to allow a deposit to pass the 'no penalties' test if it is ascribed a value for solvency purposes which is net of any redemption penalties which are incurred if notice for withdrawal is one month or less.

Paragraph 11 - Unsecured Debts; Aggregate Limit 5%

145. This paragraph applies an aggregate 5% limit to unsecured debts from companies, individuals or unincorporated bodies of persons. Debts due from a

regulated institution and all debt securities are excluded from this aggregate limit.

Paragraph 12 - Unlisted (Or Listed But Not Readily Realisable) Investments, Unit Trusts 1%

Paragraph 13 - Aggregate Limit 10%

146. Paragraph 12 applies a limit of 1% to investment in any one body made up of the asset types described within Paragraph 12 and 12(a).

Paragraph 12, which excludes secured debt securities, applies the limit of 1% exposure to any one body of investments which fall within the valuation rules set out in regulation 6 OTHER THAN listed and readily realisable investments, which are excluded from this paragraph. In other words, paragraph 12 covers

- shares in the company and any of its connected companies (other than shares in an open ended investment company)
- unsecured debt securities
- beneficial interest in a limited partnership

Paragraph 12(a) places a 1% limit on units in a collective investment scheme (which fall under the valuation rule described in regulation 10(1)(c)) which are managed by that company and any of its connected companies. Such collective investment schemes are those where the scheme only includes assets which can be ascribed a value under the AVRs and does not employ unapproved derivatives contracts.

Paragraph 12(b) is required in order to extend the limits in paragraphs 12 and 12(a) to connected companies of the body.

Paragraph 13 applies an overall aggregate limit of 10% to total investments of types described in paragraphs 2 and 12.

Paragraph 14 - Shares And Hybrid Securities 2½%

147. This is the limit which applies to investments of the type which fall within the definition in Part I of Schedule 1 of 'hybrid securities' and 'shares'; shares holds the same meaning as common parlance.

The table below summarises the position. The term "listed" is defined in regulation 2; "hybrid security" and "readily realisable" are defined in Part I of Schedule 1.

Type of Hybrid	Admissibility limit for each individual issuer and any of its connected companies	Aggregate exposure to hybrid securities of this type, for ALL issuers
1. Listed preference shares	2½% (para 14 of Part II of Sch 1)	None
2. Unlisted, or listed but not readily realisable, preference shares	1% (para 12 of Part II of Sch 1)	10% (para 13 of Part II of Sch 1)
3. Listed hybrid securities (other) {including subordinated debt}	2½% (para 14 of Part II of Sch 1)	None
4. Unlisted, or listed but	1%	10%

Type of Hybrid	Admissibility limit for each individual issuer and any of its connected companies	Aggregate exposure to hybrid securities of this type, for ALL issuers
not readily realisable, hybrid securities (other) {including subordinated debt}	(para 12 of Part II of Sch 1)	(para 13 of Part II of Sch 1)

The admissibility limit for listed preference shares has therefore been reduced from the previous limit of 5%, as a result of the Amendments. Listed equity shares remain admissible up to the 2½% limit.

Paragraph 15 - All Securities Issued By Issuer Which Is Not An Approved Counterparty - 5%

148. Paragraphs 15 and 16 are applicable to ALL securities which include, therefore, debt securities. Paragraph 15 applies the aggregate limit for all securities (whether equity, preference shares or debt securities) in any one company which is not an approved counterparty, or any of its connected companies.

Paragraph 16 - All Securities Issued By Any One Counterparty 10%

149. Paragraph 16 applies, in essence, to approved counterparties (since issuers which are not approved counterparties are caught by para 15 of Part II of Schedule 1). The rule applies an aggregate limit for all security types (whether equity, preference shares of debt securities) issued by any one counterparty. The limit has not changed from the previous Regulations and is 10% of the total exposure by way of securities to any one (approved) counterparty. (Reference should be made to the definition of 'approved counterparty' within regulation 2.)

The table below summarises the position. The terms, "secured", "listed", "approved counterparty" and "regulated institution" are defined in regulation 2.

Type of bond	Admissibility limit for each individual issuer	Aggregate exposure to bonds of this type, ALL issuers
1. Sovereign or supranational issuer	No limit (reg 15(5))	None
2. Fully secured bonds issued by an approved counterparty (either listed or unlisted)	10% (para 16 of Part II of Sch 1)	None
3. Fully secured bonds - other (either listed or unlisted)	5% (para 15 of Part II of Sch 1)	None
4. Unsecured listed bonds issued by an approved counterparty	10% (Para 16 of Part II of Sch 1)	None
5. Unsecured listed bonds (other)	5% (para 15 of Part II of Sch 1)	None
6. Unsecured unlisted	1%	10%

Type of bond	Admissibility limit for each individual issuer	Aggregate exposure to bonds of this type, ALL issuers
(or listed but not readily realisable) bonds	(para 12 of Part II of Sch 1)	(para 13 of Part II of Sch 1)

Paragraph 17 - Unit Trusts 5%

150. This paragraph limits holdings in any single authorised unit trust scheme or recognised scheme to 5%. Collective investment schemes recognised under the EC UCITS Directive are allowed 100% admissibility by virtue of regulation 15(5).

Paragraph 18 - Cash 3%

151. This limit relates to pure cash in hand, i.e. money held at a bank is not subject to this 3% limit.

Paragraphs 19 And 20 - Equipment 2.5% - 5%

152. These paragraphs set limits of 5% for computer equipment and 2.5% for other office equipment.

Aggregate Exposure - Illustrative Examples

153. At this stage, it is worth considering a few worked examples of aggregate exposures.

Example 1

Company 1 holds £500 of equity shares in ABC, a listed company which is not an approved counterparty, has £750 of listed debentures in that company; has £200 of equity shares which it has "transferred" under a stock lending agreement; and has entered into a futures contract to sell 500 shares in ABC in three months time at a price of £1 (the current price of the equity being 75p). The general business amount (GBA) of the company is £10,000. The company's aggregate exposure to ABC is as follows:

Description	Equities	Debs	Exposure to ABC	Reason
	£	£	£	
actual holding of equity	500			
holding lent under stock loan	200			
shares due to be sold 500 @ 75p	(375)			Note 1
total exposure ABC equity shares	325		325	
listed debentures		750	750	
admissibility restrictions				
Para 14, 2½% GBA for shares	(75)		(75)	
Para 15, 5% GBA for debt securities	(250)	(250)		
Para 15, 5% GBA for all securities in any one counterparty		(250)	(250)	Note 2
ADMISSIBLE ELEMENTS	**250**	**250**	**500**	

Note 1

In determining the aggregate exposure, exposure to numbers of shares under derivative contracts is converted to a monetary amount by reference to the current market value of those shares. The actual monetary value of the derivative contract itself is not relevant for these purposes as, in many cases, it will be negligible compared to the quantum by which it alters the company's economic exposure to certain assets.

Note 2

This deduction can be made against the equities or the debentures - it would make no difference to the overall level of the admissible elements. In this example, we have deducted against the debentures.

Example 2

Company 2 holds £200 of listed equity shares in DEF and has entered into a futures contract to buy 800 shares in DEF in two months time at a price of 50p. The current share price is 60p. The company's GBA is £10,000. The company's aggregate exposure to DEF is as follows:

	£	Reason
Actual holding	200	
shares due to be bought 800 @ 60p	480	Note 1
total exposure DEF equity shares	680	
Admissibility restrictions		
Para 14, 2½% GBA for shares	(430)	Note 2
ADMISSIBLE ELEMENTS	**250**	

Note 1

As with Example 1, in determining the aggregate exposure, exposure to numbers of shares under derivative contracts is converted to a monetary amount by reference to the current market value of those shares.

Note 2

In this case the inadmissible element is greater than the value of the equities actually held. Regulation 15(2)(b) therefore applies. This instructs that the equity asset admissibility is written down to NIL, but the remaining restriction (£230) should be deducted from the aggregate value of the other assets. It is not necessary to allocate this further deduction against any one particular class of asset and, therefore, an additional line in Form INS 5 ('deduction for inadmissible items') has been introduced specifically for disclosure of such items.

Example 3

Company 3 has unsecured debts due from the following corporate bodies, none of which is a "regulated institution":

X - £250, Y - £150, Z - £200

It also has unsecured debts due from 25 different individuals of £50 each. The GBA of the company is £10,000. The maximum exposure for these debts is as follows:

	£	Reason
debt from X	250	
debt from Y	150	

	£	Reason
debt from Z	200	
debts from individuals	1,250	25 @ £50 each
total of unsecured debts	1,850	
Admissibility restrictions		
Para 6, 1% GBA for X debt	(150)	
Para 6 ,1% GBA for Y debt	(50)	
Para 6, 1% GBA for Z debt	(100)	
Para 4, ¼% GBA for debts from individuals	(625)	25 @ £25 each
sub-total	925	
Para 11, 5% GBA for the aggregate of all unsecured debts	(425)	
ADMISSIBLE ELEMENTS	**500**	

Calculation Of The GBA/LTBA

154. For periods ending before 1 January 2004 and periods commencing before that date, the definitions of GBA and LTBA are as per paragraphs 155 and 156. For period commencing on or after 1 January 2004, the definitions are as set out in paragraphs 157 and 158.

General Business Amount (GBA)

155. In practical terms, there has been a simplification of the GBA such that it can be calculated as follows:

(i) The company's technical liabilities (i.e. amount calculated in accordance with the rules in respect of items C and D of the shareholder accounts, net of reinsurance); PLUS

(ii) The greater of 400,000 ECU and 20 per cent of the general premium income.

"General premium income" for the purposes of the GBA is defined by regulation 2(1) and represents, in effect, written accounted premiums gross of commission but net of reinsurance.

Long Term Business Amount (LTBA)

156. Similarly, the LTBA definition has been simplified and can now be calculated as follows.

(i) the company's technical liabilities (i.e. amounts calculated in accordance with the rules in respect of items C and D of the shareholder accounts, net of reinsurance)*;

PLUS

(ii) the amount of any deposit back under a contract of long term reinsurance;

PLUS

(iii) the margin of solvency (or MGF, if greater) which the company

(a) if its head office is in Gibraltar, is required to maintain, or

(b) if its head office is elsewhere, would be required to maintain if its head office were in Gibraltar;

MINUS

(iv) any implicit items valued under regulations 6 to 8 of the Insurance Companies (Solvency Margins and Guarantee Funds) Regulations 1996.

(* When calculating the permitted asset exposure limit, exclude linked liabilities; and, when calculating the permitted counterparty exposure limits or the excess concentration with a number of counterparties, exclude property linked liabilities).

General Business Amount (GBA) – new definition

157. The GBA is now calculated as the higher of –

(i) the insurer's technical liabilities (i.e. amounts calculated in accordance with the rules in respect of items C and D of the shareholder accounts, net of reinsurance) plus an amount equal to whichever is the greater of €3,000,000 or 20 per cent of the general premium income; or

(ii) a higher amount not exceeding the net admissible assets determined in accordance with the Insurance Companies (Valuation of Assets and Liabilities) Regulations 1996.

Long Term Business Amount (LTBA) – new definition

158. The LTBA is calculated as the higher of –

(i) the insurer's technical liabilities (i.e. amounts calculated in accordance with the rules in respect of items C and D of the shareholder accounts, net of reinsurance and excluding property linked liabilities); plus

(a) the amount of any deposit back under a contract of long-term reinsurance; plus

(b) the margin of solvency (or minimum guarantee fund) (if greater) which the insurer if its head office is in Gibraltar, is required to maintain, of if its head office is elsewhere would be required to maintain if its head office were in Gibraltar; less

(c) any implicit items valued in accordance with an Order issued under section 113 of the Ordinance,

save that for the purposes of assessing compliance with the permitted asset exposure limit, it shall further exclude linked liabilities; or

(ii) a higher amount not exceeding the net admissible assets determined in accordance with the Insurance Companies (Valuation of Assets and Liabilities) Regulations 1996.

APPENDIX A: Valuation Of Debts Under The Insurance Companies (Valuation Of Assets And Liabilities) Regulations 1996

1. The valuation and admissibility of debts under the 1996 Regulations have been discussed in the main body of this note. At this stage, it is probably useful to illustrate the basic rules with a few worked examples. Note all the examples below use the General Business Amount (GBA) as the yardstick by which to compare the admissibility limit, but the examples could apply equally where the Long Term Business Amount (LTBA) is to be used. In addition, all examples assume that the approved counterparties are also regulated institutions.

Example 1- Operation Of Overall Counterparty Exposure Limits

Status

A company has an unsecured debt of £450 due from Y which is an approved credit institution. The company also has short term deposits with Y of £1,200, listed equity shares in Y of £475 and rights under derivative contracts due from Y to £400. The company's GBA is £10,000 and there are no other assets except Government bonds (which are not subject to any Schedule 1 limits).

Application of the rules

The first stage is to identify the individual admissibility limits which impact each separate asset and then to look at the aggregate limits for that class of assets. The relevant limits are:-

Unsecured Debt - Following the steps set out in the flowchart in Appendix B, this is not a listed debenture but is an unsecured debt due from an approved counterparty. Hence, as seen from the table in paragraph 143, the individual limit is 10% of GBA (para 9 of Part II of Schedule 1).

Deposits - 20% of GBA (para 10 of Part II of Schedule 1).

Listed equity shares - 2.5% of GBA (para 14 of Part II of Schedule 1).

Rights under derivative contracts - No specific limits within Part II of Schedule 1, but are for inclusion within the aggregate counterparty exposure calculation for Part I of Schedule 1.

The admissibility limit can be described as follows:-

	£	
Unsecured debt from Y	450	
Listed shares in Y	475	
Rights under derivative contracts due from Y	400	
	1,325	
admissibility restrictions (individual)		
Para 14, 2½% GBA for shares	(225)	
Total counterparty exposure to Y **excluding** deposits	1,100	
admissibility restrictions (counterparty)		
(Para 3(c)(ii) of Part I of Sch 1)	(100)	Note 1
	1,000	

	£	
Deposits with Y	1,200	
Counterparty exposure to Y, including deposits	2,200	
admissibility restrictions (counterparty)		
(Para 3(c)(i) of Part I of Sch 1)	(200)	Note 2
Admissible assets	**2,000**	

Note 1

Although there is an individual limit of 20% of GBA for deposits, when coupled with the other assets the counterparty exposure to Y reaches 2,200. We have to therefore look to para 3(c)(i), (ii) and (iii) of Part I of Schedule 1

- sub-para (c)(iii) is excluded because the exposure is to an approved counterparty
- sub-para (c)(ii) applies exposure to all asset types, but excluding deposits with approved credit institutions. The allowed exposure under sub-para (c)(ii) is 10%. The deposits are caught under sub-para (c)(i).
- sub-para (c)(i) applies to exposure from all sources (including, therefore, the deposits) to any body corporate or group and allows maximum exposure of 20% of GBA.

Consequently, the permitted exposure to Y is 20% of GBA made up in this example of 10% deposits and 10% all other assets.

Example 2 - Unsecured Debts

Status

A company has a GBA of £10,000 and the following unsecured debts:

£250 due from A which is a chemical company

£150 due from B which is a retail company

£300 due from C which is a Gibraltar licensed insurance company

£1,275 due from D which is an approved counterparty

£280 due from E which is due from a manufacturing company

Application of the rules

The first stage (STEP ONE of paragraph 9 of the Guidance Notes) is to categorise the debts under the definitions in the regulations. The flow chart in Appendix B provides additional help. The debts are therefore categorised s follows:

A, B, E unsecured, unlisted debts from companies which are not regulated institutions or approved counterparties

C unsecured, unlisted debt from a regulated institution which is not an approved counterparty

D unsecured, unlisted debt from an approved counterparty

The result can be described as follows:-

	£
Debt from A	250

	£
Debt from B	150
Debt from C	300
Debt from E	1,275
Debt from D	280
admissibility restrictions (individual)	2,255

Para 6, 1% GBA - A	(150)
Para 6, 1% GBA - B	(50)
Para 7, 2½% GBA - C	(50)
Para 9, 10% GBA - D	(275)
Para 6, 1% GBA - E	(180)
Admissibility restrictions (individual)	(705)
Admissible assets	**1,550**

The aggregate limit which applies to all unsecured debts (other than debts due from a regulated institution or approved counterparty) is 5% of GBA, (Para 11 of Part II of Schedule 1), but it does not bite in this example.

Example 3 - Secured Debts (Secured By Assets)

Status

A company has a debt due from ABC plc (a chemical company) of £550 which is fully secured by land. There are no other charges on the land concerned and the company itself also owns £200 of the same piece of land. The company also has listed debentures in ABC plc of £450 and listed shares of £325. The company's GBA is £10,000 and there are no other "large counterparties".

Application of the rules

STEP ONE, determine what definition applies, i.e. does the debt fall within the definition for "secured" debt. Regulation 2(3) applies:

reg 2(3)(a)	-	Not applicable
reg 2(3)(b)(i)	-	condition satisfied, since land security is of a value which is sufficient to discharge the debt in full
reg 2(3)(b)(ii)	-	aggregate exposure to this piece of land is £750. This exceeds the permitted limit of £500 (5% GBA) for any one piece of land. Hence, £250 of the land offered for security cannot count as "security" for the purposes of the AVRs since it would breach the permitted exposure limit.

The debt from ABC plc can be split into two elements, being £300 secured, £250 unsecured.

In tabular form, the admissibility can be described as follows:

	£
Unsecured element of the debt	250

	£	
Secured element of the debt	300	
Listed shares in ABC	325	
Listed debentures in ABC	450	
	1,325	
admissibility restrictions (assets)		
Para 6, 1% GBA, unsecured debts	(150)	
Para 8, 5% GBA for all debts	(-)	Note 1
Para 14, 2½% GBA for shares	(75)	
Para 15, 5% GBA for debentures and shares combined	(200)	Note 2
	900	
admissibility restrictions (counterparty)	(400)	Note 3
Admissible amount	500	

Note 1

Although total debts are £550, the unsecured element has already been restricted by £150. This leaves £400 of the debt to be considered under para 8 of Part II of Schedule 1 and hence there is no further restriction since £400 < 5% GBA.

Note 2

Similarly, although the 'gross' value of the shares and debentures combined is £775, the shares have already been restricted by £75. Hence, this leaves a potential admissible combined amount of £700 to be considered under paragraph 15. The 5% GBA maximum of para 15 equates to £500 and so a further restriction of £200 is necessary.

Note 3

Under the rules introduced by the Amendments, assets in respect of companies which are not "approved counterparties" are restricted by virtue of para 3(c)(iii) of Part I of Schedule 1 to 5%. (Paragraph 134 refers.)

In this example, therefore, since ABC plc is not an approved counterparty, the admissibility limit is 5% GBA, i.e. £500 - hence a further restriction of £400 is required.

What if ABC plc was an approved counterparty instead?

If, in the example above, ABC plc is an approved counterparty, then the permitted exposure would be 10%. Such "large" exposures to approved counterparties are caught by the aggregate limit of 40% of the business amount. In this example, we have assumed there are no other "large counterparties" and hence the aggregate restrictions of para 17 of Part I of Schedule 1 would not apply.

The admissibility limit for approved counterparties is 10% GBA, i.e. £1,000 - hence the exposure of £900 would not require any further restriction.

Example 4 - Secured Debts (Secured By Bank Guarantee)

Status

Suppose in the above example, that instead of the ABC plc being secured by land it is secured by a bank guarantee from Bank Z. The company also has deposits with Z of £900, listed shares in Z of £350 and debts due from Z of £400. The company has no other large counterparties apart from Z and ABC plc.

Application of the rules

- Exposure to ABC plc

In this example, the debt will be fully secured since it falls under reg 2(3)(a)(ii)

In tabular form, the exposure to ABC plc can be seen as:

	£	
Secured debt from ABC	550	
Listed shares in ABC	325	
Listed debentures in ABC	450	
Total exposure to ABC	1,325	
admissibility restrictions (assets)		
Para 8, 5% GBA for all debts	(50)	
Para 14, 2½% GBA for shares	(75)	As in Example 3 above
Para 15, 5% GBA for debentures and shares combined	(200)	As in Example 3 above
	1,000	
admissibility restrictions (counterparty)	(500)*	
Admissible element of exposure to ABC	(500)	

*ABC is not an approved counterparty and the counterparty exposure limit is therefore 5% of the business amount. Hence a restriction of £500 applies.

- Exposure to Bank Z

In addition the company also has exposure to bank Z as follows:

	£
Debts due from Z	400
Listed shares in Z	350
	750
admissibility restrictions (assets)	
Para 14, 2½% GBA for shares	(100)
sub-total of admissible assets	650
Guarantee supporting the debt from ABC	550

	£	
Total counterparty exposure to Z **excluding** deposits	1,200	
admissibility restrictions (counterparty)	(200)	Note 1
Deposits with Z	900	
Total counterparty exposure to Z **including** deposits	1,900	Note 2

Note 1

Para 3(c)(ii) of Part I of Schedule 1 applies to exposure to all asset types, but excluding deposit with approved credit institutions. The allowed exposure under sub-para (c)(ii) is 10% GBA (since the bank is an approved counterparty) and a restriction to non-deposit exposures of £200 is required.

Note 2

With deposits, the admissible exposure to an approved credit institution can be 20% of the business amount (para 10 of Part II of Schedule 1). In this example, this equates to £2,000 and so no further restriction is required.

Example 5 - Stock Lending And Secured Debts

Status

A company engages in stock lending activities with counterparty X using a variety of collateral arrangements. It also has debts due from bank Y of £400 and listed shares of £200 in bank Y and £125 in PQR plc. Counterparty X falls within the definition of an approved investment firm. The GBA is £10,000.

There are 5 different stock lending arrangements. In cases where the company has lent stock, for the purposes of Reg 11(4)(b)(ii) the collateral provided for all of the company's stock lending arrangements can be taken together when assessing whether each individual item of collateral breaks the "15%" test outlined in sub-regulation (4)(b)(ii). If the collateral fails the "15%" test then the company looks to reg 11(4)(b)(i) to see whether the collateral, when aggregated to the companies existing exposures, would cause a breach in the admissibility limits.

In this example, unless stated otherwise, it is assumed that each piece of collateral satisfies the conditions of regulation 11(4)(b)(i).

The italics explain the circumstances when the "look through" approach applies.

(a) £250 of mixed equities (with no single large holding) are lent to Broker X. Broker X supplies cash collateral equal in value to the shares "lent".

Reg 11(2) is satisfied since the collateral equals the value of the stock "lent".

Reg 11(4)(a) is satisfied since the collateral is cash;

Reg 11(4)(b)(i) is satisfied, since it is assumed that the cash received would not cause the company to breach its exposure to cash or to deposits with approved credit institutions. Hence, reg 11(1) dictates that there is no need to include the collateral in the aggregate exposure calculations - i.e. the "look through" approach can be applied. The mixed equities "lent" should be treated as though they were still retained by the company

(b) £150 of gilts are lent to X and secured by a "pool" of gilts under a DBV (delivery by value) arrangement, whereby the value of the pool is topped up daily to reflect price movement and the value of the

collateral exceeds the value of the stock lent by a small margin to cater for intra day movements.

Reg 11(2) is satisfied since the collateral equals the value of the stock "lent".

Reg 11(4)(b)(ii) is satisfied since the collateral is mixed (within no single large holding) and is in the form of approved securities (sub-regulation (4)(a)).

Reg 11(1) dictates that the "look through approach" is taken.

(c) £175 of mixed equities are lent to X for a letter of credit.

Reg 11(2) is satisfied since the collateral equals the value of the stock "lent".

Reg 11(4)(a) may apply (depending on whether the letter of credit is established with an approved credit institution);

Reg11(4)(b)(i) is assumed to be satisfied (the company needs to aggregate the collateral with its own holding to see if any of the collateral breaches any permitted exposure limits). Hence, the "look through" approach can be applied.

(d) £150 of debentures are lent to X for a bank guarantee from Bank Y.

Reg 11(2) is satisfied since the collateral equals the value of the stock "lent".

Reg 11(4)(a) is satisfied; 11(4)(b)(i) is assumed to be satisfied (the company needs to aggregate the collateral with its own holding to see if any of the collateral breaches any permitted exposure limits). Hence, the "look through" approach can be applied.

(e) £100 of mixed equities are lent to X for collateral of listed shares in PQR plc.

Reg 11(2) is satisfied since the collateral equals the value of the stock "lent".

Reg 11(4)(a) is satisfied. 11(4)(b)(i) is satisfied, since the collateral of £100 if added to the company's own holding of £125 does not cause a breach in the allowed limit of 2½% GBA {£250}. Hence, the "look through" approach can be applied.

Aggregation of collateral with the company's own holdings

- Counterparty X

For the conditions in regulation 11(4)(b)(i) to be satisfied, the company must not be exposed to counterparty X in excess of the permitted counterparty exposure. In this example, the exposure to X can be seen as:

	£
Stock lent:	
(a)	250
(b)	150
(c)	175
(d)	150
(e)	100
Total counterparty exposure to X	825

If the counterparty exposure had exceeded 10% GBA (i.e. £1,000), then the company would be required to treat those transactions which cause the excess to occur, under first principles (i.e. as though the arrangements were a series of futures contracts). This would, of course, involve a significant number of

additional calculations because of the need to apply other asset valuation and admissibility limit rules.

- Bank Y

Similarly, the exposure to Bank Y will need to be calculated to see whether any of the collateral fails the conditions of regulation 11(4)(b)(i). The exposure to Y can be seen as:

	£
Debts due from Y directly	400
Guarantee given as security for stock loan with broker X	150
Listed shares in Y directly	200
Total counterparty exposure to Y	750

In this example, the exposure to Bank Y is within the 10% GBA limit and hence the collateral (i.e. the guarantee) satisfies 11(4)(b)(i).

APPENDIX B: Admissibility Of Debts Other Than Debt Securities

Is the debt due from an individual?	➔ Yes	Paragraphs 4 and 11 apply 0.25% individual 5% aggregate
↓ No		
Is the debt due from an unincorporated body?	➔ Yes	Paragraphs 5, 11 and 8 apply. 1% individual, 5% aggregate for unsecured 5% individual for all debts (secured and unsecured taken together)
↓ No		
Is the debt due from any one company which is NOT an approved counterparty?	➔ Yes	Paragraphs 6, 11 and 8 apply. 1% individual, 5% aggregate for unsecured 5% individual for all debts (secured and unsecured taken together)
↓ No		
Is the debt due from a regulated institution which is not an approved counterparty?	➔ Yes	Paragraph 7 and 8 apply. 2.5% individual for unsecured 5% individual for all debts (secured and unsecured taken together)
↓ No		
Is the debt due from an approved counterparty?	➔ Yes	Paragraph 9 applies. 10% individual for all debts (secured and unsecured taken together)

APPENDIX C: Shares In And Debts Due To A Group Undertaking

Shares in a group undertaking

1. Regulation 12 applies to the valuation of all shares held by the insurer in group undertakings. Group undertakings are:

   - the insurers;
   - its related undertakings (undertakings in which the insurer has a holding of 20% or more of the voting rights or capital);
   - its participating undertakings (an undertaking which has a holing of 20% or more in the insurer); and
   - the related undertakings of its participating undertakings.

2. Shares in a group undertaking may be valued either as arms-length investments under regulation 6 (see paras 78 to 91 of this Guidance Note) or under regulation 12. Shares in group undertakings that are insurance undertakings or insurance holding companies (see para 4 of Guidance Note 13 for guidance on insurance holding companies) may not be given a higher value than the surplus assets in those undertakings calculated according to regulation 12, but otherwise the insurer has the option whether or not to use regulation 6. If regulation 6 is used, then admissibility limits apply. When valuing shares in a group undertaking, regulation 12 requires net asset value to be used with certain adjustments.

3. The purpose of the adjustments to the net assets value is to assess the regulatory solvency of an insurer:

   - taking into account its proportional interest in excess assets of group undertakings (see 1B on proportionality in Annex I of the Insurance Groups Directive);
   - eliminating double-gearing whether arising from intra-group investment, reciprocal financing, intra-group holdings or unpaid share capital or otherwise;
   - including only assets of group undertakings to the extent they are available to cover the liabilities and required minimum margin of the insurer; and
   - ensuring that the liabilities and notional required minimum margin of group undertakings are only covered by assets that are available for this purpose.

Basic calculation

4. The method set out in regulation 12(2) to (4) for valuing shares in a group undertaking is in four stages.

   - First, assets of the undertaking are selected to cover its liabilities (and any notional required minimum margin). Regulation 12(3) restricts the assets that may be used and how the assets and liabilities may be valued.
   - Second, regulation 12(2)(b) to (f) requires certain other assets to be excluded to arrive at surplus assets.
   - Third, the surplus assets are valued under the Valuation of Assets and Liabilities Regulations (excluding any admissibility limits under

regulation 15(1)(a) to (c)). Admissibility limits are applied at a later stage (see para 18).

- Finally, a lower value than this may be used following regulations 3(4) and 12(1).

5. Where the liabilities (and any notional required minimum margin) cannot be covered, there are no surplus assets and the result will be zero. If the undertaking is a related undertaking which is an insurance undertaking or insurance holding company, then the insurer must make provision for the proportionate share, and where the related undertaking is a subsidiary make provision for the full amount, of the deficit in the assets available to cover liabilities or represent the notional required minimum margin (see regulation 19B). Where the responsibility of the insurer is strictly and unambiguously limited to its share in the capital of a related undertaking which is a subsidiary, the Insurance Groups Directive allows a provision to be limited to the proportionate share of the deficit. The Commissioner will consider an application for a modification of regulation 19B under section 113 of the Ordinance in such circumstances. Where a provision has been made by another member of the insurance group, the amount of the insurer's provision may be reduced by its proportionate interest in that other member of the insurance group. In particular, where a deficit in an intermediate related undertaking is due solely to a deficit in another related undertaking below it in the ownership chain, both being insurance undertakings or insurance holding companies, the insurer only needs to make provision once. Where an insurer is obliged to support a group undertaking or to meet its liabilities, a provision would also be needed.

6. Where a group undertaking is not an insurance undertaking or insurance holding company, it may be valued at market value under regulation 6. However the value of any shares held in a group undertaking arrived at under regulation 12 is a maximum value which may not always be the appropriate value.

7. A similar point arises for direct or indirect holdings by the group undertaking in shares in a related undertaking of the insurer that is an insurance undertaking or insurance holding company. Valuation of the group undertaking at market value under regulation 6 may mean that the shares in the related undertaking are valued at more than (the appropriate share of) its surplus assets. Any such excess will be eliminated by virtue of regulation 12(5).

8. An insurer may value shares in a group undertaking which is not an insurance undertaking or an insurance holding company under one of the two permitted methods (that is, under regulation 6 or regulation 12(2) to (4)) for the purposes of determining its required margin of solvency and the other method for the parent undertaking solvency calculation (see Guidance Note 13) in relation to the insurance group of which it is a member.

9. Where an insurer is valuing its shares in an insurance holding company which itself has shares in both insurance and non-insurance related undertakings, the insurance holding company should be valued applying regulation 12(1) to its related undertakings.

10. Regulation 12(1) prescribes a maximum valuation of shares in a group undertaking. This allows approximate methods and shortcuts to be used if they can be reasonably relied on not to overstate the result. It also allows an insurance undertaking to be excluded from the solvency margin test by ascribing it a nil value. This shortcut may be used where a group undertaking is immaterial, its inclusion would be misleading or the information required is not readily available. However, regulation 19B requires that where a deficit exists

in a related undertaking that is an insurance undertaking or an insurance holding company, a provision must be made and it may not simply be valued at nil.

11. The reference to sub-regulation (2)(a) in regulation 12(3) means that debts due must not be valued at more that the assets available to the debtor to cover them. The effect of this is that the market valuation option is available for valuing shares in a group undertaking which is not an insurance undertaking or an insurance holding company, but not for valuing loans to such group undertakings. The reason for this is that while shares can normally be realised at the market price, a loan can only be repaid from the assets of the debtor and so its value for solvency purposes should not exceed the value of the assets available to repay the loan. Where these assets include shares in another group undertaking that is not an insurance undertaking or an insurance holding company, those shares may be valued in accordance with regulation 12(1)(b).

12. Surplus assets (regulation 12(2)) are a group undertaking's total assets less:

- the assets selected to cover its liabilities and its notional required minimum margin. As set out in regulation 12(4)(a) for insurance undertakings located in a designated state or territory these assets may be identified as to value, admissibility, nature, location or matching either under the requirements of the designated state or territory, or the Asset Valuation Regulations. For any other group undertaking, assets must be valued according to the Assets Valuation Regulations which will require revaluation of assets and liabilities (in particular long-term business liabilities will need to be valued on an actuarial basis in accordance with the Regulations for Determination of Liabilities) and for insurance undertakings carrying on general insurance business, claims equalisation reserves will need to be calculated (if applicable) as if the undertaking were an insurer with its head office in Gibraltar;
- assets that represent holdings in the insurer's and the group undertaking's own capital, whether held directly or indirectly;
- profit reserves and future profits in an insurer carrying on long-term insurance business. (Where profit reserves and future profits are treated as implicit items available to meet the notional required minimum margin by means of an order under section 113 of the Ordinance this applies only to any excess of value after the liabilities and notional required minimum margin of the undertaking have been covered);
- long-term insurance funds and other similar funds including a fund that represents amounts yet to be apportioned between policyholders and for other purposes. Such assets may nevertheless be used to cover liabilities and the notional required minimum margin of the fund referred to in the first bullet. (This deduction does not apply to a life mutual that is the ultimate insurance parent undertaking for the purpose of the parent undertaking solvency calculation);
- unpaid share capital (whether called or otherwise), other amounts that may become due on capital, and similar amounts if those amounts are or will become due from members of the group undertaking; and
- assets that cannot effectively be made available or realised to meet a solvency deficit in the insurer. Amounts subject to regulatory constraints (e.g. regulatory capital requirements or dividend

restrictions) and exchange control restrictions should be excluded. Tax liabilities or other costs might also affect the availability of assets.

13. Where a group undertaking which is an insurance undertaking is established in a designated state or territory, the notional required minimum margin may be either the actual margin of solvency that its home state requires it to hold (or, for a pure reinsurer, the amount would be required if it were a direct insurer – in some territories pure reinsurers are not supervised) or the required minimum margin. In all other cases, the notional required minimum margin is the required minimum margin that would apply if the group insurance undertaking were a Gibraltar insurer (whether it is or not). However an application may be made to the Commissioner for an order under section 113 of the Ordinance modifying the requirements to allow application of the local regulatory requirements of another state or territory if the applicant can satisfy the tests in section 113 and demonstrate that the requirements in question are 'at least comparable' to the standards set out in the First Life and First Non-Life Directives.

14. For the purposes of regulation 12(2) to (4), liabilities and the assets selected to cover them and the notional required minimum margin must be valued in the same manner as the notional required minimum margin is determined (that is, either under the requirements of the designated state or territory, or under the Regulations applicable to an insurer with its head office in Gibraltar as the case may be). Surplus assets are valued under the Asset Valuation Regulations.

15. Designated states or territories are EEA States, Switzerland, any state of the USA, Canada or a province in Canada, Australia, South Africa, Singapore and Hong Kong.

16. In some designated states or territories there may not be an exact equivalent to the required minimum margin. In such circumstances the notional required minimum margin for any jurisdiction should be ascertained by reference to the trigger for regulatory intervention which is in effect most nearly equivalent to the required minimum margin which would apply if the undertaking were an insurer.

17. Where our Regulations are applied to a non Gibraltar group undertaking not located in a designated state or territory, implicit items cannot be valued in the absence of an order under section 113 of the Ordinance waiving the requirement. For a group undertaking in a designated state or territory, implicit items have the value that local requirements permit and no order under section 113 is needed. For a group undertaking in Gibraltar, the value would be determined under any order to it under section 113 of the Ordinance.

Admissibility limits for shares valued under regulation 12(2) to (4)

18. When applying assets and counterparty concentration limits (under regulation 15) to an insurer that holds shares in a related undertaking, it is necessary to ensure that exposures of both the insurer and its related undertakings are taken properly into account. For this purpose a distinction is drawn between subsidiary undertaking which are valued in relation to their surplus assets (dependants) and related undertakings which are either not subsidiary undertakings or which are valued under regulation 6. Because the former are valued in relation to their own assets and the insurer has a majority control over those assets we have considered it appropriate to add assets held by a dependant to assets of the same description held by the insurer in order to arrive at the aggregate exposure to which the concentration limits are applied. For other related undertakings we consider that it is more appropriate to apply concentration limits directly to the insurer's holding in those undertakings.

19. Hence, if a group undertaking is a dependant (that is a subsidiary that is valued by reference to its surplus assets), regulation 15(5)(f) disapplies admissibility limits on the value of shares held in it by the insurer. Instead paragraphs 11A and 15A of Part I of Schedule 1 require that the underlying assets of the dependant are taken into account when determining the admissible assets of the insurer under regulation 15.

20. Paragraphs 11A and 15A of Part I of Schedule 1 do not apply to shares in subsidiary undertakings which are not dependants or in group undertakings which are not subsidiary undertakings. In such cases the insurer's admissibility limits will apply directly to these shares.

Intra-group debt

21. Except in the situation described in the next paragraph, where an insurer owes a debt to a related company or group undertaking, it should make full provision under regulation 18(2) for all expenses that would arise if it had to make repayment of the debt either immediately or, if the debt is for a fixed term, on expiry of the term. These would include expenses, including taxes, that might be incurred on realising assets to meet the debt.

22. Where the debt is a long-term arrangement in lieu of payment of dividends or repayment of capital by a subsidiary undertaking, the insurer should provide for all the costs, including taxes, that would be incurred on payment of a dividend or repayment of capital (including winding-up the subsidiary undertaking if it is dormant).

Table: Treatment of shares in a group undertaking (regulations 12, 13, 15 and 19B)

Relationship of the group undertaking to the insurer	Is the group undertaking an insurance undertaking or insurance holding company?	Basis of valuation	Is the group undertaking a dependant?	Is the investment itself restricted under regulation 15?	Are admissibility limits applied when covering liabilities and notional required minimum margin (if any)?	Must the underlying assets be aggregated with the insurer's exposure for admissibility purposes?	Does provision need to be made by the insurer for any deficit?	
1	2	3	4	5	6	7	8	
Subsidiary undertaking	Insurance undertaking	Surplus assets (cap)	Yes	No	Yes	Surplus assets only	Yes (100%)	A
Subsidiary undertaking	Insurance holding company	Surplus assets (cap)	Yes	No	Yes (optional)	Surplus assets only	Yes (100%)	B
Subsidiary undertaking	Insurance holding company	Surplus assets (cap)	Yes	No	No (optional)	Yes	Yes (100%)	C
Subsidiary undertaking	No	Surplus assets	Yes	No	Yes (optional)	Surplus assets only	No	D
Subsidiary undertaking	No	Surplus assets	Yes	No	No (optional)	Yes	No	E
Subsidiary undertaking	No	Market value	No	Yes	No	No	No	F
Non-subsidiary undertaking	Yes	Surplus assets (cap)	No	Yes	No	No	Yes (pro-rata)	G
Non-subsidiary undertaking	No	Surplus assets	No	Yes	No	No	No	H
Non-subsidiary undertaking	No	Market value	No	Yes	No	No	No	I
Note 1		Notes 2 & 3		Note 4	Note 5	Note 6	Note 7	

Notes to the table:

1. Regulations 12 and 13 apply to the value of shares in or debts due from group undertakings. Group undertakings extend to the insurer, its related undertakings, its participating undertakings and the related undertakings of its participating undertakings.

2. Regulation 12(1)(a) requires the value of shares in a group undertaking which is an insurance undertaking or insurance holding company to be based on its surplus assets, determined in accordance with the Asset Valuation Regulations which require exposure in excess of the permitted asset and counterparty exposure limits to be deducted. For shares in any other group undertaking either the surplus assets can be used, or a market value arrived at by applying regulation 6. Insurers have a free choice as to which to use (the higher may in overall terms be more costly because of the inter-relationship between this rule and the admissibility rules), and may make a different choice for the purpose of the parent undertaking solvency calculation.

3. Although for a non-insurance undertaking there is a choice as to whether to use surplus assets or market value for the purpose of valuing shares, regulation 13 requires the surplus asset approach to be taken for valuing debts.

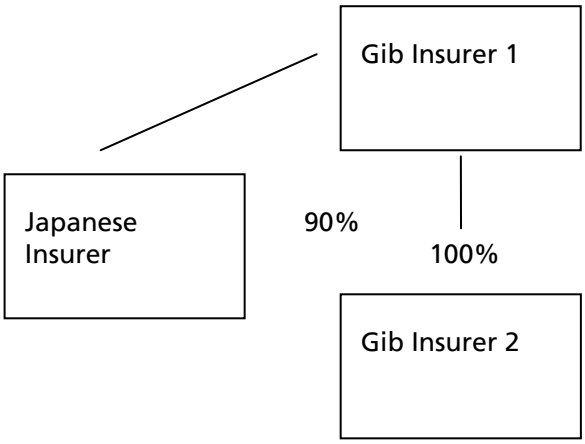
4. Regulation 15(1) requires the permitted asset and counterparty exposure limits to be applied to all assets of an insurer that are not exempt under sub-regulation (5) and (6). There is an exemption under regulation 15(5)(f) for shares in or debts due or to become due from a dependant. A dependant is defined as a subsidiary undertaking, the value of whose shares is taken to be its surplus assets under regulation 12(1).

5. Admissibility limits are applied to dependants that are insurance undertakings when choosing assets covering the liabilities and notional required minimum margin. Application to other dependants is optional.

6. Paragraph 11A and 15A of Part I of Schedule 1 require the insurer's own exposure to assets of a particular description to be increased by an amount representing the asset exposure or the surplus asset exposure, if any, of the insurer's dependants to assets of that description. The surplus asset exposure only applies if admissibility limits are applied to dependants when choosing assets covering liabilities and notional required minimum margin.

7. Regulation 19B requires an insurer to make provision in respect of a related undertaking that is an insurance undertaking or insurance holding company, in the case of a subsidiary undertaking for the whole of any deficit in the assets available to cover liabilities or represent the notional required minimum margin, and in the case of a non-subsidiary undertaking for the proportional share of any such deficit to the extent that provision has not already been made elsewhere for such deficit. Related undertaking is defined as an undertaking in which a participation is held by another undertaking or which is a subsidiary undertaking.

Example: Calculation of Solvency Margin



Gib Insurers 1 and 2 are required to meet the required solvency margin (Gib Insurer 2 will not be required to submit a separate parent undertaking solvency calculation in respect of Insurer 1 because this calculation provides substantially the same information – see Guidance Note 13).

Proforma Solvency Margin Calculation:

Example assets and liabilities on regulatory return basis:

Company	Assets (excluding book value of subsidiaries)	Liabilities	RMM/Notional RMM
	£m	£m	£m
Gib Insurer 1	150	80	50
Gib Insurer 2	100	60	20
Japanese Insurer	50	40	20

Step 1 – Calculate the values of subsidiaries of Insurer 1

	Gib Insurer 2*	Japanese Insurer
	£m	£m
Assets	100	50
Less: liabilities	(60)	(40)
Net assets	40	10
RMM	(20)	(20)
Surplus/(deficit)	20	(10)

* This is the margin of solvency to be reported for Insurer 2 (assuming it has no group undertakings).

Step 2 – Calculate the solvency position of Insurer 1

	£m	£m
Assets of Insurer 1 (excluding book value of subsidiaries)		150
Less: liabilities & RMM of Insurer 1		(130)
Net assets of Insurer 1 (excluding subsidiaries)		20
Add: surplus value of Gib Insurer 2*	20	
Less: full deficit for Japanese Insurer**	(10)	
		10
Solvency surplus (deficit) for Insurer 1		30

* Admissibility limits are not applied at this level but in this example, where the group undertaking is a dependant, surplus assets would have to be added to any assets of the same description/to the same counterpart held by Insurer 1 in order to calculate the admissibility of assets held by Insurer 1 (according to paragraphs 11A & 15A of Part I of Schedule 1).

** Where a subsidiary undertaking which is an insurance undertaking or insurance holdings company has a solvency deficit, its full value must be brought in as a notional liability, even where the subsidiary undertaking is less than 100% owned.

If in the above example Gib Insurer 2 were a non-Gibraltar insurer which in turn had an insurance subsidiary undertaking, step 1 would be to calculate the value of the subsidiary undertaking of Insurer 2. If Insurer 2 were located in a designated state or territory this could either be done according to the local requirements of the designated state or territory or according to Gibraltar legislation, at the option of Insurer 1. The former may produce a different outcome from the latter. If Insurer 2 were located outside the designated states or territories Gibraltar legislation would apply. If its insurance subsidiary undertaking were located in a designated state or territory, this would give Insurer 1 the option of using Gibraltar or local requirements in determining the assets required to cover liabilities and the notional required minimum margin in that subsidiary.

APPENDIX D: What Is A Regulated Market For The Purposes Of The Definition Of "Listed" In The AVRs?

1. A regulated market is defined in regulation 2 of the 1996 Regulations. This definition is broadly based on the definition in the Third Insurance Directives which, in turn, draws on the definition used in the Investment Services Directive (ISD). The definition of regulated market feeds into the definition of "listed" as explained in the section on Definitions and General Interpretation of these guidance notes.

2. There is no "official" list of regulated markets, instead the directors (and auditors) must be satisfied that the criteria set out in the definition have been met. The ultimate responsibility for ensuring that a market satisfies the relevant criteria will rest with the directors.

Definition

3. The key characteristics of a regulated market, as defined in regulation 2, are as follows:-

   (a) regular operation;

   (b) regulations have been issued, or approved, by the appropriate authority of the State where the market is situated, which:

      (i) define the conditions of operation and access to the market

      (ii) define the conditions to be satisfied for an investment to be effectively dealt in on the market

      (iii) require compliance with reporting and transparency requirements comparable to those laid down in articles 20 and 21 of the ISD.

   (c) for markets situated outside the EEA, the investment dealt in on the market should be of a quality comparable to those in a regulated market in the EEA.

4. In particular, the following areas are considered to be important.

   - Liquidity - effectively dealt in on the market
   - regulated - appropriate authority and reporting and transparency arrangements
   - recognised - appropriate authority
   - operating regularly - regular operation and reporting and transparency arrangements
   - open to the public - operation and access to the market

   Each of these areas are discussed below.

Liquidity

5. The directors should have regard to the overall liquidity of the market or exchange; whether securities and/or derivatives can be bought and sold in a reasonable time, at best execution and in adequate amounts; and the procedures and restrictions (if any) on the repatriation of funds.

Regulated

6. The market, or exchange, must be subject to supervision by an authority which should be a statutory body, an agency of a national or state Government, a

department of such Government, or another body designated for the purpose by one of these. Additionally, directors will need to take into account:

- The degree to which members of the market/exchange are subject to formal supervision by the market or another body and, in particular, whether that supervision includes capital adequacy requirements.
- The powers of the market/exchange and the supervising body to intervene in members' business in the event of a misconduct, financial difficulties or otherwise, including the power to reject applicants, terminate memberships, and de-list a security.
- The initial listing standards and ongoing supervision of securities trade on the market/exchange, including the publication of prospectuses and audited financial statements.
- Requirements for the issue of contracts notes (or their equivalents).
- Whether the clearance and settlement arrangements normally used for transactions on the market/exchange are prompt and secure.
- The risk of loss in the event of insolvency of a member of the market/exchange.
- How the market/exchange investigates and deals with complaints.

Reporting And Transparency Requirements

7. There should be everyday availability of current information about securities, derivatives, quotations, transactions, prices and spreads. In addition, the market should have requirements for trade reporting to the market/exchange or other supervisory body of the securities/derivatives which the insurance company intends to buy.

Operating Regularly

8. The market/exchange must have regular trading hours during which the investments listed or, admitted to dealing, on that market may be dealt in. Additionally, directors will need to take into account:

- the availability and timing of price and volume information, and the way it is distributed; and
- in respect of securities, the degree to which and the speed at which companies listed on the market/exchange must release price sensitive information, and the medium through which that information is distributed.

Recognised

9. The market/exchange must be recognised, or registered, as a market/exchange and/or self regulatory organisation by an authority which should be a statutory body, or an agency of a national or state Government, a department of such Government, or another body designated for he purpose by one of these.

Open to the public

10. Investments listed, or admitted to dealing, on the market/exchange must be freely available for trading by the public directly, or through members of the market/exchange, during normal trading hours. Additionally, directors will need to take into account the extent to which overseas investors are permitted to hold securities listed on the market/exchange.